

REPUBLIC OF TURKEY

**PRE-ACCESSION
ECONOMIC PROGRAMME
2003**

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ABBREVIATIONS

BAĞ-KUR	Esnaflık ve Sanatkarlar ve Diğer Bağımsız Çalışanlar Sosyal Sigortalar Kurumu (Social Security Organisation of the Self-Employed)
BOTAŞ	Boru Hatları ile Petrol Taşıma A.Ş. (Petroleum Pipeline Corporation)
BRSA	Banking Regulation and Supervision Agency
CAP	EC Common Agricultural Policy
CBRT	Central Bank of the Republic of Turkey
CPI	Consumer Price Index
CMB	Capital Market Board
DAP	Doğu Anadolu Projesi (The Eastern Anatolia Project)
DBILT	Domestic Borrowing Instrument Lending Transactions
DIS	Direct Income Support
DOKAP	Doğu Karadeniz Bölgesi Gelişme Planı (Eastern Black Sea Regional Development Plan)
ECOSOC	Economic and Social Council
EMRA	Energy Market Regulatory Authority
ERASMUS	European Community Action Scheme for the Mobility of University Students
ESA95	European System of Accounts 1995
EU	The European Union
FADN	Farm Accountancy Data Network
FOE	Futures and Options Exchange
FWA	Fixed-Wireless Access
FX	Foreign Exchange
GAP	South-eastern Anatolia Project
GDP	Gross Domestic Product
GERKONSAN	Gerede Steel Construction and Equipment Factory
GIRGA	General Implementing Regulation on Government Accounting
GNP	Gross National Product
GSM	Global System for Mobile Communications
HACCP	Risk Analysis for Key Control Points
HP	Hodrick-Prescott Method
IACS	Integrated Administration and Control System
ILO	International Labour Organization
IMF	International Monetary Fund
ISE	İstanbul Stock Exchange
ISGÜM	Centre for Occupational Health and Safety
İŞKUR	Türkiye İş Kurumu Genel Müdürlüğü (Turkish Employment Agency)
KBİ	Karadeniz Bakır İşletmeleri (Black Sea Copper Works Company)
KOSGEB	Small and Medium Industry Development Organization
MARA	Ministry of Agriculture and Rural Affairs
MEDA	Euro-Mediterranean Partnership
MERNIS	Central Demographic Administration System
NPAA	National Programme for the Adoption of Acquis
NUTS	Official Nomenclature of Territorial Units for Statistics

OECD	Organisation for Economic Co-operation and Development
PEP	Pre-Accession Economic Programme
PETKİM	Petrokimya Holding A.Ş. (Petrochemical Corporation)
POAŞ	Petrol Ofisi A.Ş. (Petroleum Distribution Corporation)
PSSP	Privatisation Social Support Project
PSTN	Public Switched Telephone Network
R&D	Research and Development
SCT	Special Consumption Tax
SDIF	Savings Deposit Insurance Fund
SEEs	State Economic Enterprises
SEKA	Türkiye Selüloz ve Kağıt Fabrikaları A.Ş. (Turkish Pulp and Paper Production Corporation)
SIS	State Institute of Statistics
SMEs	Small and Medium-Sized Enterprises
SPO	State Planning Organization
SSK	Sosyal Sigortalar Kurumu (Social Insurance Institution)
TAKBİS	Tapu Kadastro Bilgi Sistemi (The Land Registration and Cadastre Information System)
TAKSAN	Machine Tools Industry and Trade Inc.
TAS	Turkish Accounting Standards
TASB	Turkish Accounting Standards Board
TCDD	Türkiye Cumhuriyeti Devlet Demiryolları (Turkish State Railways)
TEDAŞ	Türkiye Elektrik Dağıtım A.Ş. (Turkish Electricity Distribution Company)
TEKEL	Tütün, Tütün Mamulleri, Tuz ve Alkol İşletmeleri Genel Müdürlüğü (General Directorate of Tobacco, Tobacco Products, Salt and Alcohol Enterprises)
TFP	Total Factor Productivity
TGNA	Turkish Grand National Assembly
THY	Türk Hava Yolları (Turkish Airlines)
TL	Turkish Lira
TMO	Toprak Mahsulleri Ofisi (Turkish Grain Board)
TRLIBOR	TL Interbank Offer Rate
TRT	Türkiye Radyo ve Televizyon Kurumu (Turkish Radio Television Corporation)
TÜGSAŞ	Türkiye Gübre Sanayii A.Ş. (Turkey Fertiliser Industry Corporation)
TÜMOSAN	Turkish Engine Industries Inc.
TÜPRAŞ	Türkiye Petrol Rafinerileri A.Ş. (Turkish Petroleum Refineries Corporation)
TZDAŞ	Türkiye Ziraî Donatım A.Ş. (Company involved in the agricultural input distribution)
UMTS	Mobile and Wireless Telecommunications Systems
US	United States
VAT	Value Added Tax
VoIP	Voice over Internet Protocol
WPI	Wholesale Price Index
WTO	World Trade Organization
YÖK	Yükseköğretim Kurulu (The Higher Education Council)

INTRODUCTION

Turkey submitted its first Pre-Accession Economic Programme (PEP) to the European Commission in October 2001 and the second in August 2002 as a part of the requirements emanating from the Pre-Accession Fiscal Surveillance Procedure, which started in 2001 in relation to the candidate countries. As the Pre-Accession Economic Programme has to be updated on an annual basis, the third Pre-Accession Economic Programme covering the period 2003-2006 has been prepared taking into consideration the assessments of the EU Commission on the second PEP.¹

This Programme presents the framework of the economic policies to be implemented for the fulfilment of the Copenhagen economic criteria and the structural convergence perspective during the EU accession period.

The Programme aims at strengthening macroeconomic stability and thereby increasing the resources allocated to the implementation of social policies to increase the welfare of the society. In this context, the main priorities of Turkey's macroeconomic policies are to ensure a sustainable growth environment in the economy, to secure a permanent reduction in inflation and to converge public deficit and public debt stock ratios to the GDP to the EU averages. A further important aim is to reduce the development gap among the regions and between Turkey and the EU. In the integration process with the EU, fulfilling the Copenhagen economic criteria and the convergence towards the Maastricht criteria constitute the main perspectives in the setting of economic policies.

In the Pre-Accession Economic Programme period, the fiscal policy aims to secure a permanent reduction in the ratio of the public debt stock to national income and in public deficit, to secure a balanced budget structure, to contribute to the establishment of a sustainable growth environment and to support the disinflation process. The monetary policy will be implemented to reduce inflation to the targeted levels in the short term and to secure and maintain price stability in the medium term. In the period ahead the floating exchange rate regime will be maintained and the exchange rate will be determined by the supply and demand conditions in the market. With the aim of supporting the disinflation policy, the incomes policy will be determined taking into consideration the inflation targets in the short term. It will be determined, taking into consideration the price stability, productivity and profitability parameters in the medium term.

Within this policy framework, the average annual GDP growth rate is expected to reach the potential level of 5 per cent, and inflation is expected to decrease to single digits during the Programme period.

Having a significant weight in the programme, structural reforms will have a determining role in reaching the economic targets, while also achieving and maintaining macroeconomic

¹ The 2003 PEP has been prepared under the coordination of Undersecretariat of State Planning Organization with the contributions of Ministry of Foreign Affairs, Ministry of Finance, Ministry of National Education, Ministry of Health, Ministry of Transportation, Ministry of Agriculture and Rural Affairs, Ministry of Labour and Social Security, Ministry of Industry and Trade, Ministry of Energy and Natural Resources, Undersecretariat of Treasury, Undersecretariat of Foreign Trade, Central Bank of Republic of Turkey, Secretariat General for the EU Affairs, State Institute of Statistics, Privatisation Administration, Capital Markets Board of Turkey, Turkish Competition Authority, Banking Regulation and Supervision Agency, Telecommunications Authority, Energy Market Regulatory Authority, and Council of Higher Education.

stability. Fulfilment of the Copenhagen economic criteria is intended by attaining a sustainable growth environment and establishing a competitive economic structure based on market principles through structural reforms.

Within this context, the main goals are restructuring the public administration with a view to providing public services in a more transparent, efficient and participatory manner, reducing the role of the public sector and improving efficiency in the economy with emphasis on privatisation, reforming the banking sector so as to provide the necessary financial resources for the real sector, increasing reliability and modernization of the markets through the strengthening the market mechanism with the establishment of regulatory bodies in various areas, increasing domestic and foreign investments, increasing the role of the private sector in the economy and creating a competitive agricultural sector.

Regarding structural reforms, a considerable progress is expected to be attained in reducing regional development gaps and eliminating economic and social imbalances in the field of education, health and social security.

The Pre-Accession Economic Programme for 2003 consists of four chapters. In the first chapter, an overview of the developments in the Turkish economy in 2002 and 2003 is given. The second chapter presents the main macroeconomic targets for the Programme period and the economic policies to be implemented in order to attain these targets. This chapter also includes a set of macroeconomic forecasts and projections of the baseline scenario and evaluates the risks that may arise in realising the baseline scenario and the impact of these risks on the main macroeconomic variables. The third chapter presents the policy framework for the attainment of a sustainable fiscal stance as well as the targets and projections for the budget and debt management during the programme period. This chapter also deals with the fiscal risks and assesses their impacts. The last chapter discusses in detail, the structural reforms to be implemented in order to attain a sustainable growth environment, to strengthen the market economy and to enhance competitiveness.

*Recent Economic Developments***1. RECENT ECONOMIC DEVELOPMENTS****1.1. Growth and Employment**

As a consequence of the financial crisis in 2001, the Turkish economy suffered a serious contraction. The increased uncertainties in the economy caused by the developments in the world conjuncture intensified this contraction even further. However, along with the structural reforms and macroeconomic policies, which were implemented in the aftermath of the financial crisis and later converted into a new three-year economic programme, a considerable economic recovery was observed. Both GDP and GNP increased by 7.8 per cent in 2002.

While the recovery in final domestic demand was limited, the change in stocks and external demand were the main sources of growth. In 2002, private consumption increased by 2 per cent while private fixed capital investment decreased by 7.2 per cent. Total final domestic demand increased by 1.7 per cent. And, the contribution of the increase in stocks to growth was 7 points.

Sectoral value added growth rates were 7.1 per cent in agriculture, 9.4 per cent in industry and 7.2 per cent in services.

Economic recovery continued in the first quarter of 2003 as well. In this period, GDP increased by 8.1 per cent, and GNP by 7.4 per cent. Total final domestic demand increased by 6.3 per cent in the same period. The monthly industrial production index shows an increase of 6.7 per cent in January-May 2003 period, compared to the same period of the previous year.

Table:1. 1. Growth Rates and Demand Components**(Percentage Change Compared with the Same Period of the Previous Year)**

	Annual		By Quarters				
	2001	2002	2002				2003
			I	II	III	IV	I
Agriculture	-6.5	7.1	0.1	2.7	6.1	15.3	7.0
Industry	-7.5	9.4	2.8	12.6	10.5	11.4	7.8
Services	-7.7	7.2	1.9	8.0	7.6	10.6	8.3
GDP	-7.5	7.8	2.1	8.9	7.9	11.4	8.1
GNP	-9.5	7.8	0.4	10.4	7.9	11.5	7.4
Total Consumption	-9.1	2.4	-1.5	3.1	3.4	4.3	5.6
Public	-8.5	5.4	2.2	2.6	12.0	4.5	-3.0
Private	-9.2	2.0	-1.8	3.2	2.5	4.2	6.5
Gross Fixed Capital Formation	-31.5	-0.8	-28.8	-2.3	5.9	22.2	9.3
Public	-22.0	14.5	-18.1	3.0	29.8	22.7	-37.8
Private	-34.9	-7.2	-30.9	-4.2	-3.7	21.8	20.4
Total Domestic Demand	-18.5	9.2	-1.0	14.9	8.2	14.7	11.6

Recent Economic Developments

The results of the Household Labour Force Survey by the State Institute of Statistics (SIS) shows that, parallel to the value added increase in the industry and services sectors in 2002, employment in these sectors increased as well. In 2002 employment in the industry and services sectors increased by 4.8 per cent and 2.9 per cent respectively. However, the contraction in agriculture and construction sectors by 7.8 per cent and 13.7 per cent respectively, caused a decrease by 0.8 per cent in total employment in 2002. As a result of these developments and of the increase in the labour force by 1.4 per cent, the rate of unemployment reached 10.3 per cent in 2002. The higher labour force participation rate in urban areas contributed to the increase in the labour force in 2002.

The distribution of unemployment between urban and rural areas indicates that the unemployment rate is much lower in rural than in urban areas, particularly due to the wide spread practice of unpaid family worker in agriculture. The rate of rural unemployment was 4.7 per cent in 2001, and 5.7 per cent in 2002. In urban areas this rate reached 11.6 per cent and 14.2 per cent respectively.

Table:1. 2. Developments in the Labour Market

	Annual		By Quarters				
	2001	2002	2002				2003
			I	II	III	IV	I
Civilian Labour Force (thousand people)	47,158	48,041	47,711	47,927	48,148	48,368	48,587
Labour Force Participation Rate (per cent)	49.8	49.6	45.9	50.6	52.4	50.3	47.5
Employment (thousand people)	21,524	21,354	19,387	21,975	22,833	21,658	20,244
Employment (percentage change)	-0.3	-0.8	0.9	4.0	4.4	9.7	4.4
Unemployment Rate (per cent)	8.4	10.3	11.5	9.3	9.6	11.0	12.3

Note: Data on labour market are revised by the SIS according to the census of population conducted in 2000. Thus, figures are different from the ones given in the previous PEP.

In the first quarter of 2003, total employment increased by 4.4 per cent as compared to the same period of the previous year. Nevertheless, due to the sharp increase in the labour force participation rate, the rate of unemployment reached 12.3 per cent.

Table:1. 3. Sectoral Developments in the Labour Market

	Level (Thousand people)					Contribution to Unemployment (Per cent)			
	2000	2001	2002	2002Q1	2003Q1	2001	2002	2002Q1	2003Q1
Labour Force	23,078	23,491	23,818	21,917	23,088	87.9	65.8	-15.3	372.9
Employment	21,581	21,524	21,354	19,387	20,244	12.1	34.2	115.3	-272.9
Agriculture	7,769	8,089	7,458	6,205	6,639	-68.1	127.0	101.2	-138.2
Industry	3,811	3,775	3,954	3,728	3,769	7.7	-36.0	-5.6	-13.1
Manufacturing Industry	3,638	3,582	3,731	3,502	3,572	11.9	-30.0	3.0	-22.3
Services	10,001	9,660	9,942	9,454	9,836	72.6	-56.7	19.7	-121.7
Trade	3,817	3,737	3,980	3,788	3,984	17.0	-48.9	-4.2	-62.4
Construction	1,364	1,110	958	790	676	54.0	30.6	41.8	36.3
Unemployed	1,497	1,967	2,464	2,530	2,844	100	100	100	100

The rate of idle labour force, which is the sum of unemployment and underemployment rates rose from 14.4 per cent in 2001 to 15.7 per cent in 2002. This rate reached 17.3 per cent in the first quarter of 2003.

In 2002, net wages in the public sector increased by 31.7 per cent in nominal terms, but they decreased by 9.2 per cent in real terms. In the same year, the nominal increase in civil servant salaries was 53.3 per cent, whereas the real increase amounted to 5.7 per cent. Minimum net wage increased by 56.6 per cent, while the real increase was 8 per cent in 2002.

1.2. Balance of Payments

Current Account Balance

The surplus in the current account balance amounting to 3.4 billion dollars in 2001, began to decline as of the beginning of 2002, due to the widening of the foreign trade deficit as parallel to the economic growth. Thus, the current account balance had a deficit of 1.5 billion dollars in 2002. In the same year, foreign trade deficit was 8.4 billion dollars, whereas the services account balance recorded a surplus of 7.9 billion dollars.

In 2003, the current account balance registered a deficit of 3.5 billion dollars in the January-May period.

In 2002, due to the low level of labour costs in the exporting sectors, the increase in productivity and the efficient marketing activities abroad, Turkey's share in the export markets increased. In 2002, merchandise exports increased by 14.1 per cent and reached 35.8 billion dollars. Annual rate of increase in exports accelerated in the second half of the year and reached an average of 21 per cent. Also the increase in export prices in the second half of the year contributed to the rise in export revenues in the same period. The upward trend in exports continued during the first five months of 2003 as well. In January-May 2003 period, exports increased by 30.1 per cent compared to the same period of the previous year and reached 17.8 billion dollars.

In 2002, shuttle trade increased by 33.8 per cent and reached 4.1 billion dollars. Positive developments in the Russian economy, as the most important market for shuttle trade, lead to a recovery in demand, particularly in textiles, clothing and leather products. In January-May 2003 however, shuttle trade dropped by nearly 200 million dollars and amounted to 1.4 billion dollars, compared to the same period of previous year.

The sharp increase observed in industrial production in 2002, caused a rapid increase in the imports of intermediate goods as well. Also the imports of investment goods and consumption goods increased considerably in the last months of 2002. Thus, in 2002, total imports increased by 23.8 per cent and reached 51.3 billion dollars. In January-May 2003 imports increased by 31.3 per cent compared to the same period of the previous year and amounted to 24.8 billion dollars.

In 2002, exports to EU countries increased by 13.7 per cent, whereas imports from EU countries increased by 27.4 per cent. In the first five months of 2003 exports to EU countries increased by 35.9 per cent, while imports from EU countries increased by 33.8 per cent. These rates of increases were higher than average rates. Also the developments in the euro/dollar parity in favour of euro increased the trade volume with EU countries in dollar terms.

In 2002, the merchandise trade deficit increased by 54.1 per cent and reached 15,5 billion dollars, whereas in January-May 2003 it amounted to 7 billion dollars.

*Recent Economic Developments***Table:1. 4. Foreign Trade by Countries**

	(Million Dollars)					
	Annual			January-May		
	2001	2002	Percentage Change	2002	2003	Percentage Change
MERCHANDISE EXPORTS	31,334	35,762	14.1	13,666	17,778	30.1
OECD Countries	20,588	23,393	13.6	8,794	11,648	32.5
EU Countries	16,118	18,331	13.7	6,851	9,314	35.9
Non-OECD Countries	9,813	10,951	11.6	4,368	5,452	24.8
Turkish Free Zones	934	1,418	51.8	504	678	34.6
MERCHANDISE IMPORTS*	41,399	51,270	23.8	18,869	24,784	31.3
OECD Countries	25,958	32,874	26.6	12,069	15,393	27.5
EU Countries	18,280	23,289	27.4	8,260	11,048	33.8
Non-OECD Countries	15,138	17,822	17.7	6,559	9,178	39.9
Turkish Free Zones	303	574	89.4	242	212	-12.3

* Excluding monetary gold imports, including non-monetary gold imports.

Tourism revenues as the most important item of the services balance increased by 4.8 per cent in 2002 and reached 8.5 billion dollars. On the other hand, the services surplus dropped by 13.7 per cent in 2002, mainly due to the reduction in the revenues from other trade services. In January-May 2003 period, tourism revenues decreased by 16 per cent compared to the same period of the previous year and went down to 1.8 billion dollars. This development could be due to the military operation in Iraq in early 2003, as well as the slow-down of tourism activities in the world as a whole because of the SARS epidemic.

The deficit of the income balance, which was 5 billion dollars in 2001, realised as 4.5 billion dollars in 2002. The main responsible factor for the deficit of the income balance is the high level of interest rate expenditures. In 2002, about two thirds of Turkey's long term interest rate payments of 4.1 billion dollars were composed of the interest rate payments of the general Government and of the Central Bank. On the other hand, in 2002 the interest payments related to the bond stocks, nearly all of which issued abroad by the government amounted to 2.2 billion dollars. In January-May 2003 period, the deficit of the income balance increased by 16.7 per cent as compared to the same period of the previous year and amounted to 2.4 billion dollars.

Current transfers suffered a rapid drop after the crisis in February 2001 and went down to 3.8 billion dollars. In 2002, it further dropped to 3.5 billion dollars. Workers' remittances as the largest item of current transfers continued to fall in 2002 and went down to 1.9 billion dollars. In 2002 imports with waiver in the amount of 1 billion dollars were realized. In January-May 2003 period, current transfers decreased by 2.8 per cent as compared to the same period of the previous year and amounted to 1.3 billion dollars.

Capital and Financial Account Balance

Excluding the change in official reserves, the net capital inflow was 7.8 billion dollars in 2002. Official reserves increased by 6.2 billion dollars. A significant portion of the capital inflow came from IMF loans. After deducting the repayment of 6.1 billion dollars by the Central Bank, the net amount of IMF loans utilized in 2002 was 6.4 billion dollars.

Recent Economic Developments

Direct foreign capital investments (net) were 862 million dollars in 2002. In the same year, the net amount of portfolio investments abroad by domestic investors was 2.1 billion dollars, whereas the net amount of portfolio investments by foreign investors in Turkey reached 1.5 billion dollars. In 2002, the Treasury bond issues abroad amounted to 3.3 billion dollars.

In 2002, the utilization of commercial loans by the non-bank private sector showed an increase parallel to the rise in the foreign trade volume. In 2002, the banks were in the position of net debt repayer in the short and long-term loans, whereas other sectors increased their long-term borrowing, along with the recovery in domestic fixed capital investments.

Table:1. 5. Balance of Payments

	(Million Dollars)			
	Annual		January-May	
	2001	2002	2002	2003
Current Account	3,390	-1,540	-1,513	-3,467
Balance on Goods	-4,543	-8,367	-2,470	-4,171
Goods: Exports (f.o.b.)	34,373	39,827	15,266	19,181
Goods: Imports (f.o.b.)	-38,916	-48,194	-17,736	-23,352
Balance on Services	9,130	7,880	1,657	1,789
Services: Credit	16,030	14,781	4,571	4,633
Services: Debit	-6,900	-6,901	-2,914	-2,844
Income Balance	-5,000	-4,549	-2,069	-2,415
Income: Credit	2,753	2,489	930	991
Income: Debit	-7,753	-7,038	-2,999	-3,406
Current Transfers	3,803	3,496	1,369	1,330
Capital and Financial Account	-1,719	1,668	2,174	3,185
Financial Account	-1,719	1,668	2,174	3,185
Direct Investment	2,769	862	376	31
Portfolio Investment	-4,515	-590	-171	243
Other Investment	-2,667	7,549	4,618	2,963
Assets	-601	-652	526	2,316
Liabilities	-2,066	8,201	4,092	647
Trade Credits	-1,930	2,432	837	534
Loans	614	5,322	3,626	-739
Monetary Authority	10,229	-6,138	-6,138	-152
General Government	-1,977	11,834	9,661	-232
Banks	-8,076	-1,027	-237	-259
Other Sectors	438	653	340	-96
Currency and Deposits	-832	350	-396	838
Monetary Authority	736	1,336	543	113
Banks	-1,568	-986	-939	725
Other Liabilities	82	97	25	14
Reserve Assets	2,694	-6,153	-2,649	-52
Net Errors and Omissions	-1,671	-128	-661	282

Despite the reduction of interest rates applied to foreign currency deposit accounts with credit letter and to super foreign currency accounts of Turkish workers abroad at the Central Bank in 2002, the introduction of 1-year time deposit accounts led to an increase in short-term deposits at the Central Bank. As a result, long and short-term foreign exchange deposits at the Central Bank increased by 1.3 billion dollars in 2002.

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In January-May 2003 period, total capital inflow was 3.2 billion dollars. In the same period, the net inflow in direct and portfolio investments was 31 million dollars and 243 million dollars respectively. In January-May 2003 period, the foreign currency assets of banks at their correspondents abroad, which is included in the assets section under the item of the other investments, decreased by 3.8 billion dollars. With regard to loans included in the liabilities section under the same item, 3.6 billion dollars loan utilization was realised in January-May 2002 period, but a loan repayment of 739 million dollars was realised in the same period of 2003.

1.3. Monetary and Exchange Rate Policy

Monetary Policy

With the aim of reducing uncertainties and shaping expectations for the future, the increase in the monetary base was set as target variable and it constituted the nominal anchor of the monetary policies in 2002 and 2003. In this context, the rate of increase in the monetary base in 2002 and 2003 was set as to be consistent with the end-year inflation target and growth rate forecasts. In addition, it was declared that the net international reserves will not be allowed to fall below certain pre-determined limits. Net domestic assets were also monitored as an indicator. All targets set for 2002 and until June 2003 were realized.

Table:1. 6. Performance Criteria, Indicators and Realizations

	Upper Limit for Monetary Base (Trillion TL)		Upper Limit for Net Domestic Assets (Trillion TL)		Net International Reserves (Million Dollars)	
	Target ⁽¹⁾	Realization	Target ⁽¹⁾	Realization	Target ⁽¹⁾	Realization
28 February 2002 ⁽²⁾	8,250 ^(P)	7,823	26,100 ^(I)	24,318	-6,500 ^(P)	-4,907
30 April 2002	8,900 ^(P)	8,680	27,700 ^(I)	25,197	-7,200 ^(P)	-4,926
30 June 2002	9,089 ^{(P)(3)}	9,009	28,739 ^(I)	26,374	-7,800 ^(P)	-5,755
30 September 2002	10,600 ^(P)	10,104	31,139 ^(I)	28,551	-8,500 ^(P)	-5,889
31 December 2002	10,850 ^(P)	10,720	33,139 ^(I)	28,603	-9,700 ^(P)	-4,614
30 April 2003	12,800 ^(P)	11,883	32,800 ^(I)	30,951	-6,500 ^(P)	-6,080
30 June 2003	13,200 ^(P)	13,039	34,100 ^(I)	29,395	-7,000 ^(P)	-3,865
September 2003	14,100 ^(I)		33,800 ^(I)		-6,000 ^(P)	
31 December 2003	14,300 ^(I)		34,200 ^(I)		-6,000 ^(P)	

Source: CBRT.

(1) Upper limits will be calculated on average stocks in the above mentioned dates and the last five work days that end-up with these dates.

(2) The performance criteria on 28 February 2002 is calculated on the average of the four work days of 11-12 February and 11-12 March 2002, in order to take the transitory effect of the religious holiday on cash demand.

(3) Due to the takeover of Pamukbank to the SDIF, it is exempted from the required reserve liability of 161 trillion TL that should be maintained in the CBRT. Therefore, the upper limit for Monetary Base determined as 9,250 trillion TL for end-June in the Letter of Intent dated 18 January 2002 is adjusted to 9,089 trillion TL, and the upper limit for Net Domestic Assets determined as 28,900 trillion TL for end-June is adjusted to 28,739 trillion TL.

(P): Performance criterion, (I): Indicator.

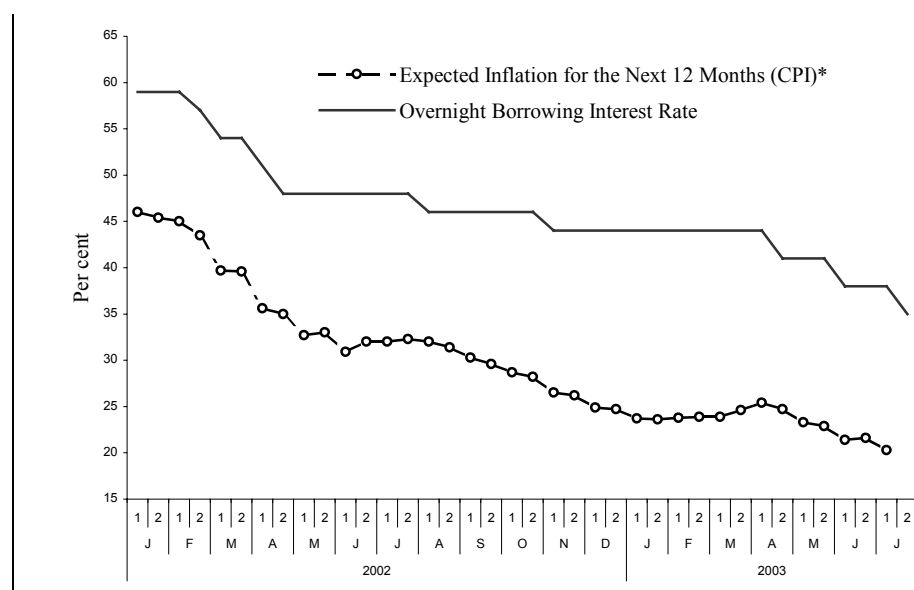
The Central Bank implemented a monetary policy strategy, which was consistent not only with the monetary indicator targets, but also with the inflation target. In this context, the Central Bank declared that although monetary targets were fully met, in order to prevent any inflationist pressures and by taking into consideration the probable inflation values in future, it might introduce changes in short term interest rates and would take additional measures.

Recent Economic Developments

Considering the inflation dynamics and inflation expectations, the Central Bank reduced short-term interest rates six times in 2002, and three times as of 17 July 2003.

The strict implementation of the economic programme in January-April 2002 and the support given to the programme by the IMF through supplementary resources increased the confidence in the programme and eliminated the concerns regarding debt sustainability. In this period, the value of the Turkish lira appreciated by around 8 per cent in nominal terms, whereas interest rates of domestic borrowings of the Treasury dropped by 20 points. The decrease in the uncertainties in the markets had a positive impact on the confidence for the future and pulled inflation expectations downward. Along with the decline of cost driven inflationary pressures, the continued insufficiency in domestic demand contributed to the slow down of price increases. In the light of these economic developments, the Central Bank gradually decreased overnight interest rates. Consequently, in January-April 2002 overnight borrowing interest rates decreased from 59 to 48 per cent, and lending interest rates from 62 to 55 per cent.

Figure: 1. 1. Short-term Interest Rates and Inflationary Expectations



Recent Economic Developments

borrowing interest rates were reduced from 48 to 46 per cent, and lending interest rates from 55 to 53 per cent.

Due to the uncertainty created by the election environment, the worsening observed in public finances and the risk of inflationary expectations being negatively influenced by the delay in structural reforms, the short-term interest rates were not changed in the period of August-November. In November, it was foreseen that the removal of political uncertainty and the increase in the probability of sustaining the structural reforms and fiscal discipline could have a positive impact on inflationary tendencies, and consequently overnight borrowing interest rates were reduced to 44 per cent, and lending interest rates to 51 per cent.

In the first quarter of 2003, the financial markets were mainly under the influence of the developments in the US military operation in Iraq. In this period, uncertainties increased and oil prices rose sharply, thus creating a negative effect on inflation dynamics and inflation expectations of economic units. However, due to the short duration of the war and the fall in oil prices, financial markets went back to normal and expectations improved rapidly. In view of these positive developments, the Central Bank reduced short-term borrowing interest rates by 3 points in April, June and July and consequently it came down to 35 per cent. Lending interest rates were reduced to 41 per cent.

In 2002 and 2003, in preparation for the inflation targeting strategy and within the context of modern central bank practices, significant changes were introduced in the operational structure of monetary policy. In this context;

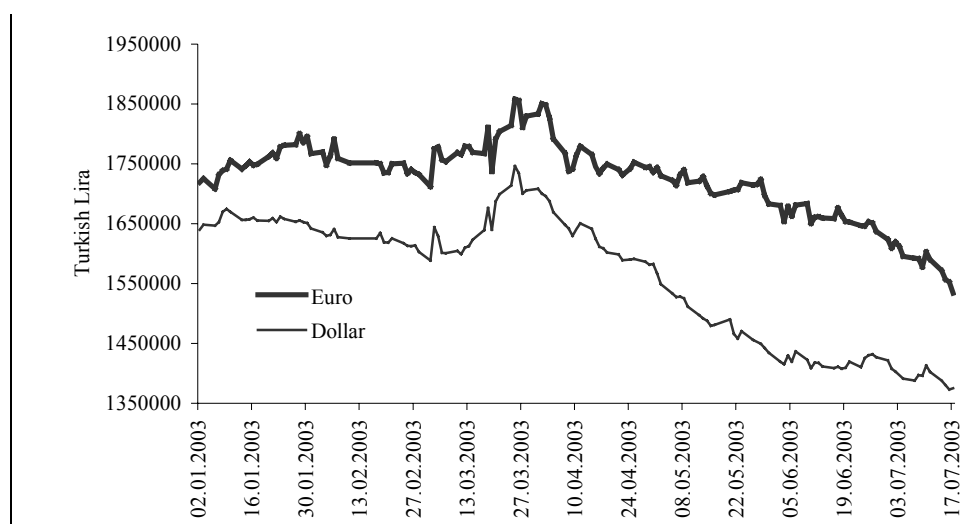
- With the purpose of decreasing the intermediation costs of financial institutions and to equip them with a more flexible structure in their liquidity management, interest payment for FX required reserves was introduced, the scope of average reserve requirements was enlarged, and the period for their build-up was prolonged.
- With the purpose of promoting the development of the foreign currency market, the stamp tax charged for forward contracts and the tax levied on inter-bank foreign currency transactions were removed.
- The implementation of TRLIBOR, launched by the Turkish Banking Association in August 2002, gradually established reference interest rates needed in the economy.
- To contribute to the deepening of financial markets, and in conformity with the primary target of price stability, the Central Bank began to support the primary dealer system, which was made functional again in September 2002, and eased Turkish lira liquidity options for primary dealer banks in the context of open market operations.
- In the framework of the banking sector restructuring programme, in order to enable the Central Bank to better sterilize the liquidity surplus in the market, 4-week deposit buying auctions have been organized in the inter-bank market.
- Within the context of its function as the lender of last resort, the Central Bank started to allow the options of late liquidity windows and repo auctions in the day-time to be used to meet the temporary liquidity needs which emerge during the course of the day, in the banking system.
- To the banks included in the re-capitalization programme, the Central Bank will provide additional liquidity, to be used in necessity until the re-capitalization is completed.
- To support the primary dealer system, the Central Bank made the Domestic Borrowing Instrument Lending Transactions Market (DBILT) operational as of February 2003.

Exchange Rate Policy

The Central Bank continued the implementation of the floating exchange rate regime in 2002 and 2003, and took the necessary measures to ensure that within the existing regime exchange rates are consistent with economic fundamentals and to enable the exchange rate market to function more efficiently. As in 2001, the Central Bank declared that with the aim of preventing any excessive volatility in the exchange rates, it would make limited interventions not directed to the level of exchange rates in the years 2002 and 2003, and also in order to build up the foreign exchange reserves, it would make transparent auctions to buy foreign currency.

The excess supply of foreign currency, which emerged in the market due to the positive developments observed in the reverse currency substitution and in the balance of payments in the first half of 2002, was sterilised through programmed foreign currency buying auctions. As announced in advance, such operations were not directed at the long-term trend and equilibrium value of the exchange rates, and no particular exchange rate level was considered. Through foreign currency buying auctions of the Central Bank in April-June period a total amount of 795 million dollars was bought. However, in view of the stagnation observed in the reverse currency substitution process and the contraction in the transaction volume in the foreign currency market, due to the political uncertainty witnessed in June, programmed foreign currency buying auctions were suspended in the period of July-December 2002. Nevertheless, due to the volatility observed in exchange rates in the same period, the Central Bank intervened into the foreign currency market twice in the form of selling, and once in the form of buying.

Figure: 1. 2. Developments in the Foreign Exchange Markets



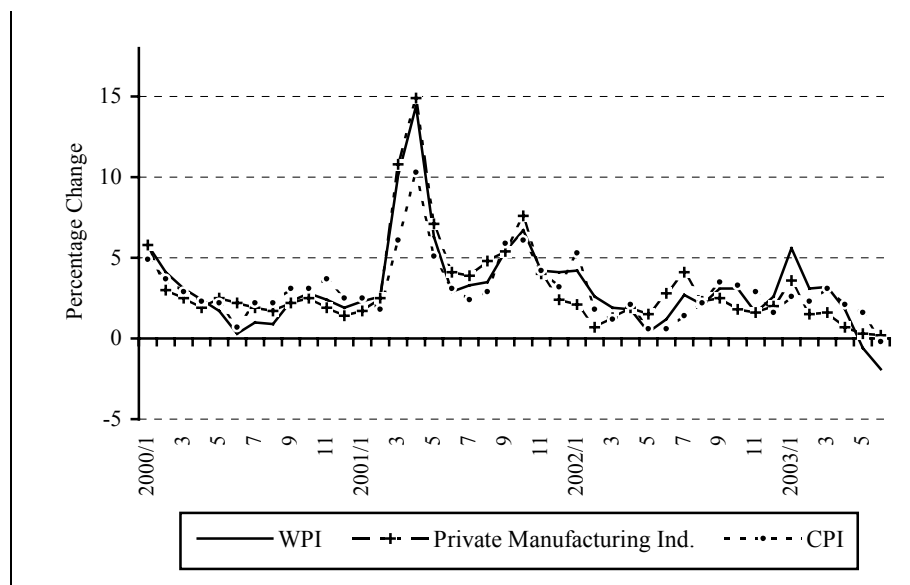
In May 2003, foreign currency buying auctions were resumed, taking into consideration the excess supply of foreign currency observed in the market as a result of the reverse currency substitution and the fact that the strong foreign currency reserve position of the Central Bank would reinforce the confidence in the implemented programme. Moreover, in view of the excessive volatility in the exchange rates, two interventions in the form of direct buying were

carried out in May. As the process creating excess supply of foreign currency in the system continued, the Central Bank gradually increased the foreign currency buying amount in the auctions carried out in the months of June and July, and also made intervention in the form of direct buying. In May-July period, the amount of foreign currency bought reached nearly 4 billion dollars.

1.4. Inflation

The strict implementation of the economic programme and the structural reforms adopted were the determining factors for the success achieved in the struggle against inflation, in 2002. In this context, maintaining fiscal discipline, implementing wage and salary adjustments in the public sector consistent with the programme targets, and the Central Bank's strict adherence to the monetary programme were the main factors which reduced the inflation rate, as well as the inflationary expectations for the future. Thus, in 2002 the rate of increase in the wholesale price index and the consumer price index went down to 30.8 per cent and 29.7 per cent respectively. The annual target for the wholesale price index was fully met, whereas in the case of the consumer price index the attained level was 5.3 points lower than the target. Compared to 2001, a total reduction of 57.8 points and 38.8 points was achieved in the wholesale and consumer price indices respectively. Thereby, the lowest level of the last sixteen years was attained in the wholesale price index, and that of the last twenty years in the consumer price index. In 2002, domestic demand was not at a level to create inflationary pressures, exchange rate displayed a steady fluctuation in the market, the cost of imported inputs decreased as a result of the real appreciation of the Turkish lira, and the price increases in the food sector remained at their lowest level of the last 15 years. All these developments were determining factors for the significant decrease in the inflation rate. Structural reforms implemented since the beginning of the programme also played a very important role in meeting the year-end inflation targets.

The inflation observed during the first quarter of 2003 originated mainly from cost pressures. Exchange rates and oil price increased with the impact of the war in Iraq, and they in turn caused a rise in production costs and accelerated the increase in wholesale prices. Nevertheless, the reflection on the consumer prices stayed limited, due to sluggish domestic demand conditions. As a consequence of severe winter conditions and floods, high rates of increase in agricultural and food prices had a negative effect on monthly inflation rates during the January-March period. The short duration of the war lifted the cost pressures in April and May and together with the impact of seasonality in agriculture, a considerable slow-down was observed in the rates of increase of both wholesale and consumer price indices. Core inflation slowed-down in the same period as well. After seventeen years wholesale price index decreased for the first time in May. In June, a reduction was observed in both indices. Thus, for the first time in 15 years wholesale and consumer price indices both decreased in the same month. In January-June 2003 period, wholesale and consumer price indices increased by 11.5 per cent and 12 per cent, respectively. The contributions of the agricultural sector, as well as of the private and public manufacturing industries to the increase in the wholesale price index were 4.9 points, 3.9 points and 2.3 points (1.2 points thereof coming from petroleum products), respectively. Developments in inflation in the first six months of the year underpin the year-end targets.

Figure: 1. 3. Monthly Price Changes

In order to reach the year-end targets it will be crucial that in the remaining part of the year the programme is implemented without any concessions, price adjustments in the public sector continue to be consistent with the targeted inflation, domestic demand does not create an upward pressure on prices, structural reforms are sustained, fiscal discipline is strictly maintained, and external factors (international oil prices, food prices etc.) display a positive development.

1.5. Fiscal Policy

Developments in the Revenues and Expenditures of the Consolidated Budget

The budget of 2002 was prepared in conformity with the main aim of achieving primary surplus and ensuring debt sustainability. To this end, measures to increase revenues and provide discipline on expenditures, as well as structural regulations were continued.

The tax strategy covering the tax regulations to be introduced in the period between 2002-2004, with the aim of restructuring the tax administration and to re-shape the tax policies, was prepared and put into implementation in 2002. In this context, 16 funds and taxes were replaced by the Special Consumption Tax Law (SCT), which entered into force as of 1 August 2002. Thereby, the taxation on many goods and services was simplified and the number of Value Added Tax (VAT) rates was reduced from 5 to 3, thus providing an important step in the harmonization process with the EU legislation. Moreover, some ministries and funds will no longer receive any share from revenues collected under SCT.

The share allocated from the tax revenues of the general budget to metropolitan administrations was reduced from 5 per cent to 4.1 per cent, but on the other hand, with the aim of increasing the revenues of local administrations, the real-estate tax rate in metropolitan cities was increased by 100 per cent.

With the aim of reaching the budget targets for 2002, along with the measures to increase revenues, measures were taken to decrease expenditures. Salary increases were set in

Recent Economic Developments

conformity with inflation targets, and the recruitment of new employees for public institutions in the scope of the budget (excluding education, health and security services) was carried out in such a manner as not to exceed 50 per cent of the number of employees who left those institutions in the previous year, due to retirement, death or resigning.

With the aim of controlling expenditures and increasing efficiency, a new law on public procurements was adopted and the Public Procurement Authority was founded. The public investment programme was rationalized, and the period of completing investments was shortened by 32 per cent.

Despite the utmost care spent to ensure fiscal discipline in 2002, the lump-sum increase in the salaries of civil servants and pensioners effected as of 1 October 2002; the increase in investment expenditures due to the revision of foreign project loans; the increase in tax rebates due to the impact of the VAT rebates in exports in particular; health expenditures in the budget being higher than the foreseen amounts; transfers to the social insurance institutions which are under an ever increasing burden due to the reduction in premiums and collection rates and increase in health expenditures; expenditures for green card had a negative effect on non-interest budget expenditures.

As a result of these developments, as a ratio of the GDP, budget revenues and expenditures were at the level of 27.4 per cent and 41.8 per cent respectively, whereas the budget deficit was 14.5 per cent and primary surplus 4.3 per cent of the GDP.

Table:1. 7. Consolidated Budget Balance by Years

	(Per cent of the GDP)			
	1999	2000	2001	2002
Expenditures	36.3	37.7	45.5	41.8
Non-Interest Expenditures	22.4	21.3	22.5	23.0
Current Expenditures	11.8	10.9	11.4	11.1
Personnel	8.9	8.0	8.5	8.4
Other	2.9	2.9	2.9	2.7
Investment	2.0	2.2	2.7	2.5
Transfer	22.4	24.6	31.4	28.3
Non-Interest Transfer	8.6	8.2	8.4	9.5
Interest Payments	13.8	16.4	23.0	18.8
Revenues	24.3	26.7	28.8	27.4
General Budget	24.0	26.4	28.4	27.0
Tax Revenues	19.1	21.3	22.3	21.6
Non-Tax Revenues	2.4	2.8	4.2	3.9
Special Revenues and Funds	2.5	2.4	2.0	1.5
Annexed Budget	0.3	0.2	0.3	0.4
Primary Surplus	1.9	5.4	6.3	4.3
Budget Deficit*	-12.0	-11.0	-16.7	-14.5

* 950 trillion TL that was paid in cash from the 2001 budget to the social security institutions is in the transfer expenditures of 2002. This amount is shown in the relevant year in Appendix Table 4. Therefore, it differs by 0.4 per cent of the GDP for 2002.

Recent Economic Developments

With the aim of reaching the primary surplus of the general government targeted in conformity with the economic programme implemented in 2003 ², a series of measures were taken to increase revenues and decrease expenditures.

Revenue increasing measures are as follows:

- The Law for Tax Reconciliation was adopted to provide a solution to the problems emerging between taxpayers and the tax administration and many tax disputes were settled by way of tax and interest reduction.
- Funds and shares allocated from the Special Consumption Tax (SCT) were abolished, SCT levied on tobacco products and alcoholic beverages was increased.
- The implementation period of special transaction and communication taxes was prolonged.
- Legal regulations were introduced for the collection of additional real estate and motor vehicle taxes.
- Certain exceptions and exemptions under corporation tax were reduced and the rate of the transitional corporate tax was increased to the level of corporate tax.

Expenditure decreasing measures are as follows:

- In 2003 it was targeted to restrict the unofficial staff assignments with 35 thousand people.
- With the aim of providing a saving in personnel expenditures, it was foreseen in 2003 to postpone one bonus payment of workers to next year.
- Premium and contribution rates to the State Pension Fund were raised from 15 per cent to 16 per cent.
- The premium rate payable by persons with optional insurance in the Social Insurance Institution (SSK) was raised from 20 per cent to 30 per cent.
- In the Social Security Organization of the Self-Employed (BAĞ-KUR) a new system was introduced, whereby the medical drug contribution share will be collected from the insured and deducted from the monthly pension.
- Meetings are conducted with the Social Security Institution with the aim of exchanging information regarding the functioning of the system and sanctions and cooperation with other institutions is continued.
- In order to curb the rapid increase in health expenditures a new system was introduced at The State Pension Fund, whereby for every class of drug an average reference price is determined and the difference between the average price and actual price of a drug is paid by the pensioner, or other drugs in the same price range with the average reference prices or cheaper drugs are used.
- New regulations were introduced for the prescribing of antibiotics that have an important share in drug expenditures.

² Primary surplus of the general government agreed with the IMF is 5.3 per cent, and the primary surplus of total public sector including the State Economic Enterprises is 6.5 per cent.

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- A negative drug list was prepared in order to prevent the contribution by the institution, concerning certain drugs and vitamins.
- Relevant measures were taken in order to cancel any authorization to make expenditures in excess of the budget allocations in the implementation of the green card system, whereby the medical treatment expenses of citizens who do not have any payment means are covered by the State.
- For the other current expenditures item, restrictive measures were taken, such as not allowing any expenditures from the budget for the repairs, maintenance and operational costs of vehicles belonging to associations and foundations which operate under the public institutions, and carrying over the unutilised portion of the other current allocations of institutions to the following year.
- As a different application from previous years, in 2003 foreign project loans in-kind were also included in the initial investment allocations, with the aim of increasing fiscal discipline and transparency.
- With the aim of ensuring fiscal discipline, restrictions were imposed on appropriation transfers between budget items.

In order to increase the purchasing power of the pensioners of SSK and BAĞ-KUR, social support payments were effected starting from 75 and 100 million TL, to be decreased parallel to the increases in the monthly pensions. Moreover, persons receiving an old-age salary were given a 100 per cent raise.

Table:1. 8. Consolidated Budget Balance in the January-June Period

	(Percentage Change)		
	January-June		
	2001	2002	2003
Expenditures	31.1	73.0	29.3
Non-Interest Expenditures	43.8	65.0	37.1
Current Expenditures	40.2	64.1	28.5
Personnel	40.2	65.8	32.8
Other	40.5	55.5	5.2
Investment	62.7	59.2	-12.6
Transfer	27.2	76.8	31.3
Non-Interest Transfer	45.7	67.0	54.4
Interest Payments	20.8	80.8	22.4
Revenues	47.7	56.2	24.8
General Budget	48.7	55.9	23.7
Tax Revenues	34.5	53.9	45.6
Non-Tax Revenues	195.0	59.9	-41.4
Special Revenues and Funds	19.0	65.5	-13.3
Annexed Budget	0.1	79.2	89.7
Primary Surplus	56.1	38.7	-4.7
Budget Deficit	-0.4	120.6	38.5

Recent Economic Developments

As a result of the measures taken for increasing revenues and ensuring expenditure discipline, in January-June 2003 expenditures were recorded as 69.4 quadrillion liras, while revenues were registered as 44.7 quadrillion liras, leading to a budget deficit of 24.8 quadrillion liras. This represents an increase in expenditures by 29.3 per cent and an increase in revenues by 24.8 per cent as compared to the same period in the previous year. In particular, the slow-down in the increase of interest payments of debts, personnel and other current expenditures, and the decline in the investment expenditures as a result of the austerity measures taken played an important role in total expenditures' displaying a limited increase. Thereby, primary surplus reached 10.1 quadrillion liras in January-June period.

Developments in the Revenues and Expenditures of the General Government

The general government balance is obtained by the consolidation of revenues and expenditures of the consolidated budget, local administrations, funds, social security institutions and revolving funds. The revenues and expenditures of the general government are presented in the table below.

Table:1. 9. Revenues and Expenditures of the General Government

	(Per cent of the GDP)			
	1999	2000	2001	2002
Taxes	23.0	25.5	27.1	24.2
Direct	10.1	10.0	10.7	8.1
Indirect	12.5	15.1	16.0	15.6
Wealth	0.4	0.4	0.4	0.5
Non-Tax Revenues	4.6	4.7	4.8	6.3
Factor Incomes	2.9	3.2	3.9	4.3
Social Funds	6.1	6.6	7.4	6.9
 Total	 36.6	 40.0	 43.1	 41.8
Privatisation Revenue	0.1	1.5	0.9	0.2
Total Revenues	36.6	41.5	44.0	41.9
 Current Expenditures	 18.2	 17.3	 18.3	 18.2
Investment Expenditures	4.5	4.7	4.7	4.1
Fixed Investment	4.5	4.6	4.7	4.1
Change in Stocks	0.0	0.0	0.0	0.0
Transfer Expenditures	27.2	29.5	37.0	32.7
Current Transfers	26.0	27.9	35.8	31.8
Capital Transfers	1.2	1.6	1.1	1.0
Stock Revaluation Fund	0.0	0.0	0.0	0.0
 Non-Interest Expenditure	 35.4	 34.4	 36.2	 35.7
Total Expenditures	49.9	51.4	59.9	55.1
 Borrowing Requirement Excluding Interest Payment *	 -1.3	 -7.1	 -7.8	 -6.2
Borrowing Requirement *	13.3	9.9	15.9	13.1

* (+) refers to deficit and (-) refers to surplus.

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In 1999, the ratio of total revenues of the general government to GDP was 36.6 per cent. It increased to 44 per cent in 2001, and in 2002 it displayed a decrease of 2.1 points and was registered as 41.9 per cent of GDP. In 2002, the share of tax revenues in GDP, representing 57.7 per cent of general government revenues, dropped by 2.9 points compared to 2001 and went down to 24.2 per cent. The main factor in this decrease were the direct taxes, the share of which in GDP dropped by 2.6 points compared to the previous year and was registered as 8.1 per cent. The low level of the increase in interest earnings and wages was the main cause of the reduction in direct taxes.

Privatisation revenues in 2002 amounted to 540 million dollars.

The share of total expenditures of the general government in GDP increased from 49.9 per cent in 1999 to 55.1 per cent in 2002. The main cause of this increase was the consolidated budget interest payments. In fact, the share of non-interest expenditures in GDP maintained nearly the same level and was registered as 35.7 per cent in 2002.

As a result, the total borrowing requirement of the general government as a ratio to GDP, which was 13.3 per cent in 1999, was realised as 13.1 per cent in 2002. Excluding interest payments, borrowing requirement increased from a surplus of 1.3 per cent in 1999 to a surplus of 6.2 per cent of GDP in 2002.

Through various adjustments, the deficit of the general government and the structure of the debt stock and accounting records are harmonized with the deficit and debt definitions of the EU, and every year on 1 April they are submitted to the relevant EU units in the form of fiscal notification tables.

When preparing the fiscal notification tables,

- Revenue and expenditure balances of public institutions which are not included under the scope of the consolidated budget, but which have to be included in the deficit of the general government according to the definition of public sector in the EU, are added to the deficit of the consolidated budget,
- Revenues and expenditures which are defined as such in ESA 95 codes, but which were not included in the consolidated budget deficit, are added to the said deficit; accounts which do not comply with the definition of revenue and expenditure, but which are included in the consolidated budget deficit are eliminated from the budget,
- Revenues and expenditures which are reported in the consolidated budget on cash basis are changed to the values on accrual basis,
- Interest expenditures of the public debt stock are calculated on accrual basis and are registered in the year they belong.

The differences emerging between the two definitions at the end of these adjustments are shown below. Especially the big difference that emerged in 2001 was due to the inclusion of duty losses of public banks into the budget.

	1999	2000	2001	2002
General Government Borrowing Requirement / GDP (per cent)	13.3	9.9	15.9	13.1
General Government Borrowing Requirement / GDP (per cent) (in accordance with the fiscal notification)	18.4	5.8	26.9	10.0

2. MACROECONOMIC FRAMEWORK

Main Objectives of the Macroeconomic Policy

The main objective of the macroeconomic policy during the period of 2003-2006 is to increase the welfare of the society. To this end, strengthening macroeconomic stability and thereby increasing the resources for the implementation of social policies will be primary target.

In this context, the main priorities of Turkey's macroeconomic policies are to ensure a sustainable growth environment in the economy, to secure a permanent reduction in inflation and to converge public deficit and public debt stock ratios to the GDP to the EU averages.

In the integration process with the EU, fulfilling the Copenhagen criteria and the convergence towards the Maastricht criteria constitute the main perspectives in the setting of economic policies. Strengthening the market economy and improving the competitiveness of the economy are priority targets. In this context, reducing the role of the state in the economy through privatisation, transferring the function of market regulation to independent regulatory authorities, strengthening private entrepreneurship and eliminating legal obstacles and economic uncertainties that have a negative impact on the functioning of the market are of special importance. Moreover, reform efforts in the public sector and efforts to open up public sector monopolies to competition will be continued. A further important aim of the economic policy is to reduce the development gap among the regions and between Turkey and the EU.

In the process of setting and implementing macroeconomic policies emphasis will be given to increase the dialogue with the EU.

Fiscal Policy

In the period of 2003-2006 the main objectives of the fiscal policy are to secure a permanent reduction in the ratio of the public debt stock to national income and in public deficit, to secure a balanced budget structure, to contribute to the establishment of a sustainable growth environment and to support the disinflation process.

In the framework of these main objectives, the implementation of the strict fiscal policy will be continued and fiscal discipline will be maintained by achieving a significant primary surplus every year. With the aim of reaching the targeted primary surpluses, tax revenues will be increased by widening the tax base and expenditures will be determined according to saving and efficiency priorities as foreseen in the public expenditure reform.

Monetary and Exchange Rate Policy

The Central Bank Law that entered into force in 2001 has made price stability the primary objective of the Central Bank. Moreover, this law secured the implementation of an autonomous monetary policy by the Bank. In this context, inflation targets will be set together with the Government, but the Central Bank will enjoy full independence in the implementation of the monetary policy to reach those targets. As a result of the effected regulations, from the point of view of transparency and accountability, the Central Bank has converged to the central banks of the developed countries in regards to monetary policy implementations.

The setting of the monetary policy in this manner is also compatible with the target of converging to the Maastricht criteria in the integration process with the EU. The permanent reduction in inflation, as one of the main causes of macroeconomic instability in Turkey, will contribute to securing macroeconomic stability and creating a predictable economic environment. At the same time, this process will bring the inflation rate closer to the EU averages.

The monetary policy will be implemented in the short term to reduce inflation to the targeted levels, and in the medium term to secure and maintain price stability. In this context, once the necessary pre-conditions are met, the Central Bank will launch the inflation targeting policy.

In the period ahead implementation of the floating exchange rate regime will continue. The exchange rate will be determined by the supply and demand conditions in the market, however the Central Bank may intervene only in the case of excessive fluctuations, without affecting the long-term level of the exchange rate. Once macroeconomic stability is achieved, it is targeted that the national currency will become stable under the floating exchange rate regime.

Incomes Policy

With the aim of supporting the disinflation policy, in the short term the incomes policy will be determined taking into consideration the inflation targets. In the medium term, the incomes policy will be determined taking into consideration the price stability, productivity and profitability parameters. Within the framework of the current economic programme, it is envisaged to replace backward indexation with forward indexation in the public sector wage policy. Since the year 2000, public sector wage increases were determined in conformity with the inflation targets. Nevertheless, due to the fact that inflation exceeded wage increases in the period of 2000-2002, the difference was partially compensated. Moreover, with the aim of improving income distribution, in early 2003 the monthly pensions of the lower income group pensioners were increased to a considerable extent. With the aim of ensuring that also the private sector implements a wage policy in conformity with the inflation targets, and to secure a consensus among the social partners the Government will continue to make use of the Economic and Social Council (ECOSOC) and similar platforms.

Structural Reform Policies

Structural reforms will play a determining role in reaching the foreseen targets and securing macroeconomic stability. The main objective of implementing structural reforms is to secure a sustainable growth environment, to create a highly competitive economic structure based on market rules, and thereby to fulfil the Copenhagen criteria.

In this context, it is targeted to reduce the role of the public sector in the economy and to increase economic efficiency through privatisation, to create a transparent and efficient public administration, to form a robust banking sector to channel resources to the real sector, to strengthen the market mechanisms through regulatory institutions created in various areas, and to further strengthen the role of the private sector in the economy. In addition, reforms in agricultural sector and infrastructure related sectors will be accelerated.

In the context of the improvements in the public finances, the share of education, health, R&D and social expenditures will be increased, in order to improve the life quality in the society,

the qualifications of human capital, and the income distribution, to struggle against poverty and to reduce regional development gaps.

External Factors

In addition to the existing sluggish trend, uncertainties in the global economy and tensions in international politics were the main factors limiting the recovery of world economy in 2002. It is expected that the stagnation continued also in the first half of 2003 will be replaced by an economic recovery, as the confidence in the world economy restores, the political tensions are removed and the oil prices come down. However, the speed of economic recovery depends on the developments in the above-mentioned factors.

The assumptions about the world economic developments that are taken into account in the analysis and forecasts of the Pre-Accession Economic Programme are in accordance with the latest forecasts of the European Commission, IMF and OECD.

Within this framework, the growth of the EU countries, which account for more than 50 per cent of our export volume, is assumed to be 1 per cent in 2003, 2.4 per cent in 2004 and the potential level of 2.5 per cent in 2005 and 2006.

The rate of increase in the import volume of developing countries is taken as 4.7 per cent in 2003, 8.0 per cent in 2004, and 7.8 per cent in 2005 and 2006. The rate of increase in the world import prices is taken as 2.5 per cent in 2003, 0.5 per cent in 2004, 0.9 per cent in 2005, and 1 per cent in 2006.

It is assumed that the oil prices, which displayed an upward trend at the end of 2002 due to the political tensions in Iraq, will be around 28 dollars per barrel in 2003. For the period of 2004-2006 the barrel price of oil is taken as 24 dollars.

The estimate of the European Commission for the euro/dollar parity is 1.07. Taking into consideration the fact that during the first seven months of 2003, the average euro/dollar parity of 1.1 was very close to the European Commission forecast, the parity for the period of 2003-2006 is taken as 1.07.

2.1. Growth and Employment

In the recent period Turkey was faced with important problems such as high inflation, high public debt stock and growth rates lower than the potential. With the contribution of structural reforms to be implemented in the period 2003-2006, macroeconomic policies will focus on the solution of these problems and implementation of strict monetary and fiscal policies will continue.

It is generally accepted that strict monetary and fiscal policies have restrictive effects on growth. However, it is also a known fact that in countries with high debt stock and inflation, policies to reduce inflation and to improve public balances can also improve expectations for future, reduce risk premium and thus increase growth. In fact, experiences in many countries show that the impact of strict monetary and fiscal policies on growth can differ depending on the size of the public debt stock.

It is foreseen that the positive effects of the strict monetary and fiscal policies to be implemented in the period of 2003-2006, such as securing confidence in the economy, reducing risk premium and inflationary expectations will be more pronounced, and therefore

will have a supportive effect on growth. The fact that the strict fiscal policies being implemented target not only increases in revenues, but also efficiency and cost saving in public expenditures will further enhance these positive effects.

In this context, it is estimated that in the period of 2003-2006 the production will catch-up with its potential level and that the average annual GDP growth rate will be around 5 per cent. It is expected that during this period a stable growth will be ensured and along with the recovery in the total final domestic demand, increases in exports will also contribute considerably to growth.

In the past years, exports displayed high performance usually when total final domestic demand contracted or showed a limited increase. This was mainly due to the fact that under sluggish domestic demand conditions, producers direct their sales efforts towards external markets. Although a recovery expected in the domestic demand during the Pre-Accession Economic Programme period, it is estimated that this recovery will be mainly due to the increase in fixed capital investments, and consumption expenditures will display a limited increase except in 2003. It is expected that the increase in fixed capital investments will increase production capacity and support exports, and therefore the recovery foreseen in the domestic demand will not limit the increase in exports. Additionally, the increases to be achieved in labour productivity will also contribute to the foreseen export performance. (Detailed analysis of export performance is given in Box 2.2).

In the period of 2004-2006 it is targeted to increase competition and secure more efficient resource utilization in the economy through continuous implementation of the structural reforms. It is foreseen that the expected rise in savings due to policies being implemented and the regulations aimed at improving the investment environment will lead to an increase in private investments. Moreover, the expected decrease in interest rates, as a consequence of raising confidence, will create a positive effect on investments.

On the other hand, the positive developments achieved in the banking sector restructuring programme are expected to facilitate the financing of private investments during the programme period. With the aim of providing a healthier structure for the banking system, initiatives were conducted in 2002 to increase the capital adequacy ratio of the banking system. The capital adequacy ratio that was recorded as 14.8 per cent at the end of these initiatives further increased to 26.2 per cent as of the end of March 2003, according to provisional data. In the context of the Istanbul Approach launched in June 2002 with the aim of solving the problematic assets of banks, 208 big companies with a debt amount of 5.4 billion dollars, and 91 small companies with a debt amount of 649.2 million dollars were taken into the scope of re-structuring until June 2003. Of these, 4.3 billion dollars of debt of big companies, and 546.4 million dollars of debt of small companies were re-structured.

In an environment of low inflation, the decrease in real interest rates and the reduction of the cost of keeping required reserves will have a positive effect on the cost of bank resources. As a result, the loan volume of banks is expected to rise. Moreover, the reduction of public deficit and the resulting decrease in the pressure caused by public finances in financial markets will also support this process. Indeed, after securing low inflation, in many countries such as Israel, Mexico and Brazil there was a considerable expansion in the real loan volume. Efforts to reduce the intermediation costs in the banking system will also support the loan expansion. The Banking Regulation and Supervision Agency in the sector (BRSA) is working on the alignment of intermediation costs in the banking system with international norms in the medium term, and parallel to the creation of suitable conditions in macro balances, deductions applied to banking transactions are expected to be reduced as well.

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Depending on the foreseen increases in growth and investments, it is expected that 2.2 million new employments will be created in the period 2003-2006 and thereby a reduction will be achieved in the unemployment rate.

Demand Components of Growth

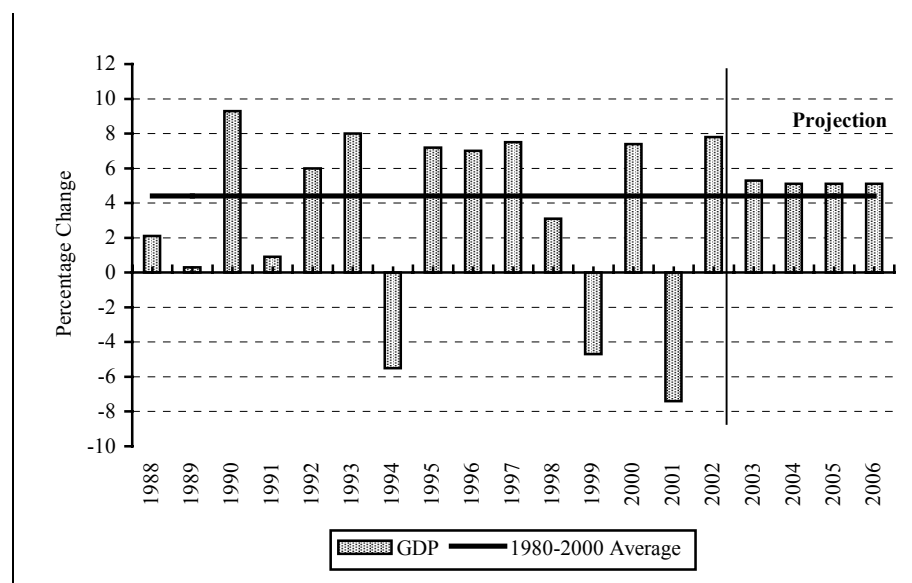
Following the economic contraction in 2001, the recovery in economic activity in 2002 was higher than expected. Although in the 2002 Pre-Accession Economic Programme the GNP growth rate was estimated as 3 per cent and the GDP growth rate as 3.9 per cent for the year 2002, both GDP and GNP growth rates were recorded as 7.8 per cent. While the private consumption and private investments remained below the predicted levels, stock change and exports were higher than expected values. Particularly, stock change was the main determinant of growth with a contribution of 7 points.

As compared to the 2002 Pre-Accession Economic Programme, no major change was foreseen in macro policies in the period of 2003-2006, however, the differences caused by the actual realizations in 2002 were reflected on the estimates.

It is expected that along with the high performance observed in the increase in exports, the consumption and fixed capital investments that remained below the forecasts in 2002, will also make a significant contribution to growth in 2003.

It is estimated that in 2003 GDP will grow by 5.3 per cent and GNP by 5 per cent. In terms of demand components, it is expected that private consumption will increase by 6.2 per cent, public consumption by 4.2 per cent and private fixed capital investments by 30.5 per cent, while public fixed investment is expected to fall by 13.7 per cent. Thereby, final domestic demand is estimated to increase by 8 per cent. Exports of goods and services are estimated to increase by 9.3 per cent, and imports of goods and services by 14.4 per cent in 2003.

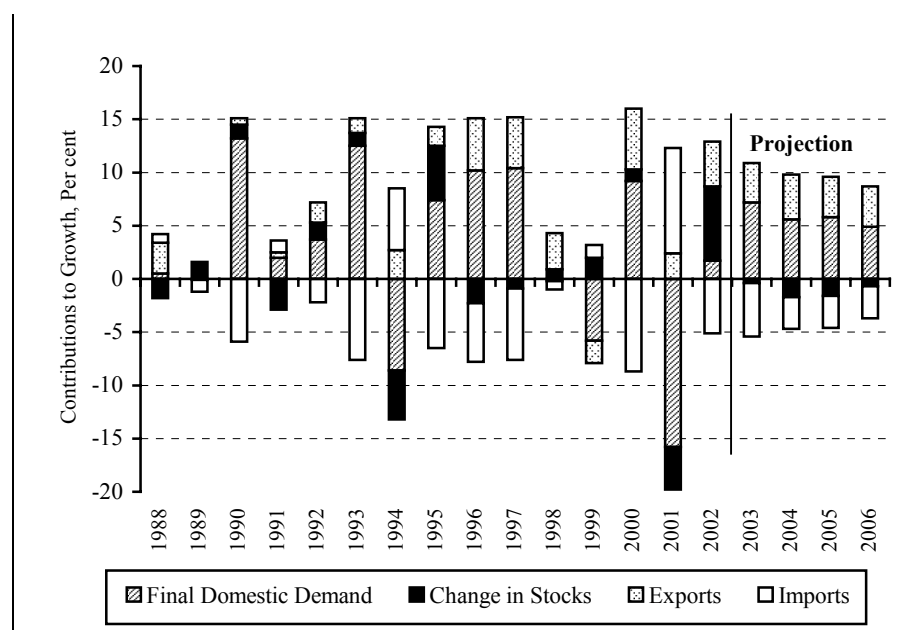
Figure: 2. 1. GDP Growth Rate



In the period of 2004-2006 average annual GNP growth rate is expected to be 5.2 per cent and the average annual GDP growth rate as 5.1 per cent. In terms of demand components, growth

is estimated to come mainly from the increase in investments and exports. In this period, average annual rates of increase in total fixed capital investments, private investments and public investments are expected to be 13.8 per cent, 15 per cent, and 10.2 per cent, respectively. In the same period, it is estimated that average annual rates of increase will be 9.2 per cent for the exports of goods and services and 7.7 per cent for the imports of goods and services. On the other hand, private consumption expenditures are estimated to register an average annual rate of increase of 3.3 per cent, while the average annual rate of increase in public consumption expenditures are targeted to be 2.4 per cent.

Figure: 2. 2. Contributions to GDP Growth



Savings-Investment Balance

As a result of the strict fiscal policy and the structural reforms being implemented, significant improvements were achieved in public finances in 2002. A considerable slow-down in domestic borrowing and a serious decrease in interest rates were observed. In this context, in the period of 2003-2006, a significant improvement in public debt management, a sustained decrease in interest rates, and parallel to these developments an expansion in financing means for private investments are expected. Additionally, improvement in the market sentiment parallel to the progress in EU-Turkey relations and the market enlargement in line with the integration with the EU is expected to result in a rise in both domestic and foreign investments. The share of private sector investments in GDP that is estimated to be 13.4 per cent in 2003 is foreseen to rise to 17.8 per cent in 2006.

As a result of the ongoing rationalization efforts for public investments and the strict fiscal policy, public investments that are expected to go down to 4.6 per cent of the GDP in 2003, are expected to increase parallel to the improvements achieved in public finances in the period ahead, and to reach the level of 5.3 per cent in 2006.

Thus, the share of fixed capital investments in GDP that is expected to be 18 per cent in 2003 is foreseen to reach 23.1 per cent in 2006. Taking into account also the changes in stocks, the

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share of total investments in GDP expected to be 22.2 per cent in 2003, is estimated to reach 23.3 per cent in 2006.

In the period of 2003-2006, as a result of the expected efficiency increases in the public debt management and the improvements in the market sentiment, it is expected that the ratio of interest expenditures to GDP that has a very large share in public expenditures will decrease, causing public disposable income to increase. In this context, the public savings- investment gap is expected to narrow, depending on the increase in public disposable income and the slow-down in the increase of public consumption expenditures.

Depending on the increase in the share of public disposable income in GDP, it is foreseen that the share of private disposable income and consequently the share of private savings in GDP will decrease.

Considering the savings-investment balance as a whole, in the period of 2003-2006 it is expected that the domestic savings, which will increase parallel to the rise in the market confidence, will have a positive effect on total investments as well. On the other hand, foreign savings that were registered as 1.7 per cent of GDP in 2002 are expected to rise to 3.2 per cent in 2003. However, in the period of 2004-2006 foreign savings are foreseen to decrease and go down to the level of 1.5 per cent in 2006. It is foreseen that through the implementation of strict monetary and fiscal policies, total savings-investment gap will be kept under control and this will in turn lead to a reduction in the foreign saving requirement after the year 2003.

Table: 2. 1. Total Savings-Investment Balance

(Per cent of the GDP)

	Average		Realization			Forecast			
	90-94	95-99	2000	2001	2002	2003	2004	2005	2006
Total Investment	23.1	23.2	23.9	15.9	21.3	22.2	22.4	22.9	23.3
-Fixed Capital Formation	24.2	22.9	21.7	17.2	16.7	18.0	19.9	21.9	23.1
-Public	6.3	5.5	5.8	5.3	5.7	4.6	5.1	5.2	5.3
-Private	17.9	17.4	15.9	11.9	11.0	13.4	14.8	16.7	17.8
-Change in Stocks	-1.2	0.3	2.1	-1.3	4.6	4.2	2.5	0.9	0.2
Total Savings	23.1	23.2	23.9	15.9	21.3	22.2	22.4	22.9	23.3
Domestic Savings	21.3	19.2	16.6	18.2	19.6	19.0	20.0	21.0	21.8
Foreign Savings (1)	1.8	4.1	7.3	-2.3	1.7	3.2	2.4	1.9	1.5

(1) The savings-investment balance is based on the SIS figures of the GDP-by expenditures. Public investments in the table include the investments of the State Economic Enterprises (SEEs) in addition to those of the general government.

*Macroeconomic Framework***Sources of Growth**

Although a high growth rate was achieved in 2002, a decline in the level of employment and consequently a significant increase in the labour productivity were observed. As a result of the decrease in employment in 2002, the contribution of employment to growth was negative, while the contribution of capital stock and total factor productivity (TFP) to growth increased considerably.

Table: 2. 2. Growth Rates of Factors of Production

(Per cent)				
Period	GDP	Capital Stock	Employment	TFP
1990-2000	4.1	7.6	1.1	0.5
2002	7.8	3.8	-0.8	6.5
2003	5.3	4.2	1.9	2.8
2004	5.1	4.7	3.3	1.2
2005	5.1	5.1	2.6	1.5
2006	5.1	5.4	2.7	1.3
2003-2006	5.1	4.8	2.5	1.7

The growth rates foreseen for the period of 2003-2006 will be supported by the increase in production factors as well as the productivity increases. As a result of the high rates of increases in investments foreseen for this period, the average annual capital accumulation is expected to be 4.8 per cent. It is envisaged that the investment increases foreseen for this period will create new employment opportunities, and that thereby labour demand will also increase, parallel to the increase in the capital stock. In this context, it is estimated that employment will increase at an average annual rate of 2.5 per cent. Moreover, total factor productivity is expected to increase considerably during this period as well.

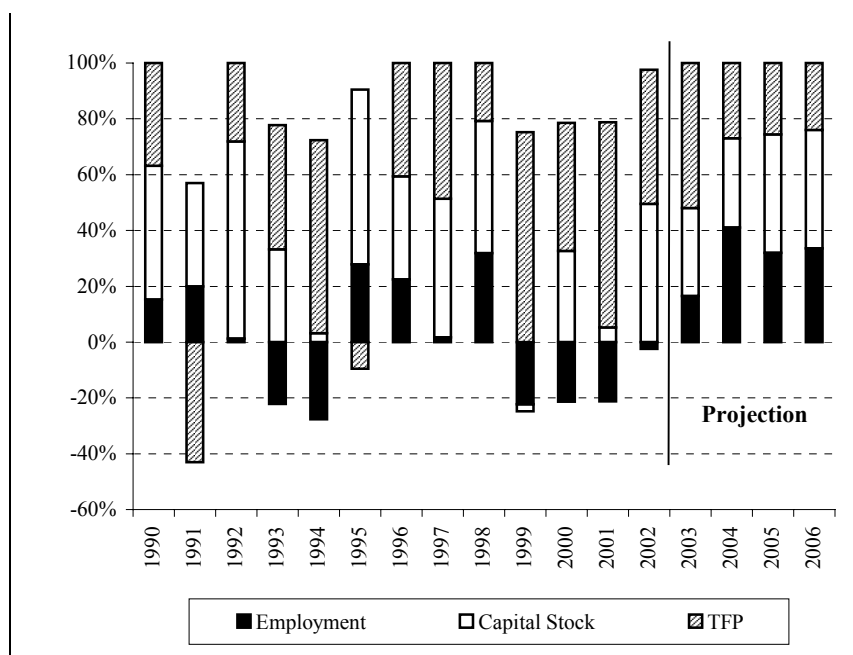
Table: 2. 3. Contribution to Growth by Factors of Production

(Per cent)			
Period	Contribution of Capital Accumulation	Contribution of Employment Increase	Contribution of TFP Increase
1990-2000	73.2	17.3	9.5
2002	52.2	-2.6	50.4
2003	31.5	16.5	52.0
2004	32.0	41.1	27.0
2005	42.4	32.0	25.6
2006	42.5	33.6	23.9
2003-2006	37.0	30.7	32.3

As a result of these developments expected in factors of production, in the Pre-Accession Economic Programme period the contributions of the capital stock, employment and total factor productivity to growth are estimated to be 37 per cent, 30.7 per cent, and 32.3 per cent, respectively.

In this context, the projected 5 per cent average annual growth rate for the Turkish economy in the Pre-Accession Economic Programme period is considered to be attainable.

Figure: 2. 3. Contribution to Growth by Factors of Production



Potential Output

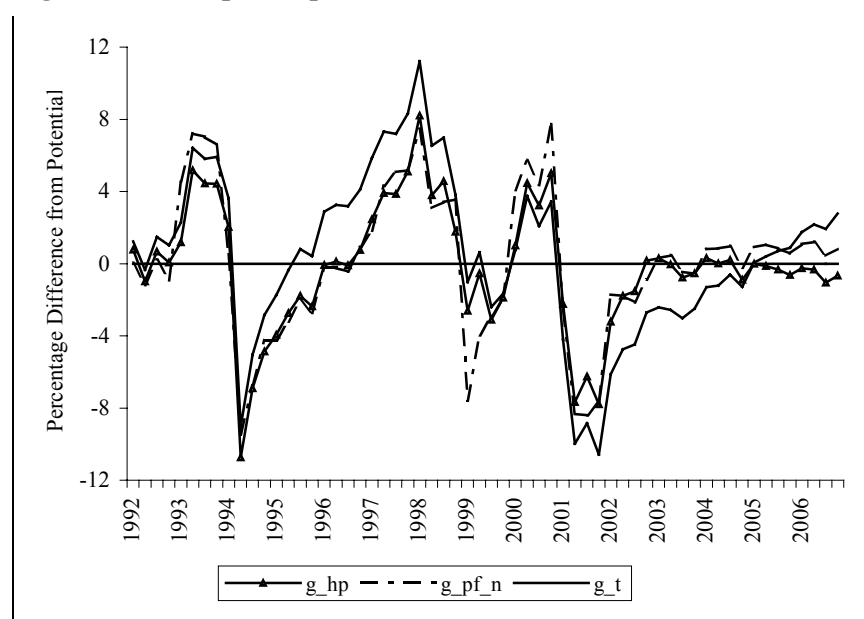
After 1990, GDP growth displayed significant fluctuations due to various reasons and remained below the potential growth. This situation was mainly caused by the internal and external shocks experienced by the economy. Together with the crises of November 2000 and February 2001, the contraction in the economy reached record levels and the output gap rapidly declined to negative levels.

The successful implementation of the economic policies and the structural reforms foreseen in the Pre-Accession Economic Programme will be effective on the GDP growth in approaching the potential growth rate. The output gap series calculated by three different methods, linear method, Hodrick-Prescott method (HP) and production function method are presented in Figure 2.4. Despite slight differences depending on the methods employed, the series display very similar movements and yield the same output gap results. Concerning the evaluation of the period of 2003-2006, all three methods indicate that the negative output gap is diminishing as of 2002, and that as of 2004 production will reach the potential level.

HP and production function methods indicate that production will be realized at around the potential level after 2004, while the linear method points to a certain warming-up in the economy. The main reason for this development is the fact that the low growth performance in the recent years pulled down the trend growth rate. Nevertheless, particularly the

production function is much better in reflecting the economic developments and the increase in the production potential. In the Pre-Accession Economic Programme period, as a result of the expected economic stability, a considerable increase in investments and a more rapid capital accumulation are foreseen. Moreover, it is estimated that during this period a greater portion of the population will participate in economic activity and that this will lead to an increase in production potential.

Figure: 2. 4. Output Gap



g_t : Output gap calculated by linear method.

g_hp : Output gap calculated by Hodrick-Prescott method.

g_pf_n : Output gap calculated by using production function and variable nairu assumption.

On the other hand, depending on the implementation of tight monetary and fiscal policies foreseen during the Pre-Accession Economic Programme period, domestic demand is expected to display a controlled increase and that growth will not create any inflationary pressures.

Box: 2. 1. Potential Output and Output Gap Projections

Output gap, defined as the difference between actual and potential output, is an important indicator of the state of the business cycle. Since potential output and output gap are not directly observable variables, they may display differences in their measured values depending on the calculation method employed. This study uses 3 different methods to calculate potential output and output gap:

1. Linear Method
2. Hodrick-Prescott (HP) Method
3. Production Function Method

Linear and HP methods are purely statistical methods and have no direct relation with the economic theory. Nevertheless, these methods are frequently used, because it is easy to calculate output gaps employing these methods and they usually give a general idea about the level of output gaps.

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In contrast to these methods, the production function method uses assumptions based on the economic theory as the starting point and establishes a direct relation with it. This method aims to estimate the supply potential of the economy.

In the calculation of the output gap with the production function, the methodology used by the European Commission was taken as a base⁽¹⁾. In this method, GDP is determined as a function of labour, capital stock and TFP. Cobb-Douglas function with constant returns to scale is used as production function and TFP is calculated as Solow residuals.

$$Y_t = L_t^\alpha K_t^{1-\alpha} TFP_t$$

$$TFP_t = \frac{Y_t}{L_t^\alpha K_t^{1-\alpha}}$$

In the transition from GDP to potential GDP, TFP has to be de-trended and the potential labour series has to be estimated. TFP was de-trended using Hodrick-Prescott filter. In estimating the potential labour-force series, supply of labour-force was estimated by taking into consideration the historical trend of the participation rate in the labour-force and the population forecasts, and then the estimated labour-force supply series was corrected by nairu (non-accelerating inflation rate of unemployment). Concerning the estimation of nairu, under the variable nairu assumption, the unemployment rate was put through the Hodrick-Prescott filter and the nairu series was calculated.

$$Y^p_t = L^p_t^\alpha K_t^{1-\alpha} TFP^p_t$$

$$L^p_t = LS_t * (1 - nairu_t)$$

$$LS_t = POP15_t * PART_t$$

Y: GDP

L: Labour demand (employment)

K: Capital stock

TFP: Total Factor Productivity

Y^p: Potential GDP

L^p: Potential labour force

LS: Labour supply

nairu: Non-accelerating inflation rate of unemployment

POP15: Working age population

PART: Participation rate

(1) Denis C., K. Mc Morrow, W. Röger, "Production Function Approach to Calculating Potential Growth and Output Gaps - Estimates for the EU Member States and the US", European Commission Directorate-General for Economic and Financial Affairs, Economic Papers 176, September 2002.

GDP Growth by Sectors

In the Turkish economy the share of agriculture in national income is declining, while the share of industry and services sectors is gradually growing. While the share of agriculture in the national income was 26 per cent in 1980, this rate declined to 17 per cent in 1990 and to 13.5 per cent in 2002. On the other hand, the share of industry in the national income increased from 19 per cent in 1980 to 25 per cent in 1990, and to 29 per cent in 2002. In this period, the services sector displayed developments parallel to the industry.

In this context, the share of agriculture in GDP is expected to continue to decline in the period of 2003-2006. It is expected that in the period of 2004-2006 the value added of agriculture will display an average annual growth rate of 2.4 per cent, and that its share in the total value added will decline from its level of 13.5 per cent in 2002 to 11.9 per cent at the end of the

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period. It is estimated that in the period of 2003-2006 the GDP will grow by an average annual rate of 5.1 per cent, and that the average annual growth of the industry and the services sectors will be slightly higher than the GDP increase. It is thereby expected that the shares of the industry and services sectors in GDP that were recorded as 28.8 per cent and 57.7 per cent in 2002, will rise to 29.4 per cent and 58.7 per cent respectively in 2006.

Table: 2. 4. Value Added by Sectors

	(Per cent)						
	Realization			Forecast			
	2000	2001	2002	2003	2004	2005	2006
Growth Rates							
Agriculture	3.9	-6.5	7.1	0.5	2.5	2.4	2.3
Industry	6.0	-7.5	9.4	6.2	5.5	5.5	5.4
Services	8.9	-7.7	7.2	5.9	5.5	5.5	5.5
GDP	7.4	-7.5	7.8	5.3	5.1	5.1	5.1
Shares in the GDP							
Agriculture	13.3	13.6	13.5	12.9	12.6	12.2	11.9
Industry	28.4	28.4	28.8	29.1	29.2	29.3	29.4
Services	58.2	58.0	57.7	58.0	58.3	58.5	58.7
GDP	100	100	100	100	100	100	100

Developments in the Labour Market

The decline in the level of employment registered in 2002 despite the high growth rate was mainly due to the decrease in agricultural employment by 470 thousand people and to the failure of non-agricultural sectors to fully absorb this decline.

In the Pre-Accession Economic Programme Period wage increases will be kept in conformity with the inflation targets and priority will be given to increase employment.

In the period of 2003-2006 it is expected that the foreseen increases in investments will create new employment opportunities. However, it is expected that the decline in the unemployment rate will remain limited due to the increase in the labour-force parallel to the population increase. The labour-force participation rate that was recorded as 49.6 per cent in 2002, is expected to display a moderate increase in the following years and to reach 50.8 per cent in 2006. It is estimated that in the programme period, parallel to the increases achieved in employment, the unemployment rate will decline from its level of 10.3 per cent in 2002 to the level of 9.6 per cent in 2006. The average annual increase in employment is expected to be 2.5 per cent.

*Macroeconomic Framework***Table: 2. 5. Developments in the Labour Market**

	Realization	Forecast			
	2002	2003	2004	2005	2006
Civilian Labour Force (thousand people)	48,041	48,909	49,793	50,680	51,598
Labour Force Participation Rate (per cent)	49.6	50.2	50.4	50.6	50.8
Employment (thousand people)	21,354	21,760	22,488	23,074	23,703
Employment (percentage change)	-0.8	1.9	3.3	2.6	2.7
Unemployment Rate (per cent)	10.3	11.4	10.4	10.0	9.6

2.2. Inflation

The permanent reduction of the inflation rate and its convergence with the levels in EU Member Countries is one of the primary targets of the Pre-Accession Economic Programme. To this end, as was the case in 2002, also in the forthcoming period the monetary policy will be set within the framework of the main aim of price stability stated in the Central Bank Law and short-term interest rates as an instrument of the monetary policy will be used efficiently only with the aim of reaching the inflation targets. Until shifting officially to inflation targeting, the strategy of implicit inflation targeting will be maintained and the monetary base will continue to function as an additional anchor for the monetary policy. However, without ensuring a permanent discipline in public finances and without uninterrupted implementation of the reform process, which has a direct impact on expectations, it does not seem possible that a permanent success will be achieved in the struggle against inflation, by means of the monetary policy alone. Consequently, the maintenance of the fiscal discipline and the uninterrupted implementation of reforms will be the main elements of the struggle against inflation in the period ahead.

Within the framework of the implemented programme, the main indicator of fiscal discipline is the primary surplus target. The implementation of the primary surplus target in conformity with the economic programme will facilitate the rollover of the debt stock and thereby reduce the risk premium. The reduction in the risk premium will lead to a decline in the real interest rates and this will in turn make further positive contributions to the process. This positive process will facilitate both the economic recovery, as well as the struggle against inflation through improving the expectations and confidence in the economy. Therefore, supporting the implemented monetary policy by fiscal discipline, by public pricing and income policies that are compatible with inflation targets, and by the required structural reforms was determined as the main strategy to be pursued in the struggle against inflation in the period ahead.

The implementation of the foreseen policies is expected to reduce the rate of increase in the CPI from 20 per cent in 2003 to 12 per cent in 2004 and to single digit numbers in 2005 and thereafter. In this context, the targets and projections for the period 2003-2006 concerning the year-end CPI and WPI and the annual average rate of increases in the GDP deflator are presented in the table below.

*Macroeconomic Framework***Table: 2. 6. Price Targets and Projections**

	(12-Month Percentage Change)			
	2003	2004	2005	2006
CPI (1)	20.0	12.0	8.0	5.0
WPI (2)	21.0	12.0	8.0	5.0
GDP Deflator (3)	25.1	13.6	9.4	6.0

(1) The year-end target for the 2003-2004 period, projection for 2005-2006.

(2) The year-end projection.

(3) Projection for average annual change.

2.3. Monetary and Exchange Rate Policy

The monetary policy strategy implemented in 2002 and 2003 covers a transition period. The Central Bank declared that before officially switching to inflation targeting as the final framework of the monetary policy, it will implement a policy of implicit inflation targeting, and that it may only make changes in short-term interest rates only in view of the probable inflation values in future. With the aim of supporting this strategy, remaining within the limits of a monetary expansion that is compatible with the macroeconomic targets and convincing economic units that such limits will not be exceeded, the monetary targeting policy was implemented. In this context, with the aim of decreasing uncertainties and shaping the expectations for the future, the increase in the monetary base, which is a balance-sheet item of the Central Bank, was determined as target variable and became the nominal anchor of the programme. The Central Bank will maintain the framework of this monetary policy that yielded positive results, until the date of the official shift to inflation targeting.

The pre-conditions for the successful implementation of the monetary policy based on inflation targeting are; (i) the maintaining of the floating exchange rate system, (ii) the maintaining of the fiscal discipline, (iii) the securing of financial deepening, (iv) the reduction of backward indexation in prices and wages, (v) the existence of a central bank whose independence from political authority is guaranteed by laws and which implements transparent policies, and (vi) the technical capability and reliability of the central bank to perform inflation estimates with small error margins for different time periods. In line with these pre-conditions, the Central Bank completed its preparations to shift to inflation targeting both institutionally, as well as technically. In this context, short and medium term inflation estimation models were built, questionnaires were prepared to measure the expectations of economic units concerning inflation and general economic developments, detailed studies on inflation developments were conducted, and all these were publicised. Moreover, by means of the amendments to the Central Bank Law, in terms of its duties and responsibilities, the Central Bank also attained an institutional structure suitable for inflation targeting.

Although the shift to the regime of inflation targeting is planned for the forthcoming period, the final date of this shift will be determined by taking into consideration the developments and expectations in the domestic and foreign markets. Factors to be taken into consideration in the setting of the final date for the inflation targeting regime are the improvement process in public finances, the avoidance of backward indexation and the weakening of the relationship between exchange rate and inflation. Following the official shift to the inflation targeting regime, the Central Bank will announce to the public the operational details of this regime by means of press bulletins and monetary policy reports.

The Central Bank considers the floating exchange rate regime that ensures the compatibility of exchange rates with economic fundamentals as the main element of achieving a permanent reduction in inflation. In this context, limited interventions will be performed only with the aim of preventing excessive fluctuations in the exchange rates without distorting the long-run equilibrium level of the exchange rates. In addition, if as a result of the reverse currency substitution and strong balance of payments situation, there should be a surplus in the foreign currency supply in the market, transparent auctions for the buying of foreign currency will be performed.

2.4. Balance of Payments

Current Account

Exports foreseen as 33.3 billion dollars for 2002 performed beyond expectations and reached 35.8 billion dollars. On the other hand, imports estimated at 44.8 billion dollars in the 2002 Pre-Accession Economic Programme reached 51.3 billion dollars mainly due to a considerably better-than-expected recovery in the economy. Since Iraq War, which was expected in 2002, took place in 2003, tourism revenues were realized at a higher level than expected and as a result no serious deviation was observed in the current account balance to GDP ratio.

The increasing trend of exports realized in 2002, despite the appreciation of the real exchange rate, is expected to continue in the medium term. The first six-month export data of 2003 also point out to a continuing high rate of increases in exports. This positive trend is expected to continue throughout the programme period (Box 2.2). In this framework, exports expected to reach 43.5 billion dollars in 2003 is estimated at 60.3 billion dollars in 2006. Imports are expected to display an increasing trend in parallel with the recovery in domestic demand, reaching 79.2 billion dollars in 2006.

Tourism revenues foreseen as 8.5 billion dollars in 2003 are expected to reach 10.6 billion dollars in 2006 through the effective utilization of the existing capacity and potential as well as extensive promotional activity.

Workers' remittances have recorded a decline since the February 2001 crisis. Circumstances such as lower rate of increases income in EU countries where majority of the Turkish workers reside have had a negative impact on workers' remittances. Therefore, the estimates given in the 2002 Pre-Accession Economic Programme have been revised down. Accordingly, workers' remittances are estimated at 2.9 billion dollars in 2006.

The Accession Partnership with Turkey adopted at the beginning of 2003 states that the European Union would provide approximately 1.1 billion euro financial aid to Turkey between 2004-2006. This aid is expected to be 250 million euro in 2004, 300 million euro in 2005 and 500 million euro in 2006.

In this framework, the current account deficit is expected to be 7.4 billion dollars in 2003, 6.6 billion dollars in 2004, 5 billion dollars in 2005, and 3.2 billion dollars in 2006. As a result, the ratio of the current account deficit to GDP is estimated at 3.2 per cent in 2003, 2.7, 1.9 and 1.2 per cent respectively in 2004, 2005 and 2006.

Box 2.2: Analysis of High Export Performance

A considerable increase in exports has been observed following the economic crisis of 2001. Because of the depreciation in Turkish lira and sharp contraction in the domestic demand as a result of the crises, companies found a way out by concentrating more on exports. Exports increased 12.8 per cent in 2001 compared to the previous year and reached 31.3 billion dollars. The high rate of increases in exports continued in 2002 and exports rose by 14.1 per cent, reaching 35.8 billion dollars. This is the highest level of increase in exports in the recent years. Factors contributing to this situation are ongoing stagnation of domestic demand, export arrangements made in 2001, the fall in the real labor costs and the increase in efficiency. In fact, according to SIS data, per capita partial productivity index in the manufacturing industry increased 10.2 per cent in 2002 and 4.2 per cent in the first quarter of 2003. On the other hand, real wages per hour worked in the manufacturing industry decreased by 5.5 per cent in 2002 and 0.9 per cent in the first quarter of 2003. These developments have increased the competitiveness of the exports in external markets.

The increase in exports accelerated in the first five months of 2003. The export arrangements made in 2001 and 2002 and the related investment and production increases have positively affected export performance in 2003. Another indication showing that companies are moving towards exports is the fact that they are benefiting in greater numbers from the support mechanisms provided by the Undersecretariat of Foreign Trade such as Promotions and Fairs, state aids and inward processing. In addition, the fact that the Euro has appreciated considerably against the dollar has had a role in the increase of exports in dollar terms.

There are positive and continuing developments regarding the sectoral structure of exports. After the crisis, high-tech sectors, which have an important share in world trade, such as the automotive industry and its sub-sectors as well as the machinery industry performed well in exports while the weight of the textile and clothing industry, which have a lower share of world trade, declined in exports. In fact, in 2000-2002 while total exports increased by 29 per cent, this figure was 106 per cent for the automotive industry and its sub-sectors, 57 per cent for office machinery and communication devices and 46 per cent for electrical machinery and equipment. Textile and clothing sectors showed a 15 and 22 per cent increase in the same period respectively and the share of these sectors in exports decreased. The investment made for exports-oriented production in the automotive sector and its sub-sectors as well as the machinery and transport vehicles sectors point out to the continuation of the increasing trend of exports.

Some positive developments are also observed in the composition of the export markets in the last two years. As of 2001, Turkey increased its market share in the European Union and the OECD markets significantly. While the share of Turkish exports in the total imports of the European Union was 1.6 per cent in 2000, this figure went up to 2 per cent in 2002. Similarly, the share in OECD imports was 0.5 per cent in 2002, up from 0.4 per cent in 2000.

In the same period, our exporters also had success in penetrating new markets. In this period, the share of our exports to countries other than the OECD countries showed a 3 per cent increase in overall exports. There has been an increase in the share of exports to the Far East, Gulf States, Black Sea Economic Cooperation countries and the Middle East countries within total exports. It is also observed in the January-May period of 2003 that the highest rate of increases was realized in exports to the countries that generally have a lower share in exports.

An Export Strategy Plan (2004-2006) was prepared with the participation of the private sector to support the positive structural changes in exports that occurred after the 2001 crisis when companies began to concentrate more on exports; and to ensure the permanency of these positive developments. Through the use of export support mechanisms as envisaged in this Plan, it is aimed to support the structural transformation in exports and to enable exports to contribute to the growth significantly not only during crises but also at all times.

Capital and Financial Account

Capital flows are expected to finance current account deficits in 2003 and 2004 and are also expected to pave the way for a 1.6 billion dollar increase in reserves for 2003 and 2 billion dollar increase for 2004. However, the approximately 18 billion dollars to be repaid to the IMF in 2005 and 2006 and the capital outflow as a result of current account deficits are expected to reduce the official reserves by 4.1 billion dollars in 2005 and 2.2 billion dollars in 2006.

Foreign direct investment in Turkey is quite low when compared to other emerging markets. Important steps are being taken to improve the regulations regarding the investment environment for the purpose of increasing the level of foreign direct investments in Turkey. In this framework, Foreign Direct Investment Law No. 4875 put into force in June 2003. This legislation regulates the conditions for the encouragement of foreign direct investment; the protection of the rights of the foreign investor and the recognition of international standards in defining investor and investment; the transformation of the permit and approval systems into a filing and information system; and efforts for increasing foreign direct investment through various policies.

Annual foreign direct investments are estimated at an average of 1.6 billion dollars throughout the programme period.

Portfolio investments are expected to contribute to a certain extent to the total capital inflow in 2003-2006 period and pave the way for a 3.9 billion dollar net capital inflow in 2006. Within the framework of the bond issuance of the Treasury abroad that constitutes a major portion of the portfolio investments, a net capital inflow of 0.8 billion dollars in 2003 and an average annual capital inflow of 2 billion dollars in the years to follow are expected.

The net contribution of the general government to capital flows is estimated at 2.8 and 4.4 billion dollars in 2003 and 2004 respectively, but estimated at -1.6 billion dollars for 2005 and -3.9 billion dollars for 2006 due especially to repayments to the IMF.

The commercial loan utilization of the non-bank private sector from abroad is expected to increase in parallel with the volume of foreign trade and long-term loan utilization from abroad is expected to increase in parallel to domestic investments. The long and short-term loan utilization by the banking sector are expected to increase gradually until 2006.

Turkey is not expected to run into any difficulty regarding the balance of payments during the Programme period.

*Macroeconomic Framework***Table: 2. 7. Balance of Payments Forecasts**

	(Billion Dollars)						
	Realization			Forecast			
	2000	2001	2002	2003	2004	2005	2006
Current Account	-9.8	3.4	-1.5	-7.4	-6.6	-5.0	-3.2
Balance on Goods	-22.4	-4.5	-8.4	-12.0	-12.4	-11.8	-10.9
Goods: Exports (f.o.b.)	30.7	34.4	39.8	47.5	52.8	59.0	65.7
Exports (f.o.b.)	27.8	31.3	35.8	43.5	48.4	54.1	60.3
Goods: Imports (f.o.b.)	-53.1	-38.9	-48.2	-59.5	-65.2	-70.8	-76.6
Imports (c.i.f.)*	-54.5	-41.4	-51.3	-61.6	-67.5	-73.2	-79.2
Balance on Services	11.4	9.1	7.9	7.2	8.2	8.8	8.9
Services: Credit	20.4	16.0	14.8	15.5	17.5	18.8	19.6
Tourism	7.6	8.1	8.5	8.5	9.8	10.2	10.6
Services: Debit	-9.0	-6.9	-6.9	-8.3	-9.3	-10.0	-10.7
Balance on Income	-4.0	-5.0	-4.5	-6.2	-6.7	-6.9	-6.4
Income: Credit	2.8	2.8	2.5	2.4	2.7	2.7	3.7
Income: Debit	-6.8	-7.8	-7.0	-8.6	-9.4	-9.6	-10.2
Current Transfers	5.2	3.8	3.5	3.6	4.3	4.9	5.3
Workers' Remittances	4.6	2.8	1.9	2.0	2.4	2.8	2.9
Capital and Financial Account							
Financial Account	12.6	-1.7	1.7	7.8	6.6	5.0	3.2
Direct Investment Abroad	-0.9	-0.5	-0.2	-0.2	-0.3	-0.3	-0.4
Direct Investment in Turkey	1.0	3.3	1.0	1.6	1.3	1.6	2.0
Portfolio Investment – Assets	-0.6	-0.8	-2.1	-0.6	-0.6	-0.6	-0.6
Portfolio Investment – Liabilities	1.6	-3.7	1.5	1.7	3.1	4.0	4.5
Equity Securities	0.5	-0.1	-0.0	0.1	0.7	0.7	0.7
Debt Securities	1.1	-3.6	1.5	1.6	2.5	3.3	3.8
Other Investments – Assets	-1.9	-0.6	-0.7	1.8	-0.9	-1.0	-1.1
Monetary Authority	0.0	-0.0	-0.0	0.0	0.0	0.0	0.0
General Government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Banks and Other Sectors	-1.9	-0.6	0.7	1.8	-0.9	-1.0	-1.1
Other Investments – Liabilities	13.7	-2.1	8.2	5.2	6.0	-2.8	-3.3
Monetary Authority	4.0	11.0	-4.8	-0.1	-1.1	-3.6	-2.2
General Government	0.1	-2.0	11.8	1.3	2.2	-4.9	-7.5
Banks and Other Sectors	9.7	-11.1	1.2	4.1	4.9	5.7	6.4
Official Reserves	-0.4	2.7	-6.2	-1.6	-2.0	4.1	2.2
Net Errors and Omissions	-2.8	-1.7	-0.1	-0.4	0.0	0.0	0.0
Memo item							
Total change in Reserves	3.0	12.9	0.2	-0.6	-1.4	-4.3	-7.7
Official Reserves	-0.4	2.7	-6.2	-1.6	-2.0	4.1	2.2
Use of Fund Credit and Loans (1)	3.4	10.2	6.4	0.9	0.7	-8.4	-9.8

* Excluding non-monetary gold imports.

(1) A new repayment scheme for Turkey's loan utilization from the IMF was adopted in the meeting of Executive Board held on August 1, 2003. According to this new scheme, the repayments to the IMF will be 2.6 billion dollars in 2003, 5.2 billion dollars in 2004, 7.8 billion dollars in 2005 and 10.7 billion dollars in 2006. The said repayment scheme could not be incorporated into the forecasts mainly due to its being a last minute change. However this rescheduling is not expected to cause any major change in the forecasts.

2.5. Main Risks During the Pre-Accession Economic Programme Period

The macroeconomic framework presented for 2003-2006 is the baseline scenario. The risks that may arise are likely to cause a deviation in the foreseen macroeconomic framework. Two different types of risks are analysed in this section. Firstly, the effect of a lower-than-expected export performance is analysed. Such a risk may arise as a result of sluggish external demand or weakening of the competitiveness in exports. The macroeconomic indicators that may be directly affected by this situation are shown below. The analyses in this section have been conducted by applying shocks to the macroeconometric model used in the preparation of the baseline scenario. Secondly, possible risks that may arise in attaining the inflation targets are presented at the end of the section.

Slowdown in Export Performance

In this scenario, the impact on macro balances of a slower export performance due to lower external demand from Turkey's foreign trade partners or a weakening of competitiveness in exports is analysed. In this framework, under the assumption that the realization of exports are 5 per cent below the baseline scenario in 2004, the GDP growth rate is estimated to be 1.6, 0.8 and 0.6 points below the baseline estimates in 2004, 2005 and 2006 respectively. The impact on the current account balance is more limited depending on the decrease in imports. Current account balance deteriorates by 0.1 points in 2004, but a 0.2 and 0.5 points improvements in 2005 and 2006 are realized due to decreasing imports resulting from lower growth rates. This situation arises from the fact that the growth elasticity of imports is quite high.

Table: 2. 8. The Effects of a Slowdown in Export Performance

	The Baseline Scenario			Difference from the Baseline Scenario		
	2004	2005	2006	2004	2005	2006
GDP Growth (per cent)	5.1	5.1	5.1	-1.6	-0.8	-0.6
Exports (billion dollars)	48.4	54.1	60.3	-2.4	-3.4	-3.9
Imports (billion dollars)	67.5	73.2	79.2	-2.2	-4.0	-5.4
Current Account Balance / GDP (per cent)	-2.7	-1.9	-1.2	-0.1	0.2	0.5

Risks Associated with Monetary Policy and Inflation

In 2004-2006, it is important to implement the economic programme with determination in order to extend the benefits of the effort to curb inflation to the medium term and to attain a sustainable growth performance by bringing the inflation rate down to single digit numbers. As was stated earlier, in order to succeed in bringing down the inflation rate in the medium and long term, it is critical that the Central Bank whose main objective is price stability has the ability to use the monetary policy tools effectively. For this reason, any development that may reduce the effectiveness of the monetary policy in the future may be perceived as a risk for the disinflation process.

Macroeconomic Framework

One of the most important risks is the implementation of the fiscal policy. The economic programme aims to improve the debt dynamics by reducing the real interest rates in the medium and long term and realizing primary surpluses through increased public savings. The programme also aims to alleviate the difficulties arising from the high debt stock in the effective utilization of the monetary policy. In this context, the greatest risk to the continuation of the programme and the inflation rate in the medium and long term is the deviation in fiscal policy targets. In other words, strict adherence to the fiscal discipline emerges as a very important element for continued success in curbing inflation.

Furthermore, an incomes policy in line with the inflation target and the continuation of structural reforms are equally important. In the event any one of these pillars of the economic programme are to be challenged, the foreseen levels of efficiency may not be achieved and the consequent developments in supply and demand may run the risk of increasing inflation.

Undoubtedly, the developments in the exchange rate will be important for inflation developments during the 2004-2006 period. Although the impact of the pass-through from exchange rate to inflation is expected to decrease over time, the developments in the exchange rate continue to be one of the main determinants of the inflation rate. In fact, the high rate of appreciation in the exchange rate in the recent months has been quite effective in slowing down the inflation rate. Therefore, the trend in the exchange rate will be important for inflation. For 2003-2006 period, a recovery in the domestic demand and achievement of the potential level of national product are foreseen. In this case, fluctuations in the exchange rate can be important for price increases.

As has been observed in the experience of other countries, the output cost of reduction in inflation increases as the level of inflation decreases. This points out to the need for increased efficiency and realization of structural transformations in the economy in order to sustain the downward trend in inflation in the long term. It is especially very important to increase efficiency in the public sector in order to be able to carry out a public sector pricing strategy in the future in line with the inflation target.

Price of oil and fluctuations in the world financial markets can deeply impact open and small economies. These external shocks remain as a risk factor disrupting the stabilization and disinflation process in Turkey where, historically, there has been a high level of chronic inflation. However, it is believed that the structural reforms carried out recently have reduced the fragility of the economy against external shocks.

3. PUBLIC FINANCE

3.1. Fiscal Policy Objectives

Fiscal Policy

The main objectives of the fiscal policy are to contribute to the establishment of a sustainable growth environment, to support the efforts towards disinflation and to achieve a substantial level of primary budget surplus each year in order to ensure the sustainability of the debt stock. Public revenue, expenditure and debt management policies will be implemented in a consistent and effective manner, taking into account the main objectives of the fiscal policy.

Public Revenues Policy

In 2002, the taxation strategy prepared for the purpose of restructuring the tax administration and tax policy was put into effect. The tax strategy comprises of various arrangements to be carried out during the 2002-2004 period. The main goals of these arrangements are to simplify the tax legislation and harmonize it with the EU.

In the area of tax strategy, most of the regulations foreseen with regard to direct taxation have been put into force in April 2003. As a result of these arrangements, the system of tax exemption on investments has been restructured and simplified, special expenditure reductions have been transformed into tax credit and the system for the deduction of some expenditures from tax in the taxation of wages has been simplified and made easier to implement. Tax structure became unitary and the tax declaration thresholds were adjusted to the current economic conditions. Declaration based revenues were redefined to include certain types of income as subject to declaration. The tax burden on corporate earnings has been reduced from 65 per cent to 45 per cent. The withholding tax ratios used for the taxation of dividends were reduced and the withholding tax ratios levied on the dividends of publicly held companies and other companies were equalized. Regulations on financial leasing were changed in compliance with international accounting standards. As a result of these changes, the tax system was simplified, tax burden was reduced and the work and transactions necessary to be carried out by the taxpayer and the tax administration for taxation purposes were reduced.

The life standard practice that was causing injustice in the tax system was brought to an end as of the beginning of 2003.

Within the framework of work carried out to render tax audits effective, an "Audit Coordination Board" attached to the Ministry was established in order to formulate tax audit policies, determine audit principles and strategies and to coordinate central and local audits in an effective and efficient manner. The Board prepared and began the implementation of the 2003 Ministry of Finance Tax Audit General Plan. In addition, there are ongoing efforts to increase the number and quality of the tax auditors.

Other tax arrangements to be carried out within the tax strategy:

- The effective tax burden on financial instruments will be harmonized. In the area of corporate taxation, arrangements will be made to index interest income and expenses, the arrangements on discretionary capital ownership and discretionary distribution of earnings will be updated and arrangements regarding the taxation of investment funds will be made.
- Arrangements parallel to that of the OECD will be adopted for transfer pricing and exceptions and exemptions will be revised.

Public Finance

- The activities carried out in order to functionally reorganize the General Directorate of Revenues will be completed in 2003 to render this Directorate more efficient with an operationally effective structure. In this framework, expert staff positions in line with the functional structure will be developed and activities to strengthen the tax policy development function will be implemented.
- The work carried out in order to extend the tax base and bring the unregistered economy into the scope of the registered economy will continue. In this framework, all tax offices will be fully on-line and the use of the tax identification number will be expanded. In addition, work will continue to render tax audits more effective and the implementation of the annual audit plan coordinated within this scope will continue. Programs to scan for high-risk taxpayers and areas and to carry out preliminary computerized audits will be prepared.
- Services to the taxpayer will be improved. On-line acceptance of tax declarations and tax payment services will be expanded.

These activities carried out within the framework of the tax strategy will allow our tax system to work more efficiently, to take under control the unregistered economy and to achieve justice in the taxation system.

Public Expenditures Policy

As of the beginning of 2000, necessary arrangements have been put into effect in order to initiate the structural reforms and measures needed to achieve a sustainable growth path.

The main expenditure policy is to control expenditures by increasing efficiency in public service and to refrain from creating pressure on the public sector borrowing requirement due to expenditures.

The following policies will be implemented in the medium term regarding expenditures:

- A comprehensive personnel policy reform is foreseen. During the reform effort, the public sector personnel system will be reorganized.
- Over employment in the public sector will be reduced.
- The policy of limiting new personnel employment (excluding education, health care and public security services) in the institutions within the scope of the consolidated budget for the purpose of reducing personnel expenditures will be continued.
- Wages in the public sector will be determined in line with the inflation target and in a way so as to maintain the public finance balance and fair distribution of wages.
- The policy of reducing interest burdens on the budget through efficient debt management will be continued.
- The health expenditures of social security institutions will be brought under control. Measures concerning pharmaceuticals, health care services and premiums to be paid will continue to be implemented in order to reduce transfers from the budget to social security institutions.
- It is of vital importance to restructure public administration with the aim of reducing expenditures and ensuring efficient allocation and utilization of resources according to strategic priorities. To this end, the duties and distribution of the authority of the central

and local administrations will be redefined and the restructuring process to increase the authority and responsibilities of the local authorities will continue.

- Efforts to rationalize the public investment programme will be continued taking into consideration sectoral priorities and available resources.
- To increase the efficient utilization of resources in the public sector and to meet the demands of society through an outcome-effective approach, the necessary capacity to implement strategic planning in governmental institutions will be developed in line with the national policy framework. Pilot organizations under the guidance of the SPO will complete their strategic plans in 2004 and prepare their budgets for 2005 in line with this strategic plan.
- Preparations for a draft law reorganizing the revenue and expenditures of revolving funds will be completed in order to streamline the legislation and put the revolving funds under control.
- Special revenue and funds will be limited to a great extent. As a result, expenditures will be more readily controlled by being foreseen in the initial budget.
- The policy of reducing the total number of personnel including civil servants, personnel under contract, temporary or permanent workers employed at state economic enterprises and their subsidiaries will continue in accordance with programme targets. Accordingly, up to only 10 per cent of personnel who have left work the year before may be hired in a current year. In addition, in line with the policy of reducing redundant employment in SEEs, 25 thousand personnel are expected to retire in 2003.
- The scheme for direct income support for farmers has been initiated with an aim to determine prices of agricultural products in the market and to allow the farmer to secure a certain amount of income. Efforts to downsize and/or privatise agricultural SEEs in the sector will continue.
- A new budget code system (analytical budget code system) has been initiated within the framework of the Public Fiscal Management Project as a result of a need for a proper budgeting classification in compliance with the activities undertaken by the state and the analysis of the impact of these activities on the national economy. This project has been in implementation in six pilot organizations since January 2002. It is aimed that the new budget code structure will be implemented in all organizations under the scope of the consolidated budget in 2004 and all institutions under the scope of the General Government in 2005.
- The Ministry of Finance has initiated the "Performance Based Budgeting" activities for the purpose of establishing a system aimed at rendering public expenditure and service efficient; closely following service developments; placing importance on performance; and establishing a relevant basis for auditing. In this framework, a project was designed to initiate 6 pilot activities/projects and after the training activities, the 2003 budget proposals were made according to the "Performance Based Budgeting" system. In addition, a guide including the merits, procedures and principles for public sector institutions in their transition to a performance based budgeting system in public fiscal management is about to be completed.

Public Finance Projections (2003-2006)

The general government fiscal balance is the consolidation of the revenues and expenditures of the consolidated budget, funds, social security institutions, revolving funds and local authorities. General government accounts have been estimated in conformity with the growth rate, inflation, interest rates, balance of payments and nominal wage increases foreseen for 2003-2006. Along with these assumptions and the revenue and expenditure policies stated in Section 3.1, other assumptions taken into account in the calculation of the revenue and expenditures of the institutions in the general government fiscal balance are as follows:

Revenue-Related Assumptions:

- The additional real estate tax and motor vehicles tax imposed in 2003 in order to reach programme targets will be abolished as of the beginning of 2004.
- It is assumed that special transaction and communication taxes will be continued.
- The tax peace implemented in 2003 is expected to generate revenue in 2004. Such a revenue item will not exist in 2005-2006.
- The deductions from the share that local authorities get from the tax revenues and the implementation of increasing the amount transferred from the revenue of the revolving fund to the budget for the purpose of achieving programme targets in 2003, will be ended as of the beginning of 2004.
- Due to the fact that the arrangements made to reduce the tax burden on corporations and the changes in the fund system will be enacted in 2004, there will be a decline in the income and corporate tax collection as of 2004.
- It is foreseen that there will be an increase in declaration-based taxes as of 2004 due to the improved efficiency of the revenue administration.
- It is thought that in 2004, a wider tax base will compensate the lower rate of corporate tax and that the increased tax collection realized as a result of arrangements made at the revenue administration will compensate for the loss of revenue due to inflation accounting.
- As of 2004, it is assumed that the amount to be transferred to the budget from the revenues and dividends of the SEEs will be reduced due to privatisation.
- In 2003-2006 period, a total of 12.4 billion dollars of privatisation revenue is targeted, 8.4 billion dollars in the privatisation fund and 4 billion dollars in the budget.

The general government tax revenues, which compose 61.4 per cent of total general government revenues, is expected to be around 26.7 per cent of GDP in 2003 as a result of the projections made in accordance with these assumptions. The general government revenue expected to be 42.6 per cent of GDP in 2003 excluding privatisation revenue, increases by 0.9 per cent to 43.6 per cent of GDP when privatisation revenues are included. Since the one-time measures in 2003 will not be valid in 2004, direct taxes and non-tax revenue will decrease and it is assumed that the total revenue will decline somewhat in 2004 and maintain a similar level in coming years. Therefore, in 2006, the total general government revenue expected to be 41.3

per cent of GDP reaches up to 42.3 per cent of GDP with a 1 percentage point increase when privatisation revenues are included.

Expenditure-Related Assumptions:

- It is assumed that the policy of limiting the number of public sector personnel will continue.
- It is assumed that the work to rationalize the public sector investment programme initiated in order to complete public sector projects in a short time by providing necessary financing; to prevent cost increases due to prolonged project duration, and thereby utilizing limited resources effectively; and making these projects a part of the economy in the shortest time possible will continue.
- The transfer expenditures that make up an important portion of general government expenditures is in a significant downward trend since 2003. In the 2003-2006 period, transfer expenditures are expected to decline, especially because of constantly decreasing budget interest payments based on the assumption that the Treasury will be able to borrow at long-term maturities and at lower costs, and the decline in social security institutions' expenditures due to austerity measures.
- In 2003-2006 period, it is assumed that Social Support Payments will continue to decline in parallel to the increase in pensions until it is completely abolished.
- The financial impact of the General Health Insurance that is expected to be enacted at the end of 2003 is not reflected in the balances.
- It is assumed that the worker, employer and state contributions to the unemployment insurance fund in 2003-2006 period, will continue to be one percentage point lower than that stipulated in the law as in 2003, in order to alleviate the premium burden on the worker and employer and to encourage employment.
- It is assumed that until the end of 2005, the Support and Price Stability Fund will continue its activities within the framework of the Agricultural Reform Implementation Project.
- It is assumed that direct income support will be increased in parallel with inflation each year and that liabilities arising in each year will be paid within the same year.
- It is assumed that the implementations regarding the limitations on appropriation transfers between budget items will continue.

As a result of projections made by taking into account these assumptions, it is estimated that the share of general government expenditures as a share of GDP will continue to decline steadily from 54.1 in 2003 to 44.8 in 2006. Non-interest expenditures are expected to show a very slight decrease from 36.3 per cent of GDP in 2003 to 35.1 per cent of GDP in 2006. Therefore, the most important factor in the decline of general government expenditures is the significant amount of decrease expected in budget interest payments. On the other hand, the improvements in economic indicators and the reforms regarding the restructuring of the public sector have had an important role in the realization of the decrease in general government expenditures.

General government fixed capital formation that is foreseen as 3.4 per cent of GDP in 2003 is expected to rise to 4.1 per cent gradually in 2004-2006 period.

*Public Finance***Table: 3. 1. General Government Revenues and Expenditures**

	(Per cent of GDP)			
	2003	2004	2005	2006
Taxes	26.7	25.2	24.8	25.2
Direct	8.2	7.2	6.8	6.9
Indirect	17.5	17.4	17.5	17.7
Wealth	1.1	0.6	0.6	0.7
Non-Tax Revenues	4.4	3.8	3.6	3.6
Factor Incomes	4.2	4.2	4.1	4.1
Social Funds	7.3	7.9	8.1	8.4
Total	42.6	41.1	40.7	41.3
Privatisation Revenues and Asset Sales	0.9	1.6	1.1	1.0
Total Revenues	43.6	42.7	41.8	42.3
Current Expenditures	18.0	18.1	18.1	18.1
Investments	3.5	3.9	3.9	4.1
Fixed Investment	3.4	3.8	3.9	4.1
Change in Stocks	0.0	0.0	0.0	0.0
Transfers	32.6	30.3	25.5	22.6
Current Transfers (net)	31.7	29.4	24.6	21.8
Capital Transfers	0.9	0.8	0.8	0.8
Stock Revaluation Fund	0.0	0.0	0.0	0.0
Non-interest Expenditure	36.3	35.6	35.4	35.1
Total Expenditures	54.1	52.2	47.5	44.8
Borrowing Requirement *	10.5	9.5	5.8	2.5
Borrowing Requirement Excluding Interest Payment*	-7.2	-7.1	-6.4	-7.2
Borrowing requirement Excluding Interest Payment and Privatisation*	-6.3	-5.5	-5.3	-6.1

* (+) refers to deficit and (-) refers to surplus.

General Government Borrowing Requirement

The general government borrowing requirement which was 13.1 per cent of GDP in 2002 is expected to fall to 10.5 per cent in 2003 and to rapidly decline as of 2004 to come down to 2.5 per cent in 2006. The most important factor in this decline is the significant decrease expected in consolidated budget interest payments. Also, the increases foreseen in privatisation revenue, the expected decrease in the deficits of social security institutions and the inclusion of the unemployment fund to the system will all have important roles in the reduction of borrowing requirements.

It is estimated that the general government primary surplus that is expected to be 7.2 per cent of GDP in 2003 will maintain the same level during the Programme period.

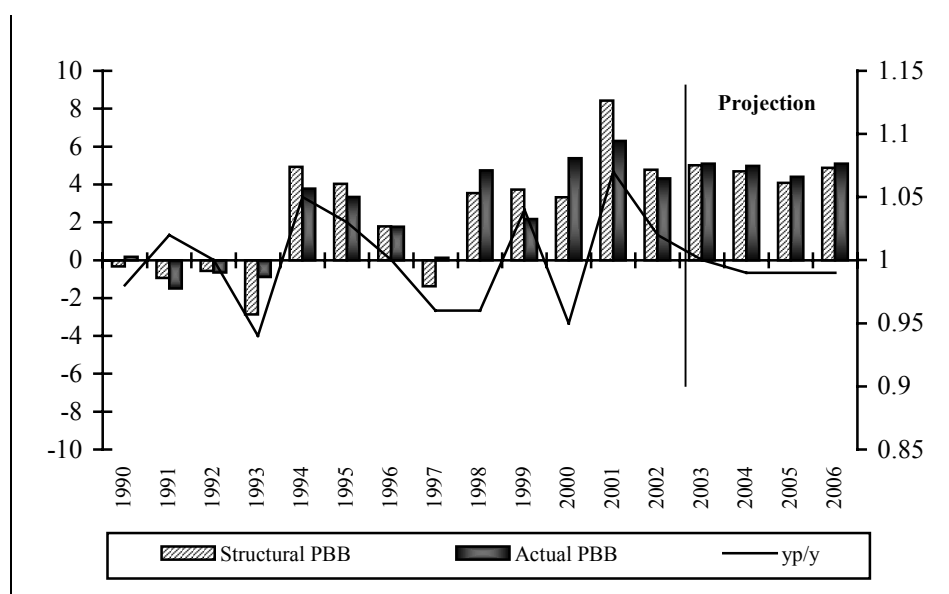
While in the 2002 Pre-Accession Economic Programme, it was assumed that the borrowing requirement would decline considerably to 0.5 per cent of GDP at the end of the Programme period, in the 2003 Pre-Accession Economic Programme period it is assumed that the annual decrease in borrowing requirement will be slower and that at the end of the Programme period it will come down to 2.5 per cent of GDP. The main difference stems from the interest expenditures. In fact, the borrowing requirement excluding interest payments shows a 1 percentage point difference between the two Programme.

Structural and Cyclical Consolidated Budget Balance

The method used by the EU Commission and the OECD was used to analyse the cyclical fluctuations in the budget for the Turkish economy. The methodology is summarized in Box 3.1.

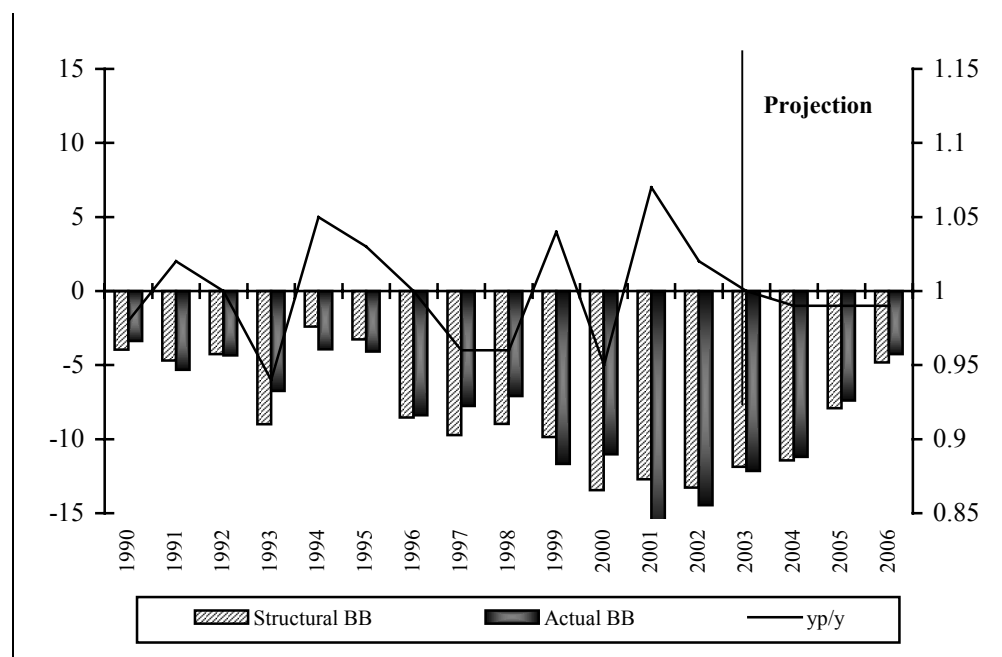
The structural primary budget balance is shown in Figure 3.1. In this respect, the ratio of the primary budget balance to GDP that fluctuated around zero between 1988-1994 reached high positive values after 1994. This situation became more apparent following the Stand-by Programme launched in 2000. Considering the forecasts for the 2003-2006 period, the non-structural primary budget balance maintains its high level.

Figure: 3. 1. Actual and Structural Primary Budget Balance



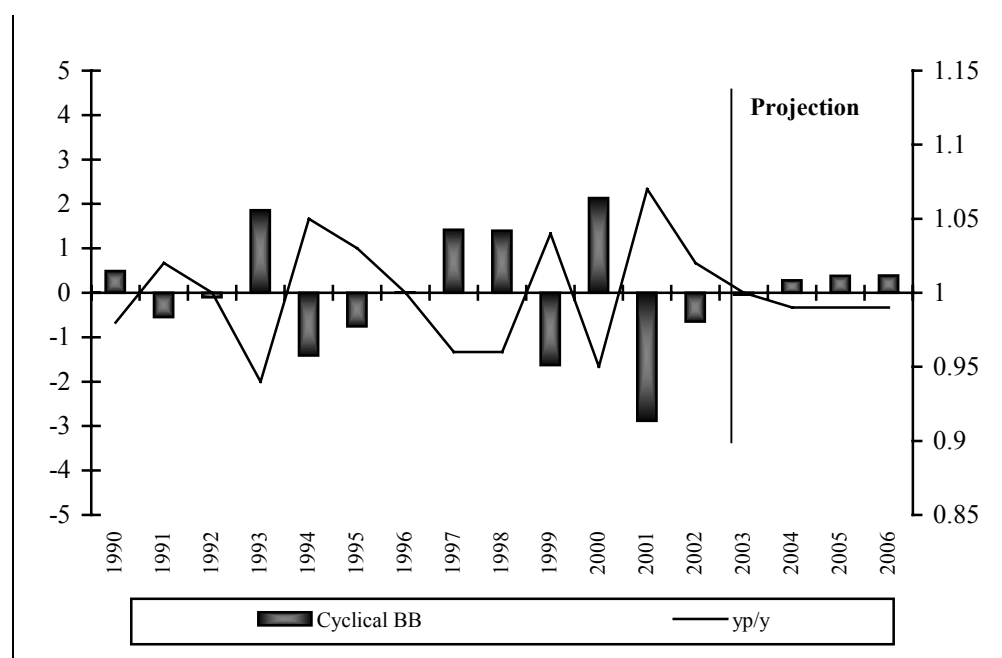
PBB: Primary Budget Balance yp/y: Potential output / actual output

The structural budget balance shows an improvement in the 2003-2006 period when the interest payments are taken into consideration and the deficit declines gradually. In this reduction, the fall in interest rates is an additional factor to the improvement in the primary balance.

Figure: 3. 2. Actual and Structural Budget Balance

BB: Budget Balance yp/y: Potential output / actual output

The cyclical budget balance defined as the difference between the actual budget balance and the structural budget balance shows that the fiscal policies are in harmony with the cyclical movements of the economy.

Figure: 3. 3. Cyclical Budget Balance

BB: Budget Balance yp/y: Potential output / actual output

Box: 3. 1. Methodology for Calculation of Structural and Cyclical Budget Balances

Many items of the budget balance are affected by macroeconomic balances. For example, during the times of economic contraction, there will be a reduction in tax revenue and an increase in unemployment benefits and social security expenditures and this situation will have a positive effect on growth by supporting private disposable income. During the times of economic expansion, there is an increase in tax revenue and a decrease in unemployment benefits and social security expenditures and this will have a negative impact on growth by decreasing private disposable income. Therefore the effects of macroeconomic balances on budget balance will have the impact of reducing economic fluctuations. These effects will be stronger in a progressive tax structure.

The determination of conjunctural effects in budget balance is important for the implementation of fiscal policies. For example, weakening the fiscal discipline by interpreting the conjunctural improvement in budget balance as permanent at a time when the economy expands may create unsustainable budget deficit and debt stock in the medium term. In a similar way, to interpret a conjunctural increase in the budget deficit as permanent when the economy contracts and taking measures to reduce the deficit may create a greater stagnation.

Mainly, the structural budget balance, which expresses a fiscal policy without the effects of economic fluctuations by eliminating the effects of cyclical movements, is defined as follows:

$$b^* = \frac{\sum_i T_i^* - G_i^* + X}{Y^P}$$

- b^* : Structural budget balance (as a ratio of national income),
 T_i^* : The structural value of tax revenues in category i,
 G_i^* : The structural value of budget current expenditures in category i,
 X : Other budget items which are not related to the cycles,
 Y^P : Potential output.

The relationship between structural tax revenues and current expenditures and their actual values is shown as follows:

$$\frac{T_i^*}{T_i} = \left[\frac{Y^P}{Y} \right]^{\alpha_i} ; \frac{G_i^*}{G_i} = \left[\frac{Y^P}{Y} \right]^{\beta_i} ;$$

- T_i : Tax revenues in category i,
 G_i : Budget current expenditures in category i,
 Y : Actual national income,
 α_i : The output elasticity of category i tax,
 β_i : The output elasticity of category i budget current expenditures.

Calculation of Potential Output: In this study, the potential output is calculated by using the Production function Method. (Box 2.1)

Output Elasticity of Taxes: Tax revenues are divided into 3 categories showing cyclical movements. These categories are taxes levied on income, corporate taxes and indirect taxes. The elasticity of indirect taxes is taken as unit elasticity. On the other hand, the elasticity of the other two taxes was calculated as time varying coefficients by using the Kalman filter.

Output Elasticity of Expenditures: Expenditures are divided into 2 components having cyclical movements, transfers to social security institutions and other expenditures excluding investment and interest payments. The national income elasticity of these variables was calculated by the Least Squares Method (OLS).

The difference between the actual budget balance and structural budget balance is defined as the cyclical budget balance:

$$b^{**} = b - b^*$$

- b^{**} : Cyclical budget balance (as a ratio of national income)
 b : Actual budget balance (as a ratio of national income)
 b^* : Structural budget balance (as a ratio of national income)

In the event the cyclical budget balance is in harmony with the cyclical movements of the economy, it has a dampening effect on the excessive fluctuations in the economy. In the opposite case, it has a magnifying effect on economic fluctuations.

3.2. Public Debt Management

Public Debt and Debt Management Strategy

The economic crises and the external developments in 2001 restricted borrowing from external markets, leading to a greater dependence on domestic borrowing. Moreover, increasing uncertainty led to shorter maturity and a rise in interest rates. This caused an increase in the cost of borrowing and created an additional borrowing requirement.

On the other hand, the state banks that borrowed heavily in the overnight money markets and the pressure in the market on interest rates caused by the unhealthy private banks transferred to the Savings Deposit Insurance Fund (SDIF) increased the cost of borrowing for the Treasury. Therefore, special government securities in order to reduce to a great extent the high level of overnight borrowing by the state and SDIF banks, the pressure on interest rates was alleviated. In this process, it also became possible for the Treasury and the Central Bank to effectively manage public debt so as to reduce costs in the long term.

As a result of all of these developments, the domestic debt stock which was 122.2 quadrillion liras at the end of 2001 rose up to 149.9 quadrillion liras at the end of 2002 and 175.3 quadrillion liras at the end of June 2003. Therefore, the ratio of the domestic debt stock to GDP went down from 68.5 per cent at the end of 2001 to 54.3 per cent at the end of 2002. As of the end of December 2002, of the total domestic debt stock which is comprised of 40.4 per cent non-cash securities and 59.6 per cent cash securities, 32.1 per cent was in the form of foreign exchange denominated and foreign exchange indexed bonds, 42.8 per cent in the form of floating rate bonds and 25.1 per cent in the form of fixed rate bonds.

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Table: 3. 2. Domestic Debt Stock Composition by Instruments

	2000	2001	2002	2003	2000	2001	2002	2003
	December	December	December	June	December	December	December	June
	At Current Prices, Quadrillion TL				Percentage Distribution			
Cash	29.6	58.4	89.3	116.7	81.3	47.8	59.6	66.6
Fixed Rate	19.4	17.7	37.6	57.3	53.3	14.5	25.1	32.7
Floating Rate	9.0	11.4	17.4	24.4	24.7	9.4	11.6	13.9
FX Denominated	1.2	7.1	16.5	17.6	3.3	5.8	11.0	10.0
FX Indexed		22.1	17.8	17.4		18.1	11.9	10.0
IMF Credit		13.8	9.7	9.3		11.3	6.5	5.3
Swap		7.7	7.6	7.6		6.3	5.1	4.4
Others		0.5	0.5	0.5		0.4	0.3	0.3
Non-Cash	6.8	63.8	60.6	58.6	18.7	52.2	40.4	33.4
Fixed Rate	1.0	0.0	0.0	0.0	2.7	0.0	0.0	0.0
Floating Rate	4.0	49.5	46.7	46.8	11.0	40.5	31.2	26.7
FX Denominated	1.8	12.4	11.9	9.8	4.9	10.2	7.9	5.6
FX Indexed		1.9	2.0	2.0		1.6	1.3	1.1
Total Stock	36.4	122.2	149.9	175.3	100	100	100	100

Note: The unsecuritised duty losses were not included in 2000, but were included in other years.

The distribution of domestic debt stock by lenders changed substantially and domestic debt to public institutions increased to 66 per cent of the total debt stock at the end of 2001. On the other hand, the domestic debt rollover rate was kept under control by restructuring the non-cash securities provided to the public institutions in order to reduce domestic debt redemptions and by decreasing the borrowing requirement through IMF loans. At the end of 2002, the share of domestic debt to public institutions within the total debt stock decreased to 52.8 per cent and the share of market debt increased. This trend continued in the first half of 2003.

Table: 3. 3. Domestic Debt Stock Composition by Lenders

	2000	2001	2002	2003	2000	2001	2002	2003
	December	December	December	June	December	December	December	June
	At Current Prices, Quadrillion TL				Percentage Distribution			
Total	36.4	122.2	149.9	175.3	100	100	100	100
Public	12.2	80.6	79.1	86.2	33.5	66.0	52.8	49.2
CBRT	1.5	18.8	18.4	18.4	4.1	15.4	12.3	10.5
State Banks	2.9	22.7	24.3	27.0	7.8	18.6	16.2	15.4
SDIF Banks	3.9	15.1	11.0	9.4	10.6	12.3	7.4	5.4
For IMF Credit	0.0	13.8	9.7	9.3	0.0	11.3	6.5	5.3
Other	4.0	10.2	15.7	22.1	11.0	8.4	10.5	12.6
Market*	24.2	41.6	70.8	89.0	66.5	34.0	47.2	50.8

* The figure which indicates "market" includes SDIF Banks' deposit transfers to the market (4.4 quadrillion TL) for December 2001.

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While the average annual compounded interest rates of the government securities in July 2001 was 95.3 per cent, it dropped to 72.5 per cent in July 2002. The declining interest rates following the optimism observed in the markets in the aftermath of the November 3, 2002 early elections began to increase again as a result of the increasing uncertainty regarding the political tension in Iraq. After the Iraq war, interest rates resumed their downward trend and went down to 46.2 per cent in July 2003.

As of June 2003, the real interest rate of the domestic debt stock which reflects the weighted average of real returns calculated separately on cash and non-cash securities making up the domestic debt stock and of stock levels (including exchange rate fluctuations) was calculated as 13.1 per cent.

The 4.8 months of average maturity on TL borrowings in 2001 went up to 8.5 months in 2002. In January to July 2003, it went up cumulatively to 9.5 months.

While the stock's average day to maturity was 38.9 months at the end of 2001, it became 32.1 months at the end of 2002 and 27.9 months at the end of June 2003.

While the total external debt including private debt was 118.7 billion dollars in 2000, it decreased to 113.8 billion dollars in 2001 and increased to 131.4 billion dollars in 2002.

While the medium to long-term debt in total external debt stock increased to 85.7 per cent in 2001, the share of short-term debt decreased to 14.3 per cent. This trend continued in 2002 and while the share of medium to long-term debt in total external debt increased to 88.4 per cent, the share of short-term debt decreased to 11.6 per cent.

Table: 3. 4. The Structure of Total External Debt Stock

	Million Dollars				Percentage Distribution			
	2000	2001	2002	2003Q1	2000	2001	2002	2003Q1
Maturity Composition	118,685	113,806	131,407	133,196	100	100	100	100
Short-Term	28,301	16,241	15,192	16,708	23.8	14.3	11.6	12.5
Medium-Long Term	90,384	97,565	116,215	116,488	76.2	85.7	88.4	87.5
By Lender	118,685	113,806	131,407	133,196	100	100	100	100
Multilateral Organisations	11,385	22,064	30,899	30,877	9.6	19.4	23.5	23.2
Governmental	8,669	8,552	9,193	9,084	7.3	7.5	7.0	6.8
Commercial Banks	44,589	35,206	34,844	35,547	37.6	30.9	26.5	26.7
Other Private Creditors	54,043	47,984	56,471	57,688	45.5	42.2	43.0	43.3
Currency Composition	118,685	113,806	131,407	133,196	100	100	100	100
USD	64,456	57,413	61,861	62,765	54.3	50.4	47.1	47.1
DEM	23,147	826	0	0	19.5	0.7	0.0	0.0
JPY	7,447	5,176	5,285	4,932	6.3	4.5	4.0	3.7
EUR	14,842	34,215	40,123	41,421	12.5	30.1	30.5	31.1
Other	8,794	16,176	24,139	24,079	7.4	14.2	18.4	18.1

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While the share of international organizations in total external debt stock increased by 10 percentage points in 2001 compared to the previous year, the share of other institutions and banks decreased. A similar trend, though to a lesser extent, was observed in 2002. In the first three months of 2003, the share of international organizations and governments has shown a tendency to decline while commercial banks and other private creditors have shown a tendency to increase.

Table: 3. 5. Total Gross Debt Stock

	(Per cent of GDP)		
	2000	2001	2002
General Government			
Domestic Debt	29.2	68.5	54.3
External Debt	31.0	53.1	48.2
Total *	60.2	121.6	102.5
Public			
Other Public External Debt	2.9	4.2	2.8
Total Public Debt*	63.1	125.8	105.3
Private			
Private External Debt	30.1	35.0	27.1
Total			
Total Debt	93.2	160.7	132.4

* including CBRT

Note: External debt stock to GDP ratios are calculated in terms of domestic currency.

As a result, while the ratio of the total public debt stock to GDP was 63.1 per cent in 2000, it increased to 125.8 per cent in 2001 and then decreased to 105.3 per cent in 2002. Therefore, the total debt stock ratio including private external debt stock went from 93.2 per cent in 2000 to 160.7 per cent in 2001 and then decreased to 132.4 per cent in 2002.

Debt Management and Institutional Responsibilities for Borrowing Limits

It is among the responsibilities and duties of the Undersecretariat of the Treasury to determine and implement borrowing strategies to meet public financing needs by taking into consideration the general macroeconomic targets and the financial system and by determining the quantity, maturity, type and selling techniques of government securities.

The Law on Public Finance and Debt Management no. 4749 which consolidates all public borrowing legislation and aims to achieve fiscal discipline and transparency as well as an effective debt and creditor management was promulgated on April 9, 2002.

In the aforementioned Law, the borrowing limit has been defined as the net borrowing equal to the difference between the total initial appropriations stated in the budget law of the fiscal year and the estimated revenues. Also, in accordance with Law 4749, the limit on the guarantees for the year in question is included in the budget law.

Lowering Public Debt Stock

In 2003-2006, the following measures and policies will be implemented in order to lower the public debt stock.

First of all, it is expected that the maintenance of confidence in domestic and external markets through the continuous implementation of the structural reforms that stimulates growth potential, and external markets and positive expectations will continue to lower the public debt stock in 2003-2006 period by reducing the cost of borrowing.

On the other hand, the high level of primary surplus foreseen in the current economic programme will maintain confidence in the market and reduce the public debt stock.

Meeting the financing needs in the medium to long term with the lowest possible cost and at a reasonable risk premium is among the priorities of the borrowing strategy. In this framework, main policies to be implemented in 2003-2006 are the following:

- To increase the annually weighted average maturity in domestic cash borrowing to more than 12 months,
- To expand the investor base and deepen secondary markets,
- As part of effective cash management, to use short term borrowing instruments in the money markets in coordination with the Central Bank,
- To keep a certain level of cash reserves in the Central Bank in accordance with market conditions and without disturbing debt dynamics in order to reduce the liquidity risk in cash and debt management.

Within the framework of the policy mentioned in the second bullet above, the Primary Dealer System was reintroduced in September 2002 for the purpose of increasing efficiency and liquidity in the issuance of government securities and secondary market transactions. Domestic Borrowing Instrument Lending Transactions were also initiated in the Central Bank as of February 2003. In this new market, the primary dealers have the possibility to borrow the bills for which they have given quotations. In this way, the effectiveness of the primary dealer system may be increased so as to improve the functioning of secondary market.

Contingent Liabilities

In order to control the impact of the market and fiscal risks on debt management, it is necessary to determine these risks and formulate a borrowing policy taking into consideration these risks. The fact that the Treasury undertakes to make payments on contingent liabilities such as Treasury guarantees, build-operate-transfer agreements creates uncertainty in the determination of cash management and borrowing needs, increases cost of borrowing due to increased risk premium and thereby increases the debt stock. In this respect, Law no. 4749 adopts in principle the implementation of an active risk management strategy by the Treasury and the taking of measures in limiting the effect of contingent liabilities of the public sector.

Fiscal Discipline and Transparency in Debt Management

Law 4749 promulgated in April 2002 includes important arrangements in order to ensure increased fiscal discipline and transparency in public fiscal management. In this framework;

For the purpose of increasing fiscal discipline,

- A single borrowing authority was determined,
- Borrowing, guarantee and loan limits were determined,
- The external project credits monitored outside the scope of the budget were taken into the scope of the budget,
- An approval process was introduced for public external borrowing without guarantee; it was stipulated that the provisions of Law 6183 shall apply in the collection of the receivables of the Treasury,
- A risk account was created; work was initiated in accordance with a budget-based fiscal risk management approach to measure the liabilities arising from contingent liabilities and the management of emerging risks within this context.

Within the framework of increasing transparency, it was provisioned that the public debt management report would be prepared quarterly to be presented to the Turkish Grand National Assembly, the Council of Ministers and to the related public institutions; and that the minister responsible for the Treasury would provide information about debt management to the Turkish Grand National Assembly Planning and Budget Commission at least once a year in a special session with a special agenda.

2003-2006 Public Debt Stock Projections

During the Pre-Accession Economic Programme period, an important recovery is anticipated in the ratio of the total gross public debt stock to GDP in a stable growth environment enhanced by the application of a tight fiscal policy and effective public debt management. This ratio, which reached 102.5 per cent in 2002, is expected to fall to 83.2 per cent in 2006.

2003 Pre-Accession Economic Programme estimates for the debt stock to GDP ratio are different from the 2002 Pre-Accession Economic Programme estimates. Most of this difference stems from the slow decline in domestic debt to GDP ratio.

In Pre-Accession Economic Programme 2002, it was estimated that the domestic debt stock to GDP ratio would be 49.3 per cent in 2002 and that it would come down to 39.5 per cent by the end of 2005. However, maturity of borrowing was shorter due to political uncertainty of the early elections and domestic borrowing interest was 15 points higher than the forecasts putting the domestic debt stock to GDP ratio at 54.3 per cent. Pre-Accession Economic Programme 2003 foresees a domestic debt to GDP ratio of 56.2 per cent in 2006 because the value at base year was higher than expected; the general government budget deficit was higher than 2002 Pre-Accession Economic Programme forecasts; and the interest rates on domestic borrowing are expected to be a few points higher than 2002 Pre-Accession Economic Programme.

Due to substantial external borrowing from international institutions in 2001 and 2002, the ratio of public external debt stock to GDP ratio has increased rapidly. It is expected that the external debt stock to GDP ratio will decline gradually and come down to 27 per cent by 2006 because of appreciation of the Turkish lira in real terms and the servicing of the debt to international organizations during the programme period. There are no major differences in the composition and amount of external debt compared to 2002 Pre-Accession Economic Programme.

*Public Finance***Table: 3. 6. Public Gross Debt Stock Projections for 2003-2006**

	Realization	(Per cent of GDP)			
		Forecast			
	2002	2003	2004	2005	2006
Domestic Debt Stock	54.3	53.6	54.6	55.9	56.2
External Debt Stock*	48.2	38.7	36.5	31.8	27.0
Total Debt Stock*	102.5	92.3	91.1	87.6	83.2
Total Debt Stock (excluding IMF credits)	90.4	82.9	82.1	82.3	81.7
Decrease in IMF loans		2.7	0.4	3.7	3.8
Decrease in Total External Debt		10.2	1.2	3.5	4.4
Borrowing requirement excluding interest payments		-7.2	-7.1	-6.4	-7.2
Primary Surplus (Excluding privatisation)		-6.3	-5.5	-5.3	-6.1

* including CBRT

3.3. Public Finance Risks

In the 2003-2006 period, tight fiscal policy aiming at a high rate of primary surplus has to be maintained in order to bring down the debt stock to GDP ratio, which is an indicator of the sustainability of debt stock. The risks that may arise in achieving this aim are listed as follows:

- The domestic debt stock consists mainly of foreign exchange denominated / foreign exchange indexed and floating rate bonds.
- Lack of a comprehensive arrangement of public personnel regime and the possibility of a widening in the gap between worker wages and civil servant salaries may increase expenditures.
- Any developments negatively affecting the collection of premiums in the social security institutions and the inability to control health expenditures may increase the transfers from the budget to social security institutions.
- The product purchases and input guarantees extended in accordance with the build-operate-transfer projects and credits under Treasury guarantee constitute a risk on the budget.
- If the foreseen targets of privatisation revenue are not realized, this may create a negative impact on the budget and economic efficiency.

3.4. Sensitivity Analysis

Two different sensitivity analyses were carried out in order to analyse the impact of various risks on public finance and to determine the sensitivity of the foreseen balances for 2003-2006

against the assumptions. In the first analysis, a comprehensive approach covering the whole economy was adopted and the macroeconomic model used for making forecasts in the Pre-Accession Economic Programme was used for the analyses. In this framework, the effects of slower growth and an increase in real domestic borrowing interest rates on public finance balance were analysed. In the second analysis, a more partial approach was adopted and the accounting approach described in Box 3.2 was used to determine the sensitivity of the general government gross debt stock to its own dynamics. The reason for these two different approaches is to analyse in greater detail the sensitivity of the public finance and public debt stock forecasts, which are both very important for economic policies, against the assumptions and risks.

Macroeconometric Approach

First of all, the effect of lower growth performance on public finance was analysed under two different scenarios. In these scenarios, GDP growth was assumed at 1 point lower than the baseline scenario as of 2004.

In the first scenario, public revenues as well as public investment and consumption expenditures are assumed to fall due to the decline of the growth rate. It is assumed that the increased budget borrowing requirement will be financed from the domestic financial markets. Thus, the share of domestic interest expenditures in GDP will increase by 0.1 points in 2004 and 0.2 and 0.3 points in 2005 and 2006 respectively, compared to the baseline scenario. The general government borrowing requirement and the domestic debt stock to GDP ratios for the same years are expected to increase by 0.2, 0.4, 0.5 and 0.7, 1.7, and 3.1 points, respectively.

In the second scenario, it is assumed that the public expenditures will keep their nominal levels in the baseline scenario despite a decrease in public revenue due to lower growth. As was the case in the first scenario, it is foreseen that the financing of the increased budget borrowing requirement will be financed from the domestic financial markets. It is estimated that there will be a 0.1 point increase in domestic interest expenditures to GDP ratio in 2004, 0.3 points in 2005 and 0.4 points in 2006. The general government borrowing requirement and domestic debt to GDP ratios for the same period are expected to increase 0.4, 0.8 and 1.3 percentage points and 0.9, 2.1 and 4.2 points, respectively. The results of both scenarios are presented in Table 3.7.

Table: 3. 7. The Effects of a Decline in the Growth Rate

	(Per cent)								
	Baseline Scenario			Scenario 1 Difference from Baseline			Scenario 2 Difference from Baseline		
	2004	2005	2006	2004	2005	2006	2004	2005	2006
GDP Growth Rate	5.1	5.1	5.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Domestic Debt Interest Payments / GDP	16.6	12.2	9.7	0.1	0.2	0.3	0.1	0.3	0.4
General Government Borrowing Requirement / GDP	9.5	5.8	2.5	0.2	0.4	0.5	0.4	0.8	1.3
Domestic Debt Stock / GDP	54.6	55.9	56.2	0.7	1.7	3.1	0.9	2.1	4.2

Secondly, the effect of an increase in real domestic borrowing interest rates with respect to the baseline scenario was analysed. It was assumed that the real domestic borrowing interest rates

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would be 5 points higher than the baseline scenario in 2004, 2005 and 2006. According to this, it is estimated that the domestic interest expenditures to GDP ratio will increase by 0.6, 1.9 and 2.4 in the same period. Similarly, the ratios of general government borrowing requirement and domestic debt stock to GDP show increases of 0.7, 1.9, and 2.4 points and 0.7, 2.1, and 4.0 points, respectively.

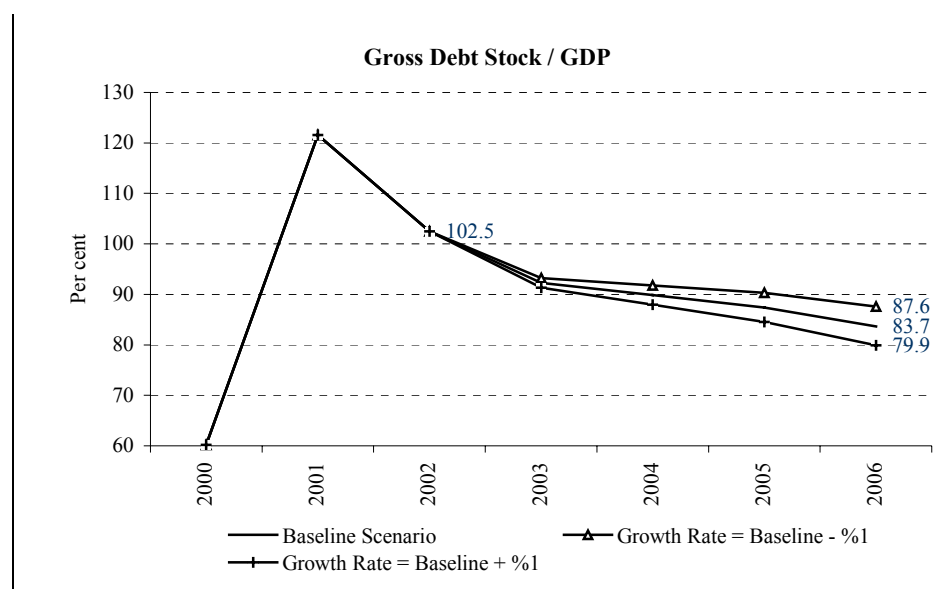
Table: 3. 8. The Effects of a Rise in the Domestic Borrowing Interest Rate

	(Per cent)					
	Baseline Scenario			Difference from Baseline		
	2004	2005	2006	2004	2005	2006
Domestic Debt Interest Payments/GDP	16.6	12.2	9.7	0.6	1.9	2.4
General Government Borrowing Requirement/GDP	9.5	5.8	2.5	0.7	1.9	2.4
General Government Total Debt Stock/GDP	91.1	87.6	83.2	0.7	2.1	4.0
Average Real Domestic Borrowing Interest Rate	16.0	11.4	10.1	5.0	5.0	5.0

Accounting Approach

Various scenarios were formed to analyse the sensitivity of the general government gross debt stock to its dynamics using an accounting approach. In this framework, the data on the composition of debt stock and the lenders in Section 3, Table 3.2 and 3.3 were used to group the total general government gross debt stock as domestic and external debt stock. Also, domestic debt stock was grouped by lenders as the public sector or the market and by type of borrowing as Turkish lira or foreign exchange.

Figure: 3. 4. Analysis of Sensitivity to Growth Rate

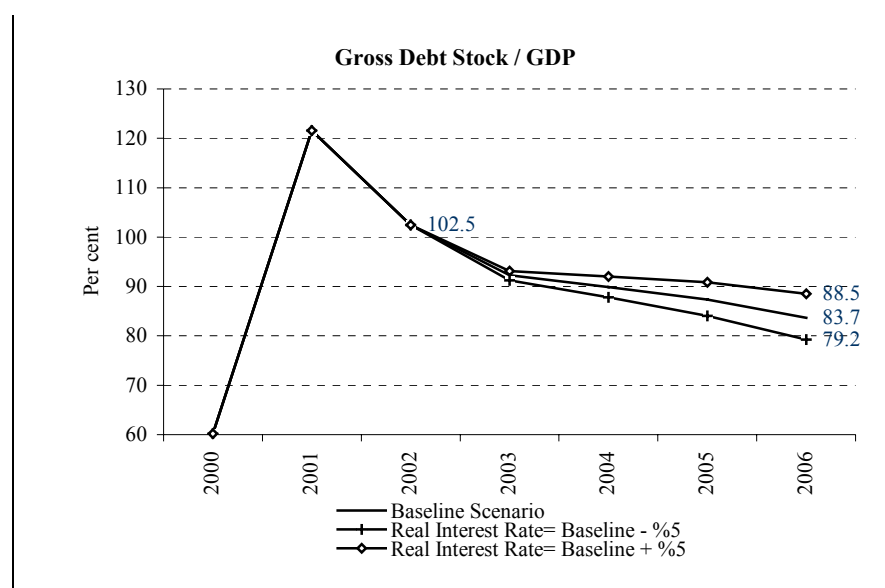


In this framework, two different scenarios where the GDP growth rate would be at 1 per cent higher and lower than the baseline scenario of 5 per cent annual growth as of 2003 were

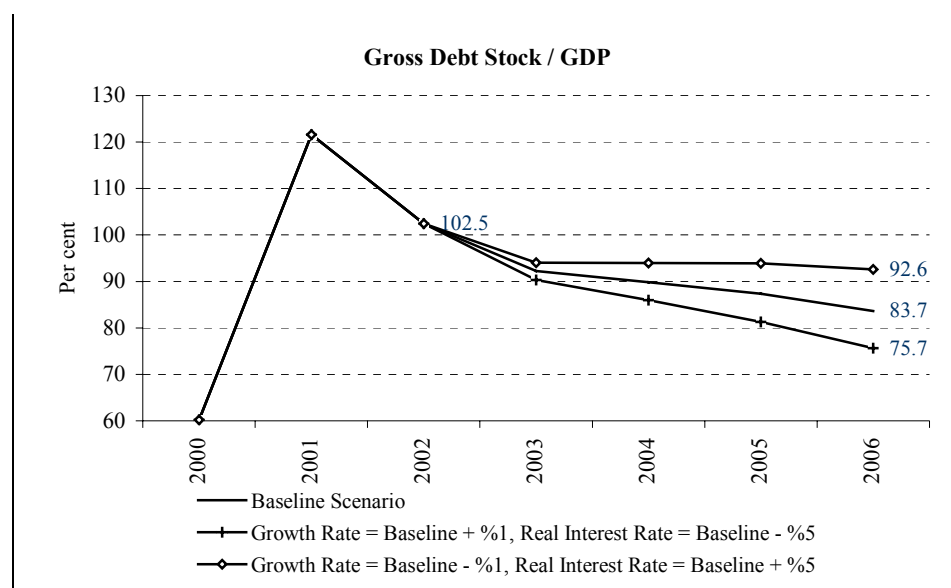
prepared in order to determine growth sensitivity. The gross debt stock to GDP ratio for each scenario is shown in Figure 3.4. According to this, in the lower growth rate scenario, the gross debt stock to GDP ratio is 3.7 points higher than the baseline scenario in 2006 and 3.9 points lower than the baseline scenario for the higher growth rate scenario.

For the analysis of sensitivity to real domestic borrowing interest rate, two different scenarios were prepared where the real interest rates would be 5 per cent higher and lower than the baseline scenario annually as of 2003. The gross debt stock to GDP ratio for each scenario is shown in Figure 3.5. According to this, the gross debt stock to GDP ratio remains 4.4 points lower than the baseline scenario in 2006 in the lower real interest rate scenario and goes 4.8 points higher than the baseline scenario in the higher real interest rate scenario.

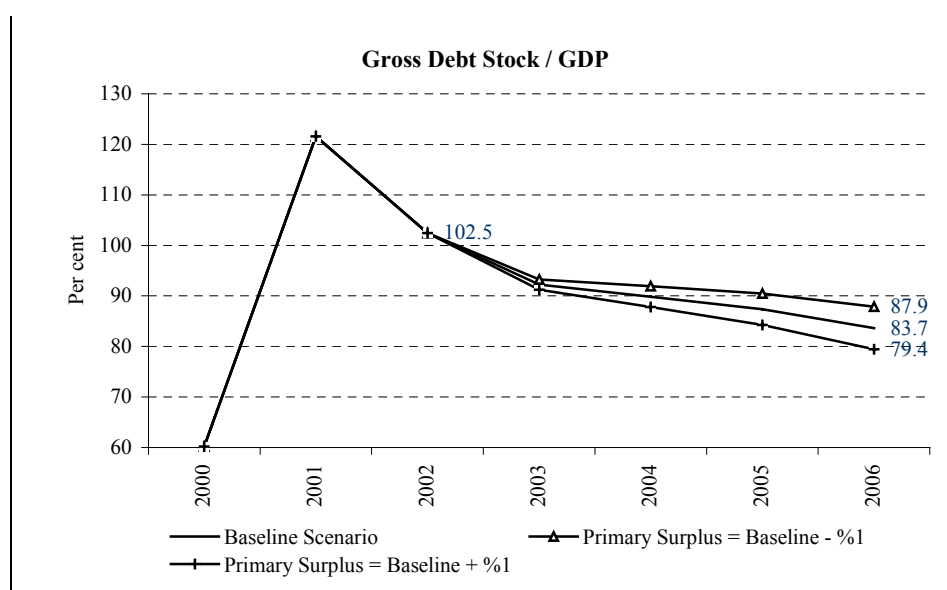
Figure: 3. 5. Analysis of Sensitivity to Real Domestic Borrowing Interest Rate



An optimistic and a pessimistic scenario were prepared to determine the effects of simultaneous changes in growth and real domestic borrowing interest rates. In the optimistic scenario, it is assumed that growth would be 1 point higher than the baseline scenario annually as of 2003 and that the real domestic borrowing interest rates would be 5 points lower than the baseline scenario annually as of 2003. According to this, the gross debt stock to GDP ratio is 8 points lower than the baseline scenario in 2006. In the pessimistic scenario, it is assumed that growth would be 1 point lower than the baseline scenario annually as of 2003 and that the real domestic borrowing interest rates would be 5 points higher than the baseline scenario annually as of 2003. According to this, the gross debt stock to GDP ratio is 9 points higher than the baseline scenario in 2006. The general government gross debt stock to GDP ratio based on these scenarios is shown in Figure 3.6.

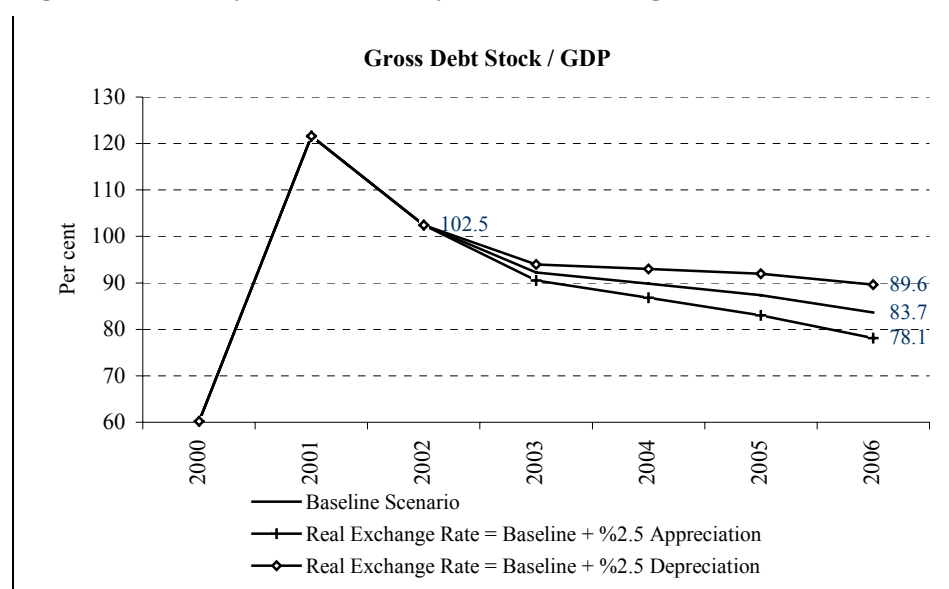
Figure: 3. 6. Analysis of Sensitivity to Growth Rate and Real Domestic Borrowing Interest Rate

Within the framework of the analysis of sensitivity to primary surplus, two different scenarios were developed where it was assumed that the primary surplus would be 1 point higher and lower than the baseline scenario annually as of 2003. The gross debt stock to GDP ratios for each scenario are shown in Figure 3.7. According to this, in the lower primary surplus scenario, the gross debt stock to GDP ratio is 4.2 points higher than the baseline scenario in 2006 and 4.3 points lower than the baseline scenario in the higher primary surplus scenario.

Figure: 3. 7. Analysis of Sensitivity to Primary Surplus

Finally, for the analysis of sensitivity to real exchange rate, two different scenarios were developed where it is assumed that the real exchange rate will depreciate or appreciate by 2.5 per cent annually as of 2003 according to the baseline scenario. The gross debt stock to GDP ratios for each scenario are shown in Figure 3.8. According to this, in the real depreciation scenario, the gross debt stock to GDP ratio is 6 points higher than the baseline scenario in 2006 and 5.5 points lower than the baseline scenario in the appreciation scenario.

Figure: 3. 8. Analysis of Sensitivity to Real Exchange Rate



Box 3.2 Sustainability of Debt According to Accounting Approach

In any given year t , total real public debt stock to real GDP ratio may be written as follows:

$$\frac{B_t / P_t}{Y_t / P_t} = \frac{\frac{(1 + i_t)BD_{t-1}}{P_t} + \frac{(1 + i_t^*)(1 + \varepsilon_t)E_{t-1}BF_{t-1}}{P_t}}{Y_t / P_t} - \frac{\frac{PS_t}{P_t}}{Y_t / P_t} - \frac{\frac{PRI_t}{P_t}}{Y_t / P_t} - \frac{\frac{M_t}{P_t}}{Y_t / P_t} \quad \text{..... (1)}$$

B_t : Total debt stock

P_t : Price level

BD_{t-1} : TL-denominated debt stock in previous period

Y_t : Nominal GDP

BF_{t-1} : FX-denominated debt stock in previous period

i_t : Nominal interest rate in TL

i_t^* : Nominal interest rate in FX

E_t : Nominal exchange rate

$(1 + \varepsilon_t)$: E_t/E_{t-1}

PS_t : Primary surplus

PRI_t : Privatization revenue

M_t : Seignorage revenue

If privatization and seignorage revenues are considered as zero and if the numerator and the denominator are multiplied by foreign inflation rate, the Formula (1) may be written as follows:

$$b_t = \frac{(1+i_t) \frac{BD_{t-1}}{P_{t-1}} + \frac{(1+i_t^*)(1+\varepsilon_t)E_{t-1}BF_{t-1}}{(1+\pi_t)P_{t-1}} \frac{(1+\pi_t^*)}{(1+\pi_t^*)}}{(1+g)y_{t-1}} - ps_t \quad \dots\dots\dots (2)$$

P_t : $(1+\pi_t)P_{t-1}$ π_t : Domestic inflation rate
 P_t^* : $(1+\pi_t^*)P_{t-1}^*$ π_t^* : Foreign inflation rate
 ps_t : Real primary surplus to real GDP ratio g_t : Real GDP growth rate

Equation (2) may be written as follows after some iterations:

$$b_t = \frac{(1+r_t)}{(1+g)} bd_{t-1} + \frac{(1+r_t^*) \frac{E_t P_t^*}{P_t} \frac{P_{t-1}}{E_{t-1} P_{t-1}^*} \frac{E_{t-1} BF_{t-1}}{P_{t-1}}}{(1+g)y_{t-1}} - ps_t \quad \dots\dots\dots (3)$$

$(1+r_t) = (1+i_t)/(1+\pi_t)$: Real interest rate in TL
 $(1+r_t^*) = (1+i_t^*)/(1+\pi_t^*)$: Real interest rate in FX
 bd_{t-1} : Real TL-denominated debt to real GDP ratio in previous period
 $(E_t P_t^*)/P_t$: Real exchange rate (rer_t)

Equation (3) may be rearranged as follows:

$$b_t = \frac{(1+r_t)}{(1+g)} bd_{t-1} + \frac{(1+r_t^*)(1+e_t)}{(1+g)} bf_{t-1} - ps_t \quad \dots\dots\dots (4)$$

$(1+e_t)$: Change in real exchange rate, rer_t/rer_{t-1}
 bf_{t-1} : Real FX-denominated debt to real GDP ratio in previous period

4. STRUCTURAL REFORMS

The structural reforms are designed to downsize public sector through privatisation, to establish a more efficient and transparent public administration, to adopt a more rational support policy in the agricultural sector and to form a robust banking system to channel resources to real sector. In addition, fulfilment of the Copenhagen economic criteria is intended by attaining a sustainable growth environment and establishing a competitive economic structure based on market principles through structural reforms.

4.1. Strengthening the Market Economy and Entrepreneurship

4.1.1. Privatisation

The main objectives of privatisation, one of the essential elements of the economic programme, are to integrate fully into world markets, to ensure free market conditions, and to increase the efficiency and competitiveness of the economy with a view to EU membership. It is also aimed to confine the role of the state in the economy to supervision and regulation by minimizing its activities in producing goods and services, and to establish international standards in the Turkish economy.

At present, there are 39 SEEs of which 19 are covered by the privatisation programme. It is envisaged that SEEs will be privatised without delay. Thus, as the promotion of wider share ownership and technological renovation are ensured, a decrease in the financial burden of the SEEs on the budget and on financial markets can be achieved.

As of 2002, the state has withdrawn completely from certain sectors such as animal feed, milk processing, airport ground handling services, petroleum distribution and cement. In certain sectors such as textiles, tourism, meat and fish products and maritime transportation, the decisive role of the state has been transferred to the private sector. In addition, the privatisation process of public banks has been launched and significant steps have been taken with a view to reducing state influence in the financial sector.

Table: 4. 1. Privatisation Implementation (1985-2003)

Privatisation Portfolio*	Privatised	Recent Situation	
		Privatisation Portfolio	Privatisation Programme
Public share in 221 companies	169 companies have been privatised through either share or asset sales.	1 company	30 companies
22 incomplete plants		6 highways	
5 real estate holdings		Fatih and Bosphorous Bridges	
4 power generation plants			

Currently, public share is less than 50 per cent in 17 companies.

* Public shares in 22 companies, 4 power generation plants, and 4 real estate holdings have been excluded from the scope of privatisation subsequently.

*Structural Reforms***Table: 4. 2. Privatisation Revenues and Expenditures (1985-2003)**

			(Billion Dollars)
Revenues			Expenditures
Privatisation Revenues	Dividends and Others	Total	
8	3.9	11.9	11

Extensive privatisation was envisaged for 2002, with a revenue target of 1.5 billion dollars. In this respect, the sale of 42.3 per cent of the public shares of POAŞ was the most important privatisation realized in 2002. Through public and international offering in domestic and international markets and by selling in ISE, 426 million dollars was obtained as privatisation revenue. Besides, in 2002, privatisation of some companies has been realized through asset sale. However, due to the uncertainties in the market conditions stemming from the early elections and insufficient foreign investment, privatisation revenues remained limited and realized as 539.7 million dollars in 2002.

The privatisation programme announced by the government in 13 January 2003 envisages 2.1 billion dollars cash inflow through the privatisations amounting to a total of about 4 billion dollars. Also, complete withdrawal of the state from the sectors like textile, paper, fertilizers, petrochemicals, tobacco, alcohol, crude oil processing and partial withdrawal from the sectors such as mining, port management, distribution of natural gas and banking are foreseen in the above mentioned programme.

In the first seven months of 2003, a total amount of 65.6 million dollars was obtained by the completion of privatisation through sale/liquidation. In the same period, the total amount of the privatisation implementations in the phase of contracting after the approval of sale/liquidation is realized at 179.7 million dollars.

With the privatisation of companies having monopoly power in their sector, such as TEKEL, THY and TÛPRAŞ (public share in TÛPRAŞ is 67.76 per cent), it is targeted to ensure a competitive market structure with free market entry for the domestic and foreign producers in these sectors. Privatisation of certain complexes, factories and ports that belong to İGSAŞ, PETKİM, GERKONSAN, ETİ GÜMÜŞ, ETİ ELEKTROMETALURJİ, TÛGSAŞ, ATAÖY OTEL-MARİNA, KBİ-ETİ BAKIR, DİV-HAN, SEKA, TDİ and SÜMERHOLDİNG is among the main targets of the programme.

With the sale of certain assets of TAKSAN and TZDAŞ, 4 premises of SEKA and 2 port of TDİ as foreseen in the programme, 189 million dollars revenue was obtained. TURBAN, TÛMOSAN and TZDAŞ were liquidated by merger under SÜMERHOLDİNG umbrella.

According to the Council of Ministers Decree of 30 April 2003, regarding the privatisation of the Türk Telekom A.Ş. it is envisaged that the preparations regarding the minimum 51 per cent block sale and international public offering of the company will be undertaken simultaneously. The decision concerning the selection of one of these two methods will be taken according to the market conditions. It is expected that the privatisation strategy will be approved until 31 October 2003.

Power generation and distribution companies in the privatisation portfolio are planned to be included in the privatisation programme by the end of 2003. Also, until the end of 2003, TŞFAŞ is planned to be transferred to the privatisation programme. Highways, Fatih and

Bosphorous bridges, vehicle control stations, Başak Hayat A.Ş. and Başak Sigorta A.Ş. are also included in the privatisation programme for the year 2003.

4.1.2. Competition Law and Policy

The Competition Authority has issued a considerable amount of secondary legislation for alignment with the EU legislation and it continues approximation process in the remaining fields.

It is aimed to ensure effective enforcement of the fines foreseen in the Law No. 4054 on the Protection of Competition and to make amendments to this Law until the end of 2003, particularly in order to overcome the problems encountered in requests for information and on the spot investigation.

In line with the European Commission's Guidelines on Vertical Restraints, the Competition Authority issued the Guidelines on the Communiqué on the Block Exemptions concerning Vertical Agreements No. 2002/2 on 30 June 2003. The aim of the Guidelines is to clarify the issues to be observed by the Competition Authority during the implementation of the Communiqué and thus, to minimize the uncertainties that may arise from enterprises' interpretations with regard to the Communiqué.

For the purpose of setting the conditions of granting block exemptions to research and development agreements, a communiqué is drafted and sent to the parties concerned to submit their opinion. The communiqué is expected to be issued by the end of 2003.

Preparatory work towards the alignment of the Communiqué No. 1998/3 on Group Exemption regarding Distribution and Servicing Agreements in relation to Motor Vehicles with the Commission Regulation (EC) No 1400/2002 on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Sector is to be completed by the end of 2003.

The work towards setting up of operationally independent state aid supervision and monitoring body within the State Planning Organisation is expected to be completed by the end of 2003. This body, in line with the EU rules and policies, will take necessary measures in relation to monitoring, coordination and control of state aid practices in Turkey, and fulfil other activities including notifications and annual reports.

In addition, the work initiated with the participation of relevant public institutions towards completing the alignment of the competition policies of Turkey applicable to public undertakings and others having special or exclusive rights to those of the EU has continued.

Over the 1997-2002 period, 2,006 applications concerning competition infringements, mergers and acquisitions, and negative clearance and exemptions were made to the Competition Authority and 1,655 of these were resolved (Table: 4.3).

*Structural Reforms***Table: 4.3. Applications Made to and Resolved by the Competition Authority****(5.10.1997-31.12.2002)**

	1997	1998	1999	2000	2001	2002	Total
Applications Made	22	177	220	255	213	265	1,152
Competition infringements							
Applications Resolved	9	44	306	262	211	217	1,049
Applications Made	8	59	80	103	82	115	447
Mergers/Acquisitions							
Applications Resolved	5	52	76	101	88	102	424
Applications Made		245	44	41	42	35	407
Negative clearance/Exemptions							
Applications							
Resolved		12	64	23	52	31	182
Applications Made	30	481	344	399	337	415	2,006
Total							
Applications Resolved	14	108	446	386	351	350	1,655

4.1.3. Improvement of Investment Environment

In addition to the policies implemented to restore macroeconomic stability, nine technical committees established in the framework of the Reform Programme for the Improvement of the Investment Environment, which was adopted by the Council of Ministers and put into effect in 2001, and which foresees improvement of the investment environment in Turkey both for domestic and foreign investments, carry on their work.

In the framework of the Reform Programme, the Law No. 4817 on the Work Permits of the Aliens has been adopted on 27 February 2003. This Law has assigned the granting of work permits to a single authority, consolidated the legislation in this area and repealed the Law No. 2007 on Crafts and Services Confined to the Turkish Citizens. Consequently, the conditionality of being Turkish citizen to work as a translator, tourist guide, photographer, driver, waiter, etc, is abolished.

The Law No. 4842 aiming to provide investment allowance, which is among the most important investment incentive measures, to the investor automatically without requiring the submission of investment incentive document, has entered into force in 24 April 2003.

Moreover, the Law No. 4884 which simplified the process concerning the establishment of a company by filling in a standard company establishment form, has been put into force on 17 June 2003. The Law has reduced the establishment process of the companies to 3 levels and one day, which could previously be completed at 19 levels and at least in two months.

Following an amendment to the Law No. 2499 on Capital Markets in 1999, the Turkish Accounting Standards Board (TASB) has been established and became operational in February 2003. At present, 20 draft Turkish Accounting Standards (TAS), which are in line with the International Accounting Standards (IAS), are expected to be taken effect as binding

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standards, following their publication according to the pending Code of Conduct of the TASB. In the next 6 months, publication of further 10 TAS is planned.

A draft law aiming at improving the institutional capacity and infrastructure of the Turkish Patent Institute has been completed and submitted to TGNA.

Law No. 4875 on foreign direct investments was adopted in 5 June 2003. The Law abolished the minimum capital requirement and the permission procedure for the companies with foreign capital, which are to be established in Turkey. By this Law, a broader definition of investor and an international definition of foreign direct investment have been introduced. Nonetheless, the Law maintains the principles contained in Law No. 6224 on the Promotion of the Foreign Direct Capital which is still in force, such as national treatment, freedom of transferring capital share to abroad in the event of liquidation or sale of the company through transferring of the profits and dividends, and freedom to employ foreign technical personnel. As regards real estate acquisition, international arbitration and protection against public expropriation, Law No. 4875 affirms the relevant provisions of the Constitution and other laws.

In the framework of Improvement of Investment Environment Reform Programme, work towards the establishment of an Investment Promotion Agency for the purpose of improving Turkey's image with respect to investment environment, increasing foreign investments and expanding current investments is about to be completed.

For the purpose of simplifying bureaucratic procedures and legislation related to the sectoral licenses, legislative work has been carried out in the fields of mining, food, medicine, chemistry and tourism. Consequently, a draft law amending the Law No. 3213 on Mining with the aim of simplifying certain procedures in the mining sector has been prepared and submitted to the TGNA.

In addition to the nine technical committee established in the framework of the Reform Programme, an SME Technical Committee, established with the aims of improving the business environment for the SMEs, which have a significant role in the economic and social development, by eliminating the obstacles to their development, and aligning the SME definition with that of the EU, has started to work.

On the other hand, an SME Strategy and Action Plan, which contains measures towards developing strategies and preparing action plans in harmony with the SME policies of the EU and preparing the Turkish SMEs to cope with the competitive pressure in the EU, has been prepared.

Towards converting Turkey into an investment region, a meeting of the Investors Committee composed of high level representatives of the leading international companies is planned for autumn 2003.

4.2. Financial Sector

4.2.1. Banking Sector

"The Banking Sector Restructuring Programme" was introduced in May 2001. The programme aims at transforming the banking sector, which has been affected negatively by the crises of November 2000 and February 2001, into a major element of sustainable growth through strengthening its structure. The programme consists of four core components:

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- restructuring the state banks both financially and operationally with the ultimate aim of privatisation,
- resolution of the SDIF banks through using the methods of merger, sale or liquidation after restructuring,
- strengthening the financial structure of the private banks which had experienced distress in the latest crises, and
- completing the legal and institutional framework aiming to enhance the efficiency of supervision and auditing and competition in the sector.

As a result of the implementation of the programme, important progress has been achieved towards a sound and competitive banking sector. In this respect, asset size of the banking sector increased from 117.7 billion dollars in 2001 to 130.1 billion dollars by the end of 2002. As of end-2002, the banking sector, whose profitability performance has also improved, had a profit amounting to 1.1 billion dollars compared to the loss amounting to 8.2 billion dollars in 2001. Following the implementation of the restructuring programme, tendency for consolidation has raised and the number of the banks fell from 61 in 2001 to 54 by the end of 2002.

Restructuring of the banking sector has been a heavy burden on public finances in Turkey as in many other countries. As a matter of fact, a restructuring cost amounting to 24.6 billion dollars has emerged (16.9 per cent of GDP), comprising 2.9 billion dollars for state banks (excluding the duty losses) and 21.7 billion dollars for SDIF banks. A total amount of 21.7 billion dollars has been transferred to the SDIF banks. Of this amount, 17 billion dollars has been undertaken by the Treasury and 4.7 billion dollars has been undertaken by the private sector.

In addition, private banks have strengthened their financial structures, which was deteriorated by nearly 6 billion dollars due to exceedingly high interest rates and devaluation, through increasing their capital by 2.4 billion dollars. In this respect, the restructuring burden on private sector also reached an important amount.

Table: 4.4. The Total Cost of the Banking Sector Restructuring Programme

	Billion dollars	% of GDP
- Duty Losses of State Banks	19.0	12.8
- Capital Transfers to State Banks	2.9	2.0
- Resolution Cost of the SDIF Banks	21.7	14.9
-Resources Transferred by the Public Sector	17.0	11.7
-Resources Transferred by the Private Sector	4.7	3.2

Restructuring of the State Banks

In the framework of the financial restructuring of the state banks, the duty losses were liquidated and the legislative arrangements creating duty losses were repealed. Also, the assignment of any task, without budget allocation, liable to generate duty losses was prohibited. Liquidation of duty losses of state banks was realized with the provision of special

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issue government bonds of 23 quadrillion TL by the Treasury in 2001. In addition, in order to meet the liquidity requirements of the banks concerned, short-term liabilities of the state banks were decreased, overnight borrowing from institutions other than the Central Bank was reduced to zero and they were recapitalised through cash injection and the provision of government bonds.

Table: 4.5. Resources Transferred to the State Banks

(Trillion TL)

	Outstanding Stock December 2000 (1)	Net Increase in 2001(2)	Total
Liability Generated from Duty Losses	18,040	7,758	25,798
- Securitized	2,907	22,954	25861
- Unsecuritized	15,133	-15,196	-63
Capital Support (With non-cash Government Bonds)	-	3,245	3,245
Capital Support (With cash injection)	-	326	326
Total	18,040	11,329	29,369

Source: Treasury, BRSA, Joint Board of State Banks.

Within the framework of operational restructuring, a detailed strategic and organizational implementation plan for the state banks was launched and important steps were taken to bring down the number of branches and personnel of these banks to rational levels. In this respect, the branch number, which was 2,494 as of December 2000, decreased by 32.4 per cent and fell to 1,685 in December 2002 and the number of personnel, which was 61,601 as of December 2000, decreased by 50.7 per cent and fell to 30,399 in the same period.

The positive impact of financial and operational restructuring of the state banks can also be observed in the profitability performance. In this regard, the state banks, which had declared a total loss of 1,338 trillion TL as of April 2001, realized 1,767 trillion TL profit (Ziraat Bank 953 trillion TL and Halkbank 814 trillion TL) as of end-2002.

The endeavours to restructure state banks have generated a burden on the public finance though minimizing negative impacts of the banks in question over the system. In this context, resources transferred by the Treasury to securitize existing duty loss receivables and to provide capital support, have reached to 14.8 per cent of GDP as of end-2001. However, given that budgetary deficits were hidden behind the state banks' balance sheets and that the bulk of government securities transferred to these banks in fact meant tying the said deficits to a repayment plan, and hence a more transparent public finance, it becomes apparent that the restructuring cost of state banks is actually lower than the aforementioned ratio. In this regard, considering the capital support excluding duty losses, the ratio of the additional burden to GDP decreased to 2 per cent.

The privatisation preparations of state banks whose financial structure has improved substantially due to restructuring efforts are continuing. Following the first unsuccessful privatisation attempt of Vakıfbank, the sale is scheduled for October 2003 in the joint study with the World Bank. Regarding the privatisation of Halkbank a study to prepare the privatisation plan by end-September 2003 is being carried out. The process to define

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appropriate corporate structure of the Ziraat Bank is continuing, by considering its role in financing agricultural sector. The government is planning to privatise Halkbank in 2004 and Ziraat Bank in the following period.

Banks Under the Savings Deposits Insurance Fund

The SDIF banks were subject to an extensive financial and operational restructuring process. Within this framework, the short-term liabilities of SDIF banks were liquidated, FX open positions were considerably reduced, the interest rates on deposits decreased and maintained in line with market conditions, the deposit and FX liabilities of these banks were transferred to other banks in order to reduce the size of the balance sheet and the number of branches and personnel were reduced. In the context of restructuring;

- a sum of 21.7 billion dollars was required to strengthen and restructure the financial structure of SDIF banks and to transfer their liabilities. Of this amount, 17 billion dollars has been undertaken by the Treasury and 4.7 billion dollars has been undertaken by the private sector (from SDIF Revenues).
- a considerable amount of deposits at SDIF banks was transferred to other banks via auctions and performing government securities. In addition, non-deposit FX liabilities of SDIF banks amounting 2.4 billion dollars were transferred to state banks.
- on-balance sheet FX open positions of the SDIF banks, which was 4.5 billion dollars in May 2001, decreased as a result of the injection of FX-indexed Treasury papers during the second half of May 2001 and fell to 561 million dollars as of end-June 2001. FX net open position of SDIF banks increased following the takeover of Pamukbank, however, as a result of FX-indexed Treasury paper injection, it decreased again and as of July 2003 turned to a surplus of 182 million dollars.
- The SDIF banks' deposit interest rates have been converged to the market rates since March 2001.

Table: 4.6. Resolution Cost of the SDIF Banks

	(Million dollars)
Resources provided by the public sector (a-b)	17,082
a. Government Securities issued by the Treasury for the SDIF	18,547
b. Government Securities returned by the SDIF	1,465
Resources provided by the private sector (c+d)	4,653
c. Deposits made from the SDIF's own resources (*)	2,457
d. Capital support provided from the SDIF's own resources (*)	2,196
Total	21,735

(*)An important part of the SDIF's income comes from insurance premiums collected from banks. The SDIF also generates income from fees, collections, bank sales and prescriptive deposits.

As of the transfer dates of the banks, a total of 1,815 branches and 37,789 personnel were transferred to the SDIF. Following the sale of banks and branches, 648 branches continued to operate and 10,337 personnel continued to be employed. Excluding Pamukbank which is in

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sale process and Turk Ticaret Bank which is under liquidation, there are 6 branches and 583 personnel taken over from Bayındırbank and transferred to the SDIF. Bayındırbank is kept as a bridge bank responsible for carrying out asset management activities. As of 3 July 2003, bank license of İmar Bank revoked, and SDIF has taken over the management of the bank. Moreover, as of 25 July 2003, members of the executive board of Adabank were replaced by a new management appointed by the SDIF.

Between the transfer date and end of March 2003, with the collection of receivables under follow-up and receivables tied-up to a repayment plan, and the sale of bank, subsidiary and real estates, the total revenue realized as 1.7 billion dollars.

Private banks

Positive results have been achieved as a consequence of the measures taken in relation to private banks:

- With the implementation of the “Programme for Strengthening the Capital Base of the Private Banks”, necessary measures have been taken regarding banks with inadequate capital, and the balance sheets of the private banks have become more transparent, with the help of, inter alia, inflation accounting. Moreover, the Programme put emphasis on the improvement of the capital base of the banks with their own resources and the limitation of market risks. In this respect, recapitalisation was amounted to 3 quadrillion TL (2.4 billion \$) in 2001-2002.
- Following the government securities swap auctions conducted in June 2001, FX open positions of the private banks were reduced considerably. With the shifting of the weight to the domestic borrowing in the form of floating rate notes, FX indexed and FX denominated bonds, the foreign exchange risk and interest rate risk of the banks were reduced.
- Adjustments have been made to put into effect the mechanisms introduced to speed up the resolving of the non-performing loans problem. In this respect, as of June 2003, 4,874.7 million dollars of debt was restructured in the framework of “Istanbul Approach”.
- With a view to resolution of the non-performing loans and liquidation of the assets of the private banks, the establishment of asset management companies were encouraged by means of tax incentives. Law No. 4743 on the Restructuring of the Debts to the Financial Sector allows participation (not exceeding 20 per cent) of the SDIF in the asset management companies. The legal framework of the asset management companies was completed by means of secondary legislation. Despite the completion of the legal framework, investors were not interested in the asset management companies, due to the war in Iraq, the macroeconomic situation and the problems related with the fulfilment of the legal procedures. Nonetheless, it is expected that interest towards asset management companies will increase, owing to the amendments made to the Code of Execution and Bankruptcy.
- A new credit limits and risk group definition in which direct and indirect lending to a group by the banks were assessed together, was introduced in June 2001 with a view to preventing credit concentration risk. Moreover, it is envisaged that banks will gradually remove the amounts exceeding the credit limits until the end of 2006. BSRA monitors the banks closely with regard to their compliance with those limits and takes the

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necessary measures. In addition, with the other amendments, banks' participation in a partnership other than financial institutions is limited to 15 per cent of own resources, while the total amount of such partnerships is limited to 60 per cent of own resources. These limitations will take effect after the expiry of the transitional period ending in 2009.

- With the entry into force in February 2001 of the Regulation on Banks' Internal Audit and Risk Monitoring System, considerable progress has been made in creating and developing institutional governance and risk culture in the private banking system.

Strengthening the Supervision and Auditing Base and Increasing Efficiency in the Banking Sector

In parallel with the financial and operational restructuring of the banking sector, significant progress were made in terms of legislative and institutional arrangements aiming at strengthening the regulation, supervision and auditing base, increasing the system's efficiency and competitiveness, improving soundness of the sector, and establishing a lasting confidence in the sector. At present, legal framework is in harmony with the international standards to a large extent.

Arrangements concerning the supervision and audit base are focused on capital adequacy, risk management, credit and partnership limitations, loss provisioning, compliance with the international standards, independent audit, and cooperation with the foreign audit agencies.

Law No. 4949 amending the Code of Execution and Bankruptcy, which aims to eliminate the deficiencies of the Code of 2004 of Execution and Bankruptcy regulating the legal follow-up of receivables not resolved through voluntary settlement, was published and entered into force on 30 July 2003.

A project has been launched in March 2003 under the leadership of the BRSA to reduce the high intermediation costs, which hinder channelling of savings to investment. With this project, which is implemented in cooperation with the Banks Association of Turkey and other relevant institutions, it is aimed to determine all financial and semi-financial liabilities resulting from the administrative regulations that increase the intermediation costs and to develop policies with a view to reducing these liabilities. BRSA has prepared an action plan regarding this issue in May 2003. In this context, the rate of the premiums to be collected by the SDIF, the principles of premium collection, and the relevant procedures are redefined, and a new system based on risks in determining the premium rates is introduced.

As regards increasing the diversity in financial services, the BRSA has prepared a draft Law on Micro Finance Institutions with a view to establishing the legal and institutional framework of the financial institutions to be set up to finance micro entrepreneurs.

On 3 July 2003, the BRSA announced changes in the general guarantee protecting all depositors and other creditors in banks. The guarantee will be effective until 5 July 2004. After that date, it will be replaced by a limited deposit protection scheme of 50 billion TL. Until then, the following two schemes will be in place: (i) the general scheme protecting all depositors and creditors in intervened banks, and (ii) a scheme fully protecting individual depositors, but not commercial deposits, in banks being liquidated directly without intervention.

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In addition to these developments, to improve the efficiency of the financial system and to create a more competitive environment, the BRSA deals with:

- increasing diversity in financial services,
- strengthening the surveillance of special financial institutions and their role in the financial system,
- speeding up the resolution of non-performing loans in the banking sector,
- strengthening the regulatory and supervisory structure of the financial sector and preventing systemic risk.

4.2.2. Capital Markets

The fact that the public sector has extensively benefited from the capital market instruments to finance its deficits has hindered the development of capital markets adequately. From the year of 1986 when the government securities were introduced, the percentage of public securities stock in the total securities stock has continuously increased and reached over 90 per cent. As of December 2002, the share of public securities in the GDP is 54.7 per cent, whereas the private sector share in the GDP, which is largely composed of equities and investment funds, is only 4.8 per cent.

As of the end of 2002, there are 875 joint-stock corporate companies registered in Capital Market Board (CMB), of which 301 are listed in the stock exchange, 282 investment funds, 32 mutual funds and 169 intermediary institutions.

The legislative arrangements in compliance with the EU legislation introduced in 2002-2003 for the protection of investors, for a stable and efficient market, are as follows:

- While the Law on Private Pension Funds was adopted in March 2001, secondary legislation implementing the Law was put into force in February 2002 and February 2003.
- With the adoption of legislation on investment funds in January 2002 and April 2002, provisions were introduced to clearly define the principles with respect to funds, types of funds, liabilities of founders and custodial functions of Istanbul Gold Exchange (IGE).
- With the Communiqué of April 2002, investment consultancy activities, including the professional guidelines and principles for those who work in printed and electronic media was regulated.
- The regulation of June 2002 regarding the real-estate appraisal companies is in line with the standards set by The European Groups of Valuers (TEGOVA).
- With a communiqué in November 2002, external auditing activities and consultancy activities were separated from each other to prevent the possible conflicts related with the external auditing activities. The amendment also introduced compulsory rotation for external auditing institutions, and committees responsible for auditing within the stock exchange companies.
- The Communiqué of December 2002, having regard to the international practices, set out the principles concerning the registration and monitoring of capital market instruments and related rights by the Central Registry Office. Thus, the legal base of the

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registration and monitoring system has been established and technical work for the practical functioning of the system is underway.

- With the Communiqué of January 2003, principles regarding the public disclosure of institutional and individual portfolio performances were defined in line with the global performance standards.
- In January 2003, the CMB web site was modified so as to make possible the use of internet for receiving and evaluating the complaints, and an Investors Petition Group was formed.
- With a communiqué in January 2003, in addition to financial institutions, domestic and foreign professional real persons and institutions were also allowed to obtain equity partnerships in portfolio management companies. Additionally, portfolio management companies rendered subject to capital adequacy requirements with this amendment.
- With the communiqué of February 2003, the rules for CMB registration and sales of securities, and the prospectus for securities are revised having due regard to the EU legislation.
- In February 2003, a Communiqué determined the principles of accumulated voting, which enables minority shareholders to be represented in the management and supervision boards of the companies.
- With a regulation of March 2003, the establishment and operational procedures of the markets, other than stock exchange markets, organised for the funding of the SMEs were regulated.
- Some legislative arrangements to facilitate the issue of non-voting shares and mutual funds were introduced in March 2003.
- In March 2003, provisions concerning venture capital investment trusts were revised in order to address some practical problems and to facilitate the establishment of such trusts.
- In July 2003, in order to raise the demand, to secure a safer and faster operational environment and to strengthen the institutional structures, some legislative arrangements were made concerning internal auditing systems carried out by intermediary institutions, record-keeping procedures in intermediary activities, and margin trading, short sales and borrowing and lending of securities.
- In order to have financially stronger institutions in the capital markets, principles regarding mergers between intermediary institutions were determined in July 2003.
- Having taken into account the relevant EU legislation, merger rules for publicly held joint stock companies and principles of information to be made public by the intermediary issuers were revised in July 2003.
- Again in July 2003, Institutional Management Guidelines, which is subject to voluntary compliance by the publicly joint stock companies, was introduced.

In the period of 2003-2006, efforts will be accelerated with a view to increasing the supply and demand, enhancing the reliability, ensuring modernization and more efficient supervision in the capital markets. In this respect:

- The application process for individual pension funds and procedural framework for supervisory systems are planned to be completed until the end of 2003.

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- Preparatory work towards operating the Futures and Options Exchange (FOE) and capital market for SMEs is planned to be completed in the period of 2003-2004.
- The meetings held to provide investors and companies with reliable information in relation to capital markets will be carried on.
- For a full alignment of the CMB's accounting standards with EU legislation and IAS, a communiqué has been drafted. The communiqué is planned to be published in 2003. Public will be informed through various programmes about the amendments brought to the accounting standards in the period of 2003-2004.
- For the dissemination of information on the internet about the joint stock companies and intermediary institutions listed in ISE, through the use of electronic signature, a joint project is carried out with the ISE. Software development, management of e-identity/smart card, and training are planned to be completed in 2003, and setting up and testing are planned to be completed in 2004. Total cost of the project is approximately 1.3 million euro.
- In 2002, institutional investors were instructed to place "public information forms" on their web sites to facilitate the access to up-to-date information about them. The system will be reviewed and improved, if necessary, in 2004.
- In 2003 and 2004, work will be carried out to restructure the barter and custody systems.
- It is planned to establish an Emergency Centre, where real-time data and back-ups of the information systems of CMB, ISE, Takasbank, Central Registration Institution, IGE, Association of Turkish Capital Markets Intermediary Institutions (TSPAKB) are stored. The relevant planning work will be completed in 2003 and the Emergency Centre will be set up in 2004.
- In the framework of the Project, which has been developed with the aim of online access to needed information through data networks between the CMB and ISE, Takasbank, Central Registration Institution, IGE, FOE, TSPAKB, it is planned to complete the network between the ISE and Takasbank in 2003, and the shareware analysis, design and networks among the other institutions in 2004.
- A communiqué with regard to remote supply of financial services is planned to be drafted in the 2003-2004 period and put into force in 2005.
- In line with the National Programme, work towards aligning the legislation regarding capital markets with the EU legislation is planned to be completed in the period of 2003-2005. In this respect, Capital Market Law and the legislation related to investment services, collective investment institutions and joint stock companies will be amended in line with the EU legislation.
- Having regard to the EU legislation, the draft communiqué on ensuring the price stability after public offerings is planned to be finalized in 2003.
- Work is carried out to prepare a guide, in line with the EU acquis, for manipulative transactions.

4.2.3. Insurance

Following the decision on the candidate status of Turkey in Helsinki in 1999, work towards the alignment of the legislation in the field of insurance with that of the EU, and

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strengthening of the regulatory framework and supervision with respect to insurance companies, has been accelerated.

As of the end of 2002, there are 57 insurance and reinsurance companies in the sector. When compared with the EU member states on the basis of main indicators, Turkish insurance sector is considered a developing sector. There is a considerable growth potential in the sector, however legislative and administrative reforms are needed to realise such potential.

The draft Law on Regulation and Supervision of Insurance Activities, which is in harmony with the relevant EU directives to a large extent, was submitted to the Prime Ministry in May 2003 and is expected to be adopted before the end of 2003. Preparatory work for related secondary legislation in line with the EU directives is continued. In this respect, a regulation concerning accounting systems of insurance companies is being drafted and expected to be adopted before December 2004.

In the framework of the pre-accession financial cooperation 2003 programming, a comprehensive project, which is funded from the EU and to be launched in April 2004, has been envisaged. The project aims at strengthening the administrative capacity of the General Directorate of Insurance and Insurance Supervision Board with a view to aligning with and implementing the EU acquis.

In respect of restructuring the regulatory and supervisory functions within the sector, work towards setting up of an efficient system in Turkey, which also involves the examination of the experiences of the EU member states, is being carried out.

The Law No. 4632 on Individual Pension Funds regulating and supervising the system of individual pension funds supplementing the public social security system, entered into force in October 2001 and implementing legislation was adopted in 2002 and 2003.

4.3. Labour Market

Increasing employment and reducing unemployment by means of sustainable economic growth, productive investments and active labour market policies is the main objective.

It is important to change employment structure in favour of non-agricultural sectors, to increase the qualified labour force needed by the economy, to raise the quality of the labour force in line with the requirements of the information age, and to increase the efficiency of the labour market and labour productivity.

SMEs, which represent the 99.5 per cent of the firms and create 35 per cent of the total value added in the manufacturing sector, have a share of 65 per cent in total employment. In this framework, it is important to increase the support given to the SMEs and individual undertakings in the fields of training, projects, financing, organisation, marketing and technology.

In 2002, while labour force increased by 1.3 per cent compared with the previous year and reached 23.8 million, employment decreased by 0.8 per cent and the number of employed was 21.3 million. Unemployment rate rose from 8.4 per cent in 2001 to 10.3 per cent in 2002, while underemployment rate decreased from 6 per cent to 5.4 per cent. Thus, the rate of idle labour force was 15.7 per cent in 2002. In the same period, the rate of idle labour force increased from 18 per cent to 20.2 per cent in urban areas and from 10.2 per cent to 10.6 per cent in rural areas. Economic recession has influenced employment particularly in non-agricultural sectors and led to an increase in urban unemployment.

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The rate of participation in the labour force was 48.6 in 2002. This rate was 70.5 per cent for men and 26.9 per cent for women.

The share of agricultural employment in total employment was 35.9 per cent in 2002. The existence of a significant percentage of labour force in the agricultural sector with low productivity reduces the efficiency of the labour market. The share in total employment of industry was 17.6 per cent, of construction was 4.5 per cent and of services was 46.3 per cent.

A total amount of 118.2 trillion TL was paid to the unemployed between 31 March 2002 and 31 July 2003 from the Unemployment Insurance Fund, which was created by Law No. 4447.

In the framework of the Privatisation Social Support Project (PSSP) implemented by the Privatisation Administration, 6.5 million dollars has been used to date. Since the beginning of the project, 10,500 persons have benefited from the project services and it is expected that this number will rise to 16,000 until the end of 2003. A total compensation payment of 64.1 million dollars was made to the 4,714 personnel of undertakings, which has been sold or closed in compliance with the privatisation programme. In respect of the recent privatisation practices, preparatory work has continued to make compensation payments of approximately 39 million dollars to 2,552 personnel.

Labour Redeployment Services component of the PSSP is implemented by the lead agencies, namely Turkish Employment Agency (İŞKUR) and KOSGEB. In this respect, 8,767 billion TL has been allocated to İŞKUR's services of consultancy, training and activities in the public interest, which include 201 projects with 7,871 participants. The project is expected to be completed by 2004.

In respect of active labour market policies envisaged by Law No. 4747, programmes on retraining of the labour force and provision of vocational and employment consultancy services have continued.

Law No. 4904 on Turkish Employment Agency was adopted on 25 June 2003. The Law foresees the maintenance, improvement and extension of employment, assistance to the elimination of unemployment and implementation of the unemployment insurance services. The Law also authorised the establishment of private employment offices, which is an obligation of Turkey stemming from international agreements.

In the framework of EU-Turkey financial cooperation, the Active Labour Force Strategy Project has been prepared in order to enhance the administrative capacity of İŞKUR and to support approximately 350 projects in the context of active employment measures. The Project with a total cost of 50 million euro will be launched in September 2003.

Turkey's Background Study on Labour Market and Employment, which is considered as an initial step towards Turkey's involvement in the European Employment Strategy was completed and sent to the European Commission.

The draft Law regarding the setting up of a National Professional Standards Institution has been drawn up with a view to establishing, spreading, developing and sustaining a professional standards, examination and certification system with the cooperation of national social partners.

Measures aiming to increase employment opportunities particularly for young people, women and the disabled are to be taken. In addition, implementation of policies aiming to prevent unskilled workers from being unemployed and to improve their skills will continue.

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Projects aiming to raise the employment level in less developed regions through utilization of the local potential are to be developed.

Table: 4.7. Matrix of Policy Commitments: Labour Market

	(1000 euro)			
	2003	2004	2005	2006
Privatisation Social Support Project				
A. Implementation Profile	X	X	X	
B. Net Direct Budgetary Effect		111,215	77,570	
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure		111,215	77,570	

Labour Issues

Significant progress has been made in adjusting the labour legislation to the changing conditions, and ILO and EU standards. In this respect, Labour Law No. 4857 was adopted on 22 May 2003. The Law, by taking into account the relevant EU legislation, contains provisions regarding non-standard employment, flexible working time, temporary employment relationship, establishment of Guarantee Fund providing protection for workers in the event of insolvency of their employer, transfer of undertakings, employer's obligation to inform employees, establishment of tripartite Advisory Board, job security, and effective implementation of occupational health and safety measures. It is expected that unregistered activities in the labour market will decrease and the number of employed persons will rise with the application of Law No. 4857.

Law No. 4817 on the Work Permits of the Aliens, which envisages codification of the rules in the field of aliens' work permits, reduction of the bureaucratic formalities, conferral of powers and responsibilities to a single authority, collection of reliable statistical data and information, prevention of illegal employment, alignment of terms and conditions of aliens' residence in Turkey with the EU legislation and international law, was adopted on 27 February 2003.

In the field of occupational health and safety at work, draft regulations are being prepared in line with the EU legislation.

In the framework of the EU-Turkey financial cooperation, the project, which aims at enhancing the administrative capacity of Centre for Occupational Health and Safety (İSGÜM) has been launched in 2003 and is to be completed in 2005.

Economic and Social Council (ECOSOC), which is a major forum for participatory social dialogue in Turkey, meets regularly. Efforts are being made to change the ECOSOC's structure with a view to its more efficient operation.

Preparatory work aiming to make amendments to Law No. 4688 on Civil Servants' Trade Unions is carried out with the participation of social partners in order to bring it in line with the EU standards.

In the context of ILO Convention No.182, a draft "Time-Bound Policy and Programme Framework for Elimination of the Child Labour" with a view to eliminating the worst forms of child labour has been prepared. Preparatory work for drafting legislation on the employment of children under 18 years old has continued.

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A draft law regarding parental leave and elimination of differences in paid-maternity-leave between the women employed at different levels has been prepared.

Table: 4.8. Matrix of Policy Commitments: Labour Issues

	(1000 euro)			
	2003	2004	2005	2006
Occupational Health and Safety (*)				
A. Implementation Profile	X	X	X	
B. Net Direct Budgetary Effect	535.9	7,324.4		
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure	535.9	7,324.4		

(*) Grants from the EU are not included.

4.4. Administrative Reform

Rapid and multi-dimensional transformation processes experienced in Turkey and in the world, increasing and diversified public demand have necessitated a radical restructuring in Turkey, particularly in the bureaucratic structures and in the conception of administration. The public administration reform, of which the timetable and tasks are set out in detail in the Urgent Action Plan adopted by 58th and 59th Governments, is based on democratisation and efficiency.

Public Administration Basic Law

A comprehensive public administration reform is to be adopted in order to create the legal and institutional environment necessary for the provision of public services in an efficient, transparent and participatory manner. At the first stage, a framework law laying down the basic principles of public administration and in particular, clarifying the division of tasks, powers and resource allocation between the central and local administrations will be adopted. At the second stage, constituting laws of all public bodies concerned will be revised in the light of the results of the Study on the Functional Review of the Government.

Functional Review of the Government

Main purposes of the Study on the Functional Review of the Government is to restructure public administration on the basis of a citizen and sector oriented approach, to accelerate the decision-making process by simplifying the organizational structure and to reduce public expenditures. In parallel with the changing role of the State, the structure of all public institutions will be revised following the review of tasks, powers and functions of those institutions, so as to enable them to fulfil their principal tasks.

The Study on the Functional Review of the Government is being carried out by the SPO. In this context, a comprehensive survey has been carried out among the public institutions and in the light of the priorities determined, interviews have been made with the institutions, and a draft report is about to be completed. The results of the Functional Review of the Government report will provide analytical input to various legal and institutional arrangements.

Civil Service Reform

A Civil Service Reform is to be prepared in accordance with the Central and Local Administration Reform and Functional Review of the Government studies, and on the basis of following key principles:

- Implementation of norm cadre in all public institutions,
- Application of objective criteria in recruitment and promotion, reduction of ranks and removal of economic and social disparities between similar ranks,
- Simplification of salary and wage system, elimination of imbalances and introduction of flexible working forms,
- Transition to a performance-based payment system in the long term,
- Determining principal and permanent public tasks, and employment of those other than carrying out these tasks under Labour Law, and limiting the number of personnel carrying out the principal and permanent tasks to a certain ratio of all public employees.

Local Administrations Reform

It is envisaged to restructure local administrations that operate under excessive central supervision with insufficient local resources, in accordance with the European Charter of Local Self-Government, to which Turkey is a party. In this respect, tasks and functions of the central administration will be determined, instead of listing the tasks and powers of local administrations. Thus, all remaining local and common tasks and services will be assigned to local administrations.

Following the implementation of these reforms, local administrations will be restructured as modern administrative units open to public control having decision making power to meet their local and common needs, generating their own resources, implementing their projects, in accordance with the principles, standards, and national and regional plans defined by the central administration.

Regional Development Agencies

Central allocation of resources has led to waste of public resources due to unnecessary and unproductive investments, and increases the regional and provincial disparities. With a view to proper and more efficient utilization of resources, reducing disparities among the provinces within the same region, and strengthening the local administrations, units at sub-region level will be established, taking into account the NUTS defined for Turkey in line with the EU norms.

Policies to reduce interregional disparities will be carried out by the central administration, while activities towards the mobilization of regional potential and removal of provincial disparities will be undertaken by regional development agencies.

Regional development agencies will develop a regional development strategy with the participation of all parties concerned, and facilitate the use of national and international funds in accordance with the regional strategy.

Right of Access to Information

A legal process has been initiated towards facilitating citizens' access to information produced by the public administration, and if necessary, providing them with the opportunity to learn the grounds of administrative acts.

Draft Law on Freedom of Information, prepared by the Ministry of Justice, which has been prepared with a view to defining the principles and procedures for the enjoyment of the right of access to information for those benefiting from the public service is about to be adopted.

e-Transformation Turkey Project

Work regarding e-Transformation Turkey Project that covers both public and private sector has started to accelerate citizens' transactions, to carry out the public services closer to the citizen in parallel with the developments in information technology, to prevent red tape in these services, and to ensure transparency and speed.

A Prime Ministry circular on the aims, stages and institutional aspects of the e-Transformation Turkey Project has been issued. An Information Society Department has been established within the SPO to carry out the activities foreseen in the Project. Moreover, work towards the establishment of an Advisory Board with the task of high level steering and monitoring of the project has been completed. An Action Plan is about to be completed with the contributions of various working groups.

Definition of Ethical Rules in the Public Administration

With a view to increasing transparency and combating corruption in public administration, legal studies have started to set out professional and ethical principles and rules for public officials. To this end, a draft Law has been prepared by the Prime Ministry and is expected to be adopted in 2003. The draft Law aims to ensure that civil servants, while fulfilling their tasks, observe the principles such as non-discrimination, citizen satisfaction, transparency, honesty and reliability.

Strengthening the Governance of State Economic Enterprises

In respect of restructuring and strengthening the governance framework of SEEs, it is envisaged to clarify the objectives of SEEs, to set new accountability standards, and to enhance management autonomy and internal governance. It is expected that the legislation concerning the realisation of these objectives will be adopted by the TGNA in 2003.

Draft Law on Public Financial Management and Control

Turkey has accelerated its efforts towards harmonizing its public internal financial control system with the EU and international standards. In this context, draft Law on Public Financial Management and Control, which has been prepared by having the opinion the European Commission, aims to increase transparency and accountability in public financial management, to enhance the efficiency of *ex-ante* control, to align *ex-post* internal and external fiscal control systems with the EU standards, to expand the powers of the spender

institutions regarding *ex-ante* control and *ex-post* internal control. The draft Law is expected to be enacted in 2003.

Transition to Strategic Planning in the Public Sector Institutions

Taking into account the financial and administrative problems of the public administration, planned service provision, policy formulation for the development plans and programmes on the basis of actual working programmes and budgets at institutional level, and active participation of the public institutions in the process of monitoring, evaluation and control of the implementation, become increasingly important. Strategic planning is a basic tool for the implementation of these activities by public institutions. Strategic planning or strategic management in broad terms is a participatory and flexible management approach that refers to the process in which the institutions will have a vision for the future on the basis of their existing situations, missions and basic principles, will set objectives in conformity with this vision and define targets and develop strategies to reach these objectives, and will also monitor and evaluate their performance by means of measurable criteria.

In this framework, a Strategic Planning Manual has been prepared by the working committee established within the SPO, to help and guide the public institutions during the strategic planning process. The Manual has been reviewed in line with the views of public institutions and finalized. It is envisaged that the implementation on a pilot basis of strategic planning will be carried out in selected public institutions, and the Manual will be improved in the light of the experiences, and the implementation will be extended to all public institutions in the coming period.

Performance-based Budgeting in Public Financial Management

Performance-based budgeting foresees the preparation of expenditure plans (budgets) complying with the mission, vision, strategic goals and targets of the strategic plans of the public institutions, and the review of those plans as to whether the performance criteria set out in the strategic plans are met.

Following the training programmes carried out within the framework of the performance-based budgeting, implementation on a pilot basis has started in six institutions in 2002 and these institutions submitted their budget proposals for 2003 in accordance with the principles of performance-based budgeting.

Work on the Performance-based Budgeting Manual, which sets out the objectives, principles and procedures that public institutions should follow, with a view to transition to performance-based budgeting in public financial management, is about to be completed.

Extending the Scope of Budget and Financial Transparency

In 2000 and 2001, with the aim of extending the scope of the budget and increasing financial transparency, 69 funds were liquidated. All budgetary funds, excluding the Support and Price Stability Fund, through which the World Bank's Agricultural Reform loans are channelled in the framework of the Agriculture Reform Project, were abolished. In addition, extra-budgetary funds were closed, except for the Defence Fund, the Social Aid and Solidarity Fund, the Savings Deposit and Insurance Fund, the Privatisation Fund, and the Promotion and Publicity Fund, which are considered to operate more efficiently in the fund system. In

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respect of the work carried on towards reducing the number of the revolving funds, the number of such funds operating within the general and annexed budget institutions decreased to 1,498 in 2002 from 2,548 in 2001, and to 1,457 in March 2003.

In the period ahead, it is planned to make necessary legislative and administrative arrangements that provide for the approval of fund budgets by the TGNA, the external audit and monthly reporting of fund accounts together with the consolidated budget accounts.

The Public Debt Management Report, to be produced quarterly in accordance with the Law No.4749 on Public Finance and Debt Management aiming to ensure financial discipline, transparency, and effective debt and claim management, was issued in April 2003.

To establish an accounting and reporting system that is compatible with the international standards regarding financial transactions is one of the basic conditions to ensure accountability and transparency in public financial administration and to conduct a performance-based control in public administration. An accounting system supporting transparency, accountability and performance-based control should ensure registering and reporting not only cash-based budget transactions, but also all kind of accrual-based financial transactions. With transition to accrual-based accounting in public administration, it is aimed to ensure accountability and transparency, to establish an appropriate structure for control and to establish a reliable database that will help the authorities to evaluate financial activities of the past years and develop policies for the future.

In 2002, General Implementing Regulation on Government Accounting (GIRGA), which contains basic principles, standards, rules and techniques of accounting generally accepted at international level, and a framework accounting plan to be applied in all public bodies within the scope of general government, was drafted. Following the adoption of GIRGA, a draft implementing regulation was prepared with the aim of implementation of GIRGA by the general and annexed budget administrations. In addition, GIRGA was implemented on a pilot basis in 6 institutions and 47 accounting offices in 2002, and positive results have been obtained.

It is planned that the GIRGA and the Implementing Regulation on the Accounting of General and Annexed Budget Administrations will be published in 2003 to establish the necessary legal base. It is envisaged that the new accounting system will be applied to general and annexed budget units in 2004, and following the completion of the necessary work, to the other units within the scope of general government in 2005. It is foreseen that the common accounting and reporting standards and framework calculation plans will be implemented in all public institutions within the scope of the general government by the end of 2006, after the completion of the procedures and principles with regard to the enumeration, accounting, depreciation calculating and revaluation methods of tangible fixed assets. Thus, the outcomes will be consolidated easily, public financial statistics will be produced and reported in line with the international standards and will be presented to the interested parties in accordance with the principles of transparency and accountability.

In view of the need for a budget classification that is appropriate for the analysis of the activities of the State and the effect of these activities on national economy, work has started towards transition to functional budget classification (analytical budget code structure) within the scope of the Public Financial Management Project, and since January 2002, the new code structure has been implemented in six pilot agencies. In addition to the pilot agencies, it is envisaged that the new code structure will be extended on a pilot basis to selected general and annexed budget units, social security institutions and local administrations in 2003. It is

planned that the new code structure will be applied to all consolidated budget agencies in 2004, and to all general government units in 2005. With the application of analytical budget code structure, it is expected that public financial statistics are recorded in a way that is more organised, reliable and appropriate for analysis and international comparisons. The analytical budget code structure will help improving transparency and accountability, since it is also applicable to the units other than consolidated budget units, and is convenient for identifying the officials responsible for the programme.

The national strategy on improving the transparency and good governance in public sector was adopted in 2002. In March 2003, a committee at ministerial level was established to increase transparency and efficiency in public administration in Turkey. Work towards increasing transparency and fight against corruption in public administration, as also foreseen in the Government's Urgent Action Plan, is underway.

4.5. Agricultural and Rural Development

The main objective of agricultural sector, taking into account the economic, social, environmental, and international development factors as a whole, is to establish an organised, highly competitive and sustainable agricultural sector, with a view to ensuring the efficient use of resources. In accordance with the principle of food security, balanced and adequate nutrition for the growing population is essential.

The guidelines of the Turkish agricultural policy are defined according to the commitments originated from the WTO Agreement on Agriculture, and the developments in the EC Common Agricultural Policy (CAP) and in international trade.

In accordance with the Economic Programme initiated in 2000, an Agricultural Reform Implementation Project, which has started in 2001, will be implemented by the Undersecretariat of Treasury until 2005 by using 600 million dollars credit provided by the World Bank. With this Project all agricultural price and input subsidies were abolished and Direct Income Support (DIS) system was introduced for minimizing or eliminating damages in the structure of markets and production. Establishing farmer registration system, replacing supplied products such as hazelnut and tobacco with alternative products and reforming the Agricultural Sales Cooperatives and Unions are also targeted in the Project.

Following the stabilisation of the economy, new agricultural programmes in line with the CAP are to be adopted and implemented.

With a view to fulfilling the obligations envisaged in the NPAA and ensuring alignment to the CAP, working groups have been carrying on their activities.

Work on Integrated Administration and Control System (IACS), which is crucial for the implementation of agricultural policies and setting up of a framework for the Farm Accountancy Data Network (FADN), Farmer Registration, Animal Identification and Land Registration Systems, have been accelerated.

Plant Production

Plant production in Turkey amounts to approximately 65 per cent of the total agricultural sector production. Nevertheless, plant production potential could not be fully realised and the resulting productivity is relatively low.

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Considering the EU and international systems, a new draft Law on Seed has been prepared. With a view to protecting product varieties, the draft law on the Protection of the Rights of Breeders of New Plant Varieties has been submitted to the Prime Ministry.

In 2002, around 2.6 million farmers included in the Farmer Registration System benefited from direct income support.

Investment requirements for the restructuring of the Commodity Exchanges in 7 provinces have been covered within the framework of the Restructuring Agricultural Commodity Exchange Project with a view to increasing efficiency and stability of the markets.

The preparatory work on the Agricultural Product Insurance Law, which is expected to be adopted in 2003 as foreseen in the Urgent Action Plan of the government, is in progress. The draft Law on Producers' Associations is about to be submitted to the Prime Ministry.

In the context of the restructuring of the public agricultural enterprises, all enterprises, with the exception of the Turkish Grain Board (TMO), are to be privatised.

From 2002 on, no support prices will be set for the cereal market. The TMO will be restructured as a market regulating authority in line with the EU system. Strengthening the Commodity Exchanges for cereals, limiting TMO's purchases to emergency and supplementary purchases, transferring the existing storage facilities to the private sector and then leasing these facilities to producers or entrepreneurs, maintaining TMO as a central institution with a view to facilitating its emergency and intervention purchases in the medium term, and guaranteeing that the TMO's purchases are made only through the markets are some of the planned changes.

Tobacco Law No. 4733, effective as of 2002, opens up the tobacco market to competition, ensures that tobacco prices are set in a free market. TEKEL (General Directorate of Tobacco, Tobacco Products, Salt and Alcohol Enterprises) is planned to be privatised until the end of 2003, following its restructuring in accordance with the Law No. 4773.

From 2002 on, sugar beet prices have been decided by an agreement between the sugar factory operators and the sugar beet producers and/or their representatives, as foreseen in Sugar Law No. 4634, which entered into force in 2001. A privatisation strategy for TŞFAŞ is to be determined in 2003 and the privatisation is expected to be finalized in 2003-2004.

As an example of public and private sector joint entrepreneurship, certain agricultural enterprises affiliated to the General Directorate of Agricultural Enterprises are to be restructured through the establishment of joint stock companies with both sectors participating. This joint venture will increase agricultural production and productivity, and ensure technological innovation and efficient service.

Land and Farmer Register Systems

With a view to setting up a proper functioning land registration system, work towards determining the current situation in Turkey and the measures required for alignment with the *acquis* has almost been completed.

The pilot studies of the Land Registration and Cadastre Information System Project (TAKBİS) are about to be completed. The acceleration of the project, having an estimated cost of 100 million euro, depends on the availability of funds.

Phytosanitary Issues

The draft law on the Protection of the Rights of Breeders of New Plant Varieties was submitted to the Prime Ministry.

The work concerning for the establishment of 4 quarantine laboratories, with the financial contribution of the EU, has started in 2003 as envisaged in the Project for the Establishment of the Necessary Infrastructure for Harmonisation of Turkish Legislation with EC Phytosanitary Legislation. The total cost of the Project is 5.3 million euro, of which 1.07 million euro will be financed by Turkey. In addition, the Agricultural Quarantine Regulation came into force in July 2003.

On the other hand, completing the necessary legal and institutional arrangements in order to carry out market surveillance of plant protecting products and setting up a monitoring system for pesticides and environmental samples are among the main priorities.

As regards harmful organisms, communiqués concerning potato diseases came into force for harmonization with the relevant EC Directives, as envisaged in the NPAA.

Livestock Sector

The main objective of the livestock sector in Turkey is to increase livestock production in order to provide adequate and balanced nutrition for the population. For this purpose, animal-breeding practices will be improved, the quality of concentrated feed and fodder crops production will be increased, the fight against animal diseases and parasites will be intensified, and extension services will be developed. To this end, MARA is implementing a variety of livestock projects.

Decree No. 2000/467 on Support for Livestock Sector will be implemented until 2004, to increase fodder crop production, to develop cattle breeding and to expand artificial insemination practices and to create a zone free of animal diseases. In 2003, 100 million euro is allocated for these purposes.

Efforts towards the harmonisation of Turkish legislation regarding the livestock sector with the relevant acquis are continuing. In this respect, establishing an animal identification system, around 7 million bovine animals out of a total of more than 10 million have been registered.

As regards harmonisation of Turkish legislation to that of the EU in the field of animal husbandry, a three-year project has started to be implemented in 2003 to establish an integrated information system on animal health and border control units. Total budget of the project is 17.04 million euro of which 3.7 million euro will be contributed by Turkey and 13.3 million euro will be financed by the EU.

Rural Development

The main objectives of the rural development policy within the framework of the integration with the EU and Development Plans are to realize physical and social development and to increase competitiveness in rural areas, to ensure economic and social development by increasing income level in rural areas, to widen training and participatory organization and to protect environment.

The activities for development of the rural areas will be improved on the following principles: to consider the integrity between rural development and agricultural development, to

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alignment with the agricultural and rural policies of the EU, to carry out rural development projects compatible with national development plans, to ensure coordination among organisations responsible for the implementation of all rural development projects, to include local administrations, the NGOs and beneficiaries in the decision-making and implementation process, to develop a financing system for rural areas and to ensure the sustainable use of natural resources. In line with these principles, a national rural development strategy will be defined by considering the rural development policy of the EU.

Several rural development projects, most of which financed by external resources, have already been realised in Turkey and some of these are still being implemented. On the other hand, the Anatolia Basins Rehabilitation Project covering 70 disadvantaged micro-basins, which takes place in the rural areas of 13 provinces located in central part of Turkey is expected to start in 2004. In addition, providing technical and financial support for 98 cooperatives in rural areas is planned in order to exploit agricultural potential, to support agricultural entrepreneurship and to accelerate socio-economic development in rural areas.

Electrification, communication, and stabilised-road infrastructures in rural areas have been almost completed; however, modernisation is needed.

The work towards widening water supply network, sewerage system and waste water treatment plants in rural areas and increasing their standards is underway. With the aim of supplying water to residential units in rural areas, a total of 2423 residential units (423 units for new construction and 2000 units for network renewal and maintenance) are planned to be benefited from drinking water services in 2003. Expansion of sewerage and waste water treatment systems to rural residential areas is in progress. Work aiming to provide sewerage services to 500 rural residential units in 2003 are continuing.

Fragmented and scattered characteristics of rural residential units cause some problems as to provision of physical and social infrastructure services. In respect of overcoming these difficulties, loans have been provided for 2625 families building their own houses in 49 villages to arrange settlement.

Fisheries

With the aim of increasing the contribution of fisheries sector to the national economy and ensuring the alignment with the Common Fisheries Policy of the EU, it is important to realise structural reforms in fisheries sector. In this respect, Legal and Institutional Alignment with the Acquis Project for fisheries has been prepared for 2004-2006 period. Total amount of the project is 6,602 million euro of which 434 thousand euro will be financed by Turkey.

In the context of this Project, necessary arrangements will be made regarding institutional development; legal and structural policies; protection, control and resource management; market organization and fisheries sector information system.

Besides, as foreseen in the Project, a circular and control forms have been prepared pursuant to the Wholesale and Retail Market Arrangements for Aquaculture Products Regulation adopted in 2002 in line with the acquis.

Foodstuffs

The ongoing Project on Improvement of Food Control Services contained in the public investment programme, contributes to the purchase of laboratory equipment that is necessary in food control laboratories, the training of personnel and the accreditation process of the

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laboratories. Works towards the utilisation of the grant in 2003, provided from the MEDA-I Fund for the implementation of the Project has been carried on.

The draft Milk Regulation prepared to improve the food safety criteria in the milk sector and to minimize the risks by monitoring health and quality standards of milk during production and delivery is expected to be issued soon.

Implementation of Risk Analysis for Key Control Points (HACCP) practices is obligatory in the food firms that receive alarm notification from the EU. Training of food controllers on HACCP is being carried out. Preparatory work for a communiqué on official controls in food industry is continuing.

Communiqués on a number of foodstuffs are being put into effect in order to ensure compliance with the Turkish Food Codex and relevant EU legislation.

An inspection, which covers Ankara, Ordu, Giresun, İzmir and Aydın provinces, has been carried out by the EU experts in 3-8 March 2003, aiming to monitor the aflatoxin control system and its practice in Turkey.

Table: 4.9. Matrix of Policy Commitments: Agriculture and Rural Development

	(1000 euro)			
Agricultural and Rural Development	2003	2004	2005	2006
1. Agricultural Reform Implementation Project				
A. Implementation profile	X	X	X	
B. Net direct budgetary impact	9,596	19,206	17,564	
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	9,596	19,206	17,564	
2. Phytosanitary - Project on Combating Plant Diseases and Harmful Organisms				
A. Implementation profile	X	X	X	
B. Net direct budgetary impact	553	531	532	
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	553	531	532	
3. Animal Health- Project on Combating Animal Diseases and Parasites				
A. Implementation profile	X	X	X	
B. Net direct budgetary impact	9,232	9,356	9,360	
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	9,232	9,356	9,360	
4. Support for Livestock Sector in line with Decree No. 2000/467				
A. Implementation profile	X	X		
B. Net direct budgetary impact	104,824	49,947		
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	104,824	49,947		
5. Fisheries Sector- Legal and Institutional Alignment to the EU Acquis Project				
A. Implementation profile		X	X	
B. Net direct budgetary impact		261	211	
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure		261	211	
6. Project on Improvement of Food Control Services				
A. Implementation profile	X	X	X	
B. Net direct budgetary impact	876	996	1065	
B.1. Direct impact on budgetary revenue	893	797	729	
B.2. Direct impact on budgetary expenditure	1,769	1,793	1,794	
7. Direct Income Support *				
A. Implementation profile	X	X	X	
B. Net direct budgetary impact	1,381,775	1,885,760	1,992,225	
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	1,381,775	1,885,760	1,992,225	
Total Net Budgetary Impact				
A. Implementation profile	X	X	X	
B. Total net budgetary impact	1,506,856	1,966,057	2,020,957	
B.1. Total impact on budgetary revenue	893	797	729	
B.2. Total impact on budgetary expenditure	1,507,749	1,966,854	2,021,686	

* Based on an average of 17.5 million hectares cultivated area.

4.6.1. Education

One of the most important aspects of Turkey's economic potential is its young population. Nevertheless, utilisation of this potential depends on training the new generation in line with the qualifications that the economy needs. The most important steps for this purpose are: increasing the level of education; overcoming inequalities, stemming from economic and social structure, in accessing education, and providing the young generation with formation that support economic development. In this framework, main priorities of Turkish education system are to increase schooling rates at all levels and to raise the quality of education. Steps taken for this purpose will accelerate the economic development by contributing to the improvement of human capital in Turkey.

Pre-School Education

As in the EU countries, pre-school education is voluntary in Turkey. It is aimed to increase the schooling rate of pre-school education in Turkey to the EU levels by raising social awareness.

In order to inform families about the importance of pre-school education, various television programmes on pre-school education are being broadcasted by the Turkish Radio Television Corporation (TRT). In addition, various projects are being developed in cooperation with the UNICEF and non-governmental organisations.

With a view to increasing the schooling rate in pre-school education, 6,230 personnel were trained as foreseen in Training of Teachers for Pre-School Education Project and 125,000 additional capacity was created in 2001-2002 academic year.

Schooling rate for children of 36-72 months increased from 6.9 per cent in 2001-2002 to 7.6 per cent in 2002-2003.

Primary Education

The duration of compulsory primary education in Turkey is 8 years and free of charge for all citizens in the public schools. By primary education reform, which is known as Basic Education Reform launched in 1997, it is aimed to increase the schooling rate to 100 per cent and to enhance the quality of education.

In the 2002-2003 academic year, 10,330 thousand students attended the primary education at approximately 35,000 schools and the schooling rate reached 96.3* per cent.

As of June 2003, 225 million dollars has been spent during the implementation of Basic Education Project. The Project, at the cost of 600 million dollars, is financed by the World Bank, and is planned to be completed by the end of 2006.

To improve living standards of people in slums and disadvantaged rural areas by raising their educational level and to provide basic education for children, young and adults who are lacking basic education, 100 million euro is allocated from MEDA Programme. A financing agreement was signed for the Basic Education Support Project. This Project was included in

* It is lower than the rate of previous period due to change in data collection method.

the public investment programme in 2001. A preliminary draft report was prepared following the consultations for the project.

Secondary Education

The number of students in secondary education is increasing. The preparatory work to extend the duration of compulsory basic education is continuing. It is planned to start the vocational training with a broad-based basic education programme and to set up a programme type-oriented approach in secondary education. In addition, emphasis is being given to formal and mass vocational technical education within secondary education.

To increase employability of vocational and technical education students as intermediary personnel, an arrangement was made to enable students to receive applied training in industry, besides internship. In addition, it is targeted to make arrangements on the content of education by taking into account the needs of private sector and to encourage private sector to invest in the field of education.

Plans are underway to regulate vocational and technical education on a broad base and in a modular manner and to design flexible and comprehensive programmes allowing vertical and horizontal transfers within the education system, including higher education.

A Draft Law on Occupational Standards has been prepared aiming to set up vocational and technical education programmes based on occupational standards and to develop functional cooperation with business.

Pilot projects supported with the framework of MEDA Programme have been launched.

Strengthening of Vocational Education System Project is launched in 2002 to improve the quality of vocational education and its connection with national needs, to strengthen institutional capacities of public administration and enterprises related to vocational training at national, regional and local levels, to accelerate transition to decentralisation in vocational education and to increase the participation of social parties. The Project has a budget of 58.2 million euro in total, of which 51 million euro is EU contribution. It will be completed in 5 years. Occupational standards, national competency system, modular programmes, pilot school applications, quality certification system, decentralized administration and institutional development programmes are expected project outputs.

Modernisation of Vocational and Technical Education Institutes Project, aims at contributing to the studies of Vocational Education Reform of the Ministry of Education by improving the system of vocational and technical education of teachers, establishing a modern and efficient in-service teacher training system and improving the institutional capacity. The project period is 4 years. It has a budget of 18.5 million euro in total, of which 14 million euro is EU contribution. Project studies are continuing. Tender for consulting has been completed.

Higher Education

As of 2003, the total number of universities reached 76, with 23 being private universities. The number of faculties is 602. In addition, there are 238 higher schools, 603 vocational colleges (two-year vocational schools) and 290 institutes. The academic staff reached 74,134 in the 2002-2003 academic year. The need to increase the quality and quantity of the academic staff still preserves its importance.

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It is planned to amend the Law on Higher Education until the end of 2003 with a view to decentralizing the higher education, improving competition in higher education system, ensuring financial and administrative autonomy of universities, and restructuring the Higher Education Council (YÖK) to prepare long term plans for higher education, as a coordination body among universities.

As regards participation in ERASMUS (EU Education Programme), necessary preparations have been made by higher education institutions.

Diploma supplement studies are finalized. Starting from the next academic term, diploma supplement in line with European standards will be given to university graduates.

Studies for the alignment of education programmes in higher education with those of the EU are continuing.

Transfers to the vocational colleges without examination started in the 2002-2003 academic year. 282,677 applications were made and 266,939 students were placed.

National Agency

In January 2002, a National Agency was established in the SPO for the coordination of EU education and youth programmes in Turkey. The Agency began functioning, following the designation of required number of personnel and establishment of the necessary infrastructure.

The first official contacts between representatives of the National Agency and the Directorate-General of Education and Culture of the EU Commission took place in June 2002. Studies on work programmes including preparatory measures were concluded in December 2002. The agreement on Preparatory Measures and the Agreement on Socrates Pilot Actions were signed. According to the agreement, during preparatory measures period in 2002-2003, approximately 6 million euro will be used, of which 80 per cent provided by the EU. Implementation of the agreements started as of January 2003. A considerable part of tenders for the infrastructure has been concluded. Pilot universities have been chosen, training for European Credit Transfer System has been completed and activities for the exchange of students have been started. The Law No. 4968 constituting the legal infrastructure of the Turkish National Agency and establishing the European Union Education and Youth Programmes Centre has entered into force in August 2003. Preparations for secondary legislation have started.

The budget for 2004-2005 period, after Turkey's full participation in EU education and youth programmes, has yet to be clarified. During first talks, it is decided that Turkey's financial contribution for 2004 would be low, taking into account Turkey's capacity to use programmes and its project production capacity; however, it is expected to increase in following years. It is estimated that the Turkey's contribution will be around 20-25 million euro in 2004 and 50 million euro in 2006.

*Structural Reforms***Table: 4.10. Matrix of Policy Commitments: Education**

	(1000 euro)			
	2003	2004	2005	2006
1. Basic Education Project I. II(*)				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	16,673.4	19,055.4	19,055.4	19,055.4
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	16,673.4	19,055.4	19,055.4	19,055.4
2. Supporting Vocational-Technical Education Project(**)				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	77.4	2,501.0	2,501.0	2,501.0
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	77.4	2,501.0	2,501.0	2,501.0
3. Modernisation of Vocational-Technical Education Institutions Project (**)				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	35.7	1,500	1,500	1,500
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	35.7	1,500	1,500	1,500
Total Net Budgetary Impact				
A. Implementation profile	X	X	X	X
B. Total net budgetary impact	16,786.50	23,056.40	23,056.40	23,056.40
B.1. Total impact on budgetary revenue				
B.2. Total impact on budgetary expenditure	16,786.50	23,056.40	23,056.40	23,056.40

(*) Financed by the World Bank Credit.

(**)The part provided as MEDA grant not included.

4.6.2. Regional Development

Regional policy aims mainly at reducing interregional imbalances and improving metropolitan areas throughout the country by way of preventing disordered urbanization. In this regard, sustainability, reducing interregional imbalances, establishing social and economic balances, improving life quality, enabling equal opportunities, cultural development and participation are main principles in the implementation of regional development policies.

In the context of approximation of Turkish regional development policy; the Council of Ministers' Decree No. 2002/4720 on the establishment of the Classification of Regional Units for Statistics throughout the country entered into force in 22 September 2002 to enable collection and improvement of regional statistics, to make socio-economic analysis of the regions, to set the framework of regional policies and to establish a comparable statistical database corresponding to the NUTS classification in the EU.

In addition, in order to develop a national economic and social cohesion policy to reduce regional disparities, the SPO is preparing a Preliminary National Development Plan, and regional development plans at NUTS 2 level.

In the context of preparing regional development plans at NUTS 2 level, the programming has started at Samsun (Amasya, Çorum, Samsun and Tokat provinces), Kastamonu (Çankırı, Kastamonu and Sinop) and Erzurum (Bayburt, Erzincan and Erzurum provinces) NUTS 2

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regions, within the framework of Turkey-EU financial cooperation for 2003. Implementation will cover the 2003-2005 period.

Eastern Anatolia Development Programme (Van, Muş, Bitlis, Hakkari), supported by MEDA, will be implemented in the 2003-2006 period.

Regional development plans to be prepared for Kayseri (Kayseri, Sivas and Yozgat) and Konya (Konya, Karaman) NUTS 2 regions is planned to be implemented in 2004. Master plans for Southeastern Anatolia Project (GAP), Eastern Anatolia Project (DAP), Eastern Black Sea Regional Development Project (DOKAP) and Zonguldak-Bartın-Karabük Project will be transformed into regional operational programmes in line with EU standards.

In the framework of Turkey-Bulgaria Cross-Border Cooperation Programme, which is supported by 2003 Financial Cooperation Agreement, the Draft Project Fiche on the establishment of Joint Small Projects Fund was prepared. In addition, preparatory work for drafting Joint Programming Document for the 2004-2006 period is continuing.

“Support with the Preparation and Identification of EU Funded 2003 Regional Development Programme” Project, launched in 2003, is in progress.

In order to ensure coordination among the regions and central organizations, “Department of EU Regional Programmes” was established within the “Regional Development and Structural Adjustment DG” in the SPO, in the context of the regional development programmes and cross-border cooperation programmes, which are implemented in the framework of the EU-Turkey Financial Cooperation.

In 2004, a twinning project will be initiated for the SPO to strengthen the administrative capacity with respect to implementation of in regional development policies.

Draft Law on the Establishment of Regional Development Agencies at NUTS 2 level is being prepared, with the aim of accelerating regional development in accordance with the principles and policies foreseen in Development Plans and Annual Programmes, ensuring efficient use of resources at local level, to implement EU programmes, improving cooperation among public sector, private sector and NGOs, and ensuring coordination among the provinces.

Table: 4.11. Matrix of Policy Commitments: Regional Development (*)

	(1000 euro)			
	2003	2004	2005	2006
Regional Development				
A. Implementation profile		X	X	X
B. Net direct budgetary impact		15,740	25,910	29,910
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure		15,740	25,910	29,910

(*) Expected

4.6.3. Social Security and Social Assistance

The main objective is to extend the public insurance programmes, which provide a minimum social insurance protection for contingencies, so as to cover the whole population.

In 2002, while 88.1 per cent of the population was covered by the social insurance schemes, 83.8 per cent was covered by the social insurance schemes in respect of health care services.

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Social security reform, which was planned to be achieved in two stages and which aims to ensure a sustainable social security system, to establish the long-term actuarial balances of the social insurance institutions, and to improve their administrative and financial efficiency, has been implemented since 1999.

In the course of the reform process, laws that bring significant changes to the social security legislation and in particular to the organizational structures of the social security institutions were adopted by the TGNA.

Government's Urgent Action Plan, *inter alia*, foresees:

- separation of financing and provision of health services from each other,
- establishment of a general health insurance system,
- establishment of an integrated social security network,
- abandonment of payments not based on premiums.

Work for legal and institutional arrangements towards the restructuring of social security system has started in accordance with the Urgent Action Plan. In this respect, committees comprising the representatives of the institutions concerned were established and began to work on the following issues: unification of social security institutions, separation of long-term and short-term insurance programmes from each other, and establishment of a general health insurance system.

The Social Risk Mitigation Project signed with the World Bank in 2001 is being implemented.

4.6.4. Health

The main objective of the health policy is to have a healthy society by improving the quality of life and increasing the lifespan of individuals who are physically, socially, and mentally fit.

A Health-21 Programme has been developed for Turkey, in accordance with the World Health Organisation's Health for Europe-21 Programme. The programme aims at increasing life expectancy, improving the quality of life, and reducing inequalities among different regions and different socio-economic groups by improving the health status indicators.

Within this scope, it is envisaged that the following studies to be completed by the end of the year:

- restructuring the Ministry of Health,
- consolidating all public hospitals, namely state hospitals, SSK hospitals and other public institutions' hospitals, into a single framework,
- ensuring the autonomy of hospitals in terms of their financial and administrative structures,
- improving family practitioners practice,
- giving special emphasis on mother and child health care services,
- encouraging private sector to invest in the field of health,
- extending the preventive health services.

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The Health Reform Project prepared in cooperation with the World Bank and in conformity with the EU norms, aims at improving accessibility to health services, developing financial protection, improving primary health care services and the quality of health services, establishing a dispatching system and reinforcing the administrative capacity of the institutions in the health sector. Consultations with the World Bank on the Health Reform Project is continuing and the project is expected to be launched in 2004.

The Draft Law on Nursing and the Union of Turkish Nurses has been prepared. The preliminary studies for the Draft Law on Private Hospitals, Draft Law on Midwives and the Union of Turkish Midwives, Draft Law regarding the amendment on Vocational Training Law and the Draft Law on the establishment of the Refik Saydam National Hygiene Institution are underway.

The amendment of Regulation on Pharmacies and Pharmaceutical Services entered into force in March 2003.

Alignment with the *acquis* in the field of health is in progress.

Turkey has become a member of the Collaboration Agreement between Drug Regulatory Authorities in European Union Associated Countries in April 2001. Regulation on Licenses for Blood Products entered into force on 20 May 2002 (Official Gazette No:24760). Regulation on Implantable Active Medical Devices, and Regulation on Medical Devices will enter into force in September 2003 and Regulation on Toys in November 2003. The Reproductive Health Project prepared in cooperation with the EU launched in 2003.

Studies regarding the integration of reproductive health services into primary health services and facilitating access to these services and extending woman and family health centres are underway. Cooperation with international and voluntary organisations in this field is continuing. In cooperation with the UNFPA, an International Reproductive Health Training Centre was established.

Application guides for the programmes of Vocational Health Schools for midwives, nurses and health officers have been aligned with the EU norms.

The European Network of Health Promoting Schools Project is being implemented.

A memorandum of understanding on Health Information System and Public Health Action Programme was signed with the European Union.

Health Reform Project II, which is implemented with the support of the World Bank will be completed by the end of 2003.

Preparations for “Population and Health Survey 2003 Project” and “National Health Accounts Survey” have been completed. National Disease Burden and Cost Efficiency Survey is expected to be completed in September 2003.

*Structural Reforms***Table: 4.12. Matrix of Policy Commitments: Health****(1000 euro)**

	2003	2004	2005	2006
1. GAP Region Public Health Project				
A. Implementation Profile	X	X		
B. Net Direct Budgetary Effect	119.1	123.8		
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure	119.1	123.8		
2. National Food and Nutrition Survey				
A. Implementation Profile	X	X		
B. Net Direct Budgetary Effect	208.4	148.8		
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure	208.4	148.8		
3. Neonatal Screening Programme (Phenylketonuria, Hypothyroidism)				
A. Implementation Profile	X	X	X	
B. Net Direct Budgetary Effect	178.6	1,324.9	1,786.4	
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure	178.6	1,324.9	1,786.4	
4. Programme of Reproductive Health in Turkey (2004-2007) (*)				
A. Implementation Profile	X	X	X	X
B. Net Direct Budgetary Effect	1,000	1,000	1,500	1,500
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure	1,000	1,000	1,500	1,500
5. Cancer Screening and Education Centres (MEDA-I) (*)				
A. Implementation Profile	X	X	X	X
B. Net Direct Budgetary Effect	287.3	287.3	287.2	287.2
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure	287.3	287.3	287.2	287.2
Total Net Budgetary Impact				
A. Implementation profile	X	X	X	X
B. Total net budgetary impact	1,793.4	2,884.8	3,573.6	1,782.2
B.1. Total impact on budgetary revenue				
B.2. Total impact on budgetary expenditure	1,793.4	2,884.8	3,573.6	1,782.2

(*) EU grants are not included.

(**) Expected.

4.6.5. Information and Communications Technologies

e-Europe+ initiative, in parallel with the e-Europe initiative which sets the objective for the Europe to become the most competitive and dynamic knowledge based economy in the world for the next 10 years, was launched in 2001 in Turkey simultaneously with the other candidate countries.

e-Transformation Turkey Project is included in the Urgent Action Plan prepared by the 58th Government and SPO is delegated for coordination, monitoring, evaluation and guidance. An Information Society Department within the SPO is established for carrying out these tasks. The main objective of the Project is to establish conditions for a new governmental structure on the principles of participation, transparency, efficiency and simplification, to provide citizens with high quality and faster services.

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The Draft Short Term Action Plan has been completed by eight working groups coordinated by Information Society Department. An Advisory Board for the coordination and guidance of the Project at a high level has been set up. The Board consisting of the representatives of public and private institutions, NGOs, and universities has held its first meeting to discuss the Short Term Action Plan in May 2003. Action Plan covering 2003-2004 period contains Information Society Strategy and milestones of e-Transformation Turkey Project. It is planned to be announced through a Prime Ministry Circular.

Discrepancy among identification numbering systems, which is applied by several public institutions has been eliminated by the Circular No. 2002/22 of Prime Ministry. According to the Circular, public institutions should use Turkish Republic Identification Numbers of MERNİS Project in all documents related to citizens. The MERNİS Project started to be implemented by January 2003.

Draft Law on Electronic Signature which is essential for increasing electronic commerce and e-Government applications has been submitted to the Parliament. Draft Law on Right of Access to Information is about to be adopted. A regulation on consumer protection in the field of electronic sale of goods and electronic provision of services was adopted in June 2003.

In addition, work concerning national information security, amendment of Law on Intellectual and Artistic Works, amendment on Turkish Criminal Code in the field of protection of individual data and felonies regarding information is being carried on.

Work on the process of liberalization and regulation of telecommunications sector has been continuing since January 2000, mainly following the entry into force of Law No. 4502 and 4673.

According to the Council of Ministers Decree of 30 April 2003, regarding the privatisation of the Türk Telekom A.Ş., it is envisaged that the preparations regarding the minimum 51 per cent block sale and international public offering of the company will be undertaken simultaneously. The decision concerning the selection of one of these two methods will be taken according to the market conditions.

The preparatory work for Türk Telekom by consulting a consortium is being carried on to increase its competitiveness and to ensure that it operates in market conditions prior to the liberalization of the sector in 2004 as foreseen.

In pursuant to the Urgent Action Plan of the government, preparation for a framework law in the field of telecommunications has been started in order to consolidate related legislation and to lay down new provisions. Drafting of new law, which includes general principles regarding the sector and provisions on operators, regulatory body and users, is expected to be completed at the end of 2003.

A new regulation on authorization procedures and principles is being drafted in accordance with Law No.4673, with acquis and sectoral requirements and it is planned to be published in the second half of 2003.

Regulation on Access and Interconnection was adopted in May 2003. Its purpose is setting out the principles and procedures regarding access to telecommunications networks including interconnection, to encourage the applications ensuring that the users draw maximum benefit from the telecommunications services and networks in return for a reasonable price, the provision of efficiency and sustainable competition in telecommunications sector and incentives for investment in infrastructures to constitute competitive environment in so far it serves the long-term benefit of end-users.

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To facilitate the application of the above-mentioned regulation:

- A guideline about "Procedures and Principles of Accounting Separation" is planned to be completed in 2003 to ensure the separation of revenues, expenses and costs related to each activity and business unit including internal transfer payments for avoiding cross subsidies and to eliminate discriminatory treatment of operators with significant market power.
- Regulatory work on facility sharing and co-location is planned to be completed in 2003 for efficient use of incumbent operator's infrastructure.
- Work on cost models for PSTN and GSM networks will be carried on 2003 to determine interconnection and end-user prices.

"Communiqué on Principles and Procedures regarding the Determination of Operators Having Significant Market Power" and "Communiqué on Principles and Procedures regarding the Determination of Operators Having Dominant Position" were adopted in June 2003, to constitute basis for regulations on interconnection, carrier selection, carrier pre-selection, by taking into account *acquis*.

Preparatory work is continuing for clearing and allocating relevant frequency bands in order to implement the Council and European Parliament Decision of December 1998 regarding the introduction of third-generation mobile and wireless telecommunications systems (UMTS).

Draft regulation on procedures and principles regarding installation and use of short distance radio equipments is published on the web site for deliberation.

Current National Numbering Plan is being reviewed by taking into account the new operators entering into the market following the full liberalization in voice transmission and the new services requiring number assignment. During the preparation of the Plan, it is aimed that the number assignments are based on fair, transparent and non-discriminatory criteria, and the numbering is used and monitored so as to ensure effective competition. Regulatory work for the Plan is in progress.

Drafting the regulations on rights of way, facility sharing and co-location are continuing regarding alignment with Directive 96/19/EC on full competition and Directive 97/33/EC.

Regulation on Radio Equipment and Telecommunications Terminal Equipment was adopted in May 2003, to align with Directive 1999/5/EC on radio equipment and telecommunications terminal equipment and the mutual recognition of their conformity. Although it will enter into force on 11 May 2004, old and new legislation are both applicable until 11 May 2005. By 11 May 2005 "Regulation on Radio Equipment and Telecommunications Terminal Equipment" shall be applied solely, hence alignment with Directive 1999/5/EC shall be completed.

Draft regulation on Market Surveillance and Monitoring for Radio Equipment and Telecommunications Terminal Equipment and draft regulation on Certified Bodies for Radio Equipment and Telecommunications Terminal Equipment have been prepared and published on the web site for deliberation.

In the framework of EU-Turkey Financial Cooperation; 4.8 million euro will be allocated to implement regulation on Market Surveillance and Monitoring for Radio Equipment and Telecommunications Terminal Equipment and to improve infrastructure of existing laboratories by which surveillance activities will be performed; 1.1 million euro will be allocated to implement draft regulation on Certified Bodies for Radio Equipment and Telecommunications Terminal Equipment and to improve infrastructure of existing

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laboratories by which conformity assessment activities will be performed for certified body candidates.

To ensure fair competition in the sector, a cooperation protocol signed between Competition Authority and Telecommunications Authority entered into force on 16 September 2002.

Preparatory work for the establishment of National Telecommunications Strategies Research and Development Foundation which will contribute to determine the sectoral needs is in progress.

A draft law regarding the establishment of a Universal Service/Access Fund has been prepared in order to enable the service offerings that are under the universal service obligations in a competitive environment, to protect rights of access of consumers having physical and social disabilities, and to support the access of every citizen to information and communication via community communication centres.

Draft regulation on processing of personal data and the protection of privacy in the telecommunications sector has been prepared in line with the related Directive.

The regulatory studies regarding the licensing of Fixed-Wireless Access (FWA), Long Distance, and Voice over Internet Protocol (VoIP) operators during the process of full liberalization, are underway.

In the framework of EU-Turkey Financial Cooperation for 2002, a project is developed to reinforce the administrative capacity of the Telecommunications Authority. Total amount of the project is 2.3 million euro of which Turkey will contribute 40,000 euro.

Table: 4.13. Matrix of Policy Commitments: Information and Communications Technologies

(1000 euro)

	2003	2004	2005	2006
1. Upgrading the Physical Infrastructure in the Telecommunications sector regarding Market Surveillance				
A. Implementation Profile		X	X	
B. Net Direct Budgetary Effect		1,070	120	
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure		1,070	120	
2. Institution Building in the Telecommunications Authority				
A. Implementation Profile	X			
B. Net Direct Budgetary Effect	40			
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure	40			
Total Net Budgetary Impact				
A. Implementation Profile	X	X	X	
B. Net Direct Budgetary Effect	40	1,070	120	
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure	40	1,070	120	

4.6.6. Transportation

Reorganisation of the Turkish State Railways (TCDD) is one of the reform areas in the transportation sector.

Main objectives of the reorganisation are:

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- to increase the share of rail transport in the sector by implementing customer-oriented business strategies, and to establish a sustainable and effective transport infrastructure,
- to ensure sustainability in public transportation service,
- to increase the autonomy of the TCDD,
- to cancel unprofitable local and urban lines where the operational loss is not compensated by the government,
- to develop new markets and to extend the product range,
- to use private sector resources at the utmost level,
- to strengthen the information communication infrastructure of the TCDD.

The draft law that has been prepared in 2002 regarding the reorganisation of the railways is being redrafted considering the relevant EU directives. TCDD has prepared Reorganisation Action Plan for the years 2003-2008. A project has been decided to be included in the Turkey-EU financial cooperation programme for 2004, with the aim of supporting the restructuring efforts in the railway sector and reorganization of TCDD.

Besides, studies have been carried on to facilitate the loans from the Country Assistance Strategy Programme of World Bank, for the reorganization of TCDD administration. It is planned to allocate 75 million dollars, which will be needed for the retirements as a result of reorganization, by the financial sources that will be provided by Country Assistance Strategy Programme. Being a long-term project, it is estimated that the reorganisation of the TCDD State Railways requires an annual investment of 140 million dollars for the period 2003-2008.

Table: 4.14. Matrix of Policy Commitments: Transportation

	(1000 euro)			
	2003	2004	2005	2006
Restructuring of Railways/Establishment of Financial Information Systems				
A. Implementation Profile	X			
B. Net Direct Budgetary Effect	477			
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure	477			

4.6.7. Energy

By means of the Law on Electricity Market and Law on Natural Gas Market entered into force in March 2001 and in May 2001 respectively, it has been targeted the opening of the energy sector to competition and creating an environment in which the private sector can operate freely.

Energy Market Regulatory Authority (EMRA) set up in accordance with the above-mentioned Laws, introduced various secondary legislation, mainly on license regulations, regulations on transmission and distribution regulations and tariff regulations, to improve the competitiveness of electricity and natural gas market.

A considerable amount of the secondary regulations regarding the electricity have been issued by EMRA. Preparatory work by EMRA on the mediation and conciliation, demand estimation and safety of supply is underway.

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The share of TRT, which constitutes a substantial burden on electricity prices, has been reduced from 3.5 per cent to 2 per cent. On the other hand, measures to decrease the distribution losses and to increase the collection rates of TEDAŞ have been put into practice. It is expected that the distribution losses in the year 2003 will be reduced considerably compared with the previous year.

Work on the privatisation of electricity sector is being carried on. In this regard, distribution facilities have been divided into 33 fields of activity by the Ministry of Energy and Natural Resources. Plants and distribution areas having legal problems in transferring the right to exploitation are excluded from the privatisation process. Some certain plants and distribution areas, however, have been taken in the scope of privatisation. In the next stage, privatisation of the electricity institutions will be realized as envisaged in the programme which is to be prepared by the Privatisation Administration.

In the field of natural gas sector, regulations on licenses, plants, transmission, distribution and customer services, certification, inner construction, tariffs and supervision have been put into force. The new tariffs started to be applied in the distribution regions.

BOTAŞ's monopoly rights have been removed by the Law No. 4646. Inner-city distribution licenses have been tendered by EMRA, in line with the Natural Gas Market Law.

The studies is being carried on to establish electricity and natural gas links with the South-eastern Europe countries. Turkey, as a participant to the Southeast Europe Regulatory Forum, closely observes the developments in the regional energy market.

Issues regarding strengthening the institutional capacity and efficient enforcement have been in the agenda of EMRA. A twinning project financed by the EU on strengthening the institutional capacity of EMRA was approved. The Project is expected to be initiated by October 2003. Total budget of the Project is 1,068,000 euro of which 21,000 euro will be financed by national budget.

The Project on Development of a Regulatory Information System for EMRA which enables EMRA to function efficiently and cooperate with the electricity market actors will be financed by the EU after the approval of the PHARE Committee. Total budget of the project is 1,085,000 euro of which 35,000 will be financed from national budget.

In addition, it has been planned to complete licensing of all market participators, to adjust revenue and tariff levels for the period 2004-2007, to update the current legislation, to establish an infrastructure for market monitoring and measuring-communication-control network and to initiate cost-based tariff application.

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ANNEX TABLES

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Table:1- Growth and Associated Factors

Percentages unless otherwise indicated	ESA Code	2002	2003	2004	2005	2006
1. GDP Growth at Constant Market Prices (14+15+16)	B 1 g	7.8	5.3	5.1	5.1	5.1
2. GDP Level at Current Market Prices (quadrillion TL)	B 1 g	276	364	434	499	556
3. Change in GDP Deflator (annual average)		43.5	25.1	13.6	9.4	6.0
4. CPI Change (annual average)		45.0	26.8	14.4	9.8	6.2
5. Employment Growth*		-0.8	1.4	3.3	2.6	2.7
6. Labour Productivity Growth**		8.1	3.8	1.7	2.4	2.3
7. Investment Ratio (per cent of the GDP)		21.3	22.2	22.4	22.9	23.3
Sources of Growth: Percentage Changes at Constant Prices						
8. Private Consumption Expenditure	P3	2.0	6.2	3.1	3.3	3.5
9. Government Consumption Expenditure	P3	5.4	4.2	2.4	2.7	2.3
10. Gross Fixed Capital Formation	P51	-0.8	15.4	16.3	15.2	10.0
11. Changes in Inventories and Net Acquisition of Valuables as a Per cent of the GDP***	P52+P53	7.0	-0.4	-1.7	-1.6	-0.7
12. Exports of Goods and Services	P6	11.0	9.3	10.2	8.9	8.6
13. Imports of Goods and Services	P7	15.7	14.4	7.8	7.7	7.5
Contributions to GDP Growth						
14. Final Domestic Demand		1.7	7.2	5.6	5.8	4.9
15. Changes in Inventories and Net Acquisition of Valuables	P52+P53	7.0	-0.4	-1.7	-1.6	-0.7
16. External Balance of Goods and Services	B11	-0.9	-1.5	1.2	0.9	0.9
Growth of Gross Value Added						
17. Agriculture		7.1	0.5	2.5	2.4	2.3
18. Industry		9.4	6.2	5.5	5.5	5.4
19. Construction		-4.9	5.3	5.1	5.1	5.1
20. Services		7.2	5.9	5.5	5.5	5.5

* Occupied population, domestic concept, persons, national account definition.

** Growth of GDP at market prices per person employed at constant prices.

*** Contribution to growth.

Annex**Table:2- Labour Markets Developments**

	2002	2003	2004	2005	2006
1.Population (thousands - mid-year)	69,626	70,712	71,789	72,844	73,905
2.Population Growth Rate (per cent)	1,59	1,55	1,51	1,46	1,45
3.Working Age Population (thousands)*	48,041	48,909	49,793	50,680	51,598
4.Labour-Force Participation Rate (per cent)*	49,6	50,2	50,4	50,6	50,8
5.Employment Level (thousands)*	21,354	21,760	22,488	23,074	23,703
6. Employment Growth Rate (per cent)	-0,8	1,9	3,3	2,6	2,7
7.Unemployment Rate (ILO definition) (per cent)	10,3	11,4	10,4	10,0	9,6
8.Average Real Wage Growth Rate (per cent)	-14,16	-	-	-	-

* +15 years-old

Annex**Tablo:3- Balance of Payments**

Millions of Dollars, unless otherwise indicated	2002	2003	2004	2005	2006
1. Current Account (per cent of the GDP)	-0.8	-3.2	-2.7	-1.9	-1.2
2. Exports (Fob)	39.8	47.5	52.8	59.0	65.7
3. Imports (Fob)	-48.2	-59.5	-65.2	-70.8	-76.6
4. Balance on Goods	-8.4	-12.0	-12.4	-11.8	-10.9
5. Services: Credit	14.8	15.5	17.5	18.8	19.6
6. Services: Debit	-6.9	-8.3	-9.3	-10.0	-10.7
7. Balance on Goods and Services	-0.5	-4.8	-4.2	-3.0	-2.0
8. Income: Credit	2.5	2.4	2.7	2.7	3.7
9. Income: Debit	-7.0	-8.6	-9.4	-9.6	-10.2
10. Current Transfers	3.5	3.6	4.3	4.9	5.3
11. <i>of which</i> from EU			0.3	0.3	0.5
12. Current Account Balance	-1.5	-7.4	-6.6	-5.0	-3.2
13. Capital and Financial Account	1.7	7.8	6.6	5.0	3.2
14. Direct Investment Abroad	-0.2	-0.2	-0.3	-0.3	-0.4
15. Direct Investment in Turkey	1.0	1.6	1.3	1.6	2.0
16. Official Reserves	-6.2	-1.6	-2.0	4.1	2.2
17. External Debt (total)	131.4	138.6	146.1	145.5	144.9
18. A. <i>Of which</i> : Public **	81.1	84.0	86.3	80.0	72.9
18. B. IMF	20.7	21.6	22.3	13.9	4.1
19. <i>Ofw</i> : Foreign Currency Denominated (public)	81.1	84.0	86.3	80.0	72.9
20. <i>Ofw</i> : Repayments Due	11.4	7.8	8.6	14.4	15.4
21. Exchange Rate vis-à-vis EURO (end-year)	1,703,477	1,789,031	1,964,990	2,119,948	2,260,048
22. Exchange Rate vis-à-vis EURO (annual average)	1,429,766	1,679,313	1,881,698	2,057,798	2,204,166
23. Foreign Savings (per cent of the GDP)	1.7	3.2	2.4	1.9	1.5
24. Domestic Private Savings (per cent of the GDP)	32.5	26.3	26.8	23.9	21.8
25. Domestic Private Investment (per cent of the GDP)	11.0	13.4	14.8	16.7	17.8
26. Domestic Public Savings (per cent of the GDP)	-12.9	-7.2	-6.8	-2.9	-0.0
27. Domestic Public Investment (per cent of the GDP)	5.7	4.6	5.1	5.2	5.3

*Savings-investment balance calculations are based on the GDP-by expenditure figures of SIS.

The public investment figures in the table also include SEEs investments in addition to general government.

** General government.

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Table:4- General Government Budgetary Developments

Per cent of the GDP	ESA code	2002	2003	2004	2005	2006
Net Lending (B9) by Sub-Sectors *						
1.General Government	S13	13.1	10.5	9.5	5.8	2.5
2.Consolidated Budget (1)	S1311	14.1	12.1	11.2	7.4	4.3
3.Funds		0.0	-0.7	-0.8	-0.8	-0.8
4.Local Government	S1313	0.1	0.2	0.2	0.2	0.1
5.Social Security Fund	S1314	0.0	0.0	0.0	0.0	0.0
6.Revolving Funds		-0.1	-0.1	-0.1	-0.1	-0.1
7.Unemployment Funds		-1.0	-1.0	-1.1	-0.9	-1.0
General Government (S13)						
8.Total Receipts	ESA	41.9	43.6	42.7	41.8	42.3
9.Total Expenditures	ESA	55.1	54.1	52.2	47.5	44.8
10.Interest Payments	D41	19.4	17.8	16.6	12.2	9.7
11.Primary Balance		-6.2	-7.2	-7.1	-6.4	-7.2
Components of Revenues						
12.Taxes	D2+D5	24.2	26.7	25.2	24.8	25.2
13.Social Funds	D61	6.9	7.3	7.9	8.1	8.4
14.Other		10.8	9.5	9.6	8.8	8.7
15.Total Receipts	ESA	41.9	43.6	42.7	41.8	42.3
Components of Expenditures						
16.Total Consumption	P32	18.2	18.0	18.1	18.1	18.1
17.Social Security Transfers		10.2	11.1	10.8	10.9	10.9
18. Interest	D41	19.4	17.8	16.6	12.2	9.7
19.Subsidies (2)	D3	1.1	1.2	1.1	1.1	0.9
20.Gross Fixed Capital Formation	D51	4.1	3.5	3.9	3.9	4.1
21.Other		2.1	2.5	1.8	1.4	1.1
22.Total Expenditure	ESA	55.1	54.1	52.2	47.5	44.8

(1): 950 trillion TL that is paid in cash from the 2001 budget to the social security institutions is shown in the relevant year in the table. This amount is shown in 2002 in Table 1.7. Therefore, it differs by 0.4 per cent of the GDP for 2002.

(2): Includes agricultural support, duty losses of SEEs and Support and Price Stability Fund.

* (+) refers to deficit, (-) refers to surplus.

Annex**Table:5- General Government Debt Developments**

	ESA code	2002	2003	2004	2005	2006
Per cent of the GDP						
1. Gross Debt Level		102.5	92.3	91.1	87.6	83.2
2. <i>Of which:</i> Repayments Due		41.6	31.8	37.7	44.6	51.6
3. Change in Gross Debt		-19.1	-10.2	-1.2	-3.5	-4.4
Contributions to Change in Gross Debt						
4. Primary Balance (per cent)	B9	-6.2	-7.2	-7.1	-6.4	-7.2
5. Interest Payments (per cent)	D41	19.4	17.8	16.6	12.2	9.7
6. Nominal GDP Growth (per cent)	B1g	-56.1	-29.3	-17.7	-13.1	-9.4
7. Other Factors Influencing The Debt Ratio: Exchange Rate Change etc.		24.0	9.4	8.6	4.9	3.5
8. Other Factors Influencing The Debt Ratio: Privatisation Receipts		-0.2	-0.9	-1.6	-1.1	-1.0

Annex**Table:6- Divergence From Previous Update**

	2002	2003	2004	2005	2006
1.GDP Growth (per cent)					
Previous Update	3.9	4.9	5.0	5.1	-
Latest Update	7.8	5.3	5.1	5.1	5.1
Difference	3.9	0.4	0.1	0.0	-
2.Current Account Balance (million euro)					
Previous Update	-1,677	-2,128	-2,090	-2,144	-
Latest Update	-1,648	-6,893	-6,126	-4,651	-2,999
Difference	29	-4,765	-4,036	-2,507	-
3.Total Foreign Debt Levels (million euro)					
Previous Update	136,437	138,931	141,721	137,610	-
Latest Update	125,353	129,565	136,496	135,951	135,390
Difference	-11,085	-9,366	-5,225	-1,660	-
4. Actual General Government Balance (per cent of the GDP)					
Previous Update	-13.2	-5.9	-3.0	-0.5	-
Latest Update	-13.3	-10.5	-9.5	-5.8	-2.5
Difference	-0.1	-4.6	-6.5	-5.3	-
5.Actual General Government Primary Balance (per cent of the GDP)					
Previous Update	7.9	8.5	7.8	7.8	-
Latest Update	6.2	7.2	7.1	6.4	7.2
Difference	-1.7	-1.3	-0.7	-1.4	-
6. General Government Gross Debt Level (per cent of the GDP)					
Previous Update	99.6	85.6	79.6	73.0	-
Latest Update	102.3	92.3	91.1	87.6	83.2
Difference	2.7	6.7	11.5	14.6	-

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Table:7- Assumptions on the External Economic Environment Underlying the 2003 PEP Framework

	2002	2003	2004	2005	2006
Interest Rates (per cent)					
Domestic Interest Rate (Treasury bill rate, simple)	56.8	44.3	28.0	18.9	16.4
Euro Area: Short-term (3-months money market)	3.3	2.4	2.7	-	-
Euro Area: Long-term (10-years govt. bonds, lowest one prevailing in Euro area)	4.8	4.2	4.8	-	-
USA: Short-term (3-months money market)	1.8	1.4	2.4	-	-
USA: Long-term (10-years govt. bonds)	4.6	4.0	4.6	-	-
Exchange Rates					
TL / €	1,429,766	1,679,313	1,881,698	2,057,798	2,204,166
Change in Annual Average (“-“ depreciation)	-30.7	-17.4	-12.1	-9.4	-7.1
USD / €	0.94	1.07	1.07	1.07	1.07
Percentage Change in Real Exchange Rate (“+“ depreciation)	20.0	17.6	1.8	-0.4	-1.7
Real GDP Growth					
World, excluding EU	3.2	3.6	4.0		
USA	2.4	2.4	2.5	-	-
OECD	1.8	-	-	-	-
EU 15	1.1	1.3	2.4	2.5	2.5
World Trade (in real terms)					
Developing Countries Import Volumes (percentage change)	5.4	4.7	8.0	7.8	7.8
International Prices					
World Import Prices (percentage change)	-1.5	2.5	0.5	0.9	1.0
World Export Prices (percentage change)	0.1	1.2	1.0	1.0	1.0
Oil Prices (USD per barrel)	25.0	27.8	24.5	24.0	24.0

Annex**Table:8- Cyclical Developments ***

	2002	2003	2004	2005	2006
1. Real GDP Growth	7.8	5.3	5.1	5.1	5.1
2. Actual Balance ⁽¹⁾	14.1	12.1	11.2	7.4	4.3
3. Net Interest Payments	18.8	17.2	16.2	11.9	9.4
4. Potential GDP Growth	2.2	3.7	4.3	4.8	5.1
5. Output Gap (percentage difference from the potential)	1.6	0.1	-0.7	-0.9	-0.9
6. Cyclical Budget Component	-0.7	0.0	0.3	0.4	0.4
7. Cyclically Adjusted Balance	-13.3	-11.9	-11.4	-7.9	-4.8
8. Cyclically Adjusted Primary Balance	4.8	5.0	4.7	4.1	4.9

* Consolidated budget

(1): (+) refers to deficit, (-) refers to surplus.