REPUBLIC OF TURKEY

PRE-ACCESSION ECONOMIC PROGRAMME 2005

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TABLES

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BOXES

ABBREVIATIONS

ABC	Analytical Budget Classification
ADSL	Asymmetric Digital Subscribers Line
APL	Applicable Program Loan
ARIP	Agricultural Reform Implementation Project
BAĞ-KUR	Social Security Organization of the Self-Employed
BEC	Classification of Broad Economic Categories
BITT	Banking and Insurance Transactions Tax
BMIS	Budget Management and Information System
BO	Build-Operate
BOT	Build-Operate-Transfer
BOTAŞ	Petroleum Pipeline Corporation
BRSA	Banking Regulation and Supervision Agency
CBRT	Central Bank of the Republic of Turkey
CMB	Capital Market Board
COICOP	Classification of Individual Consumption by Purpose
CPI	Consumer Price Index
DEM	Deutsche Mark
DIS	Direct Income Support
EAFRD	European Agricultural Fund for Rural Development
EIB	European Investment Bank
EIEI/UETM	Electrical Power Resources Survey and Development Administration-National Energy Savings Center
EMRA	Energy Market Regulatory Authority
ERASMUS	European Community Action Scheme for the Mobility of University Students
ESA 95	European System of Accounts 1995
EU	European Union
EU-15	The EU Member Countries Before Enlargement on May 1, 2004.
EUR	Euro
EUROSTAT	European Union Statistics Office
FOE	Futures and Options Exchange
FX	Foreign Exchange
GDBI	Government Domestic Borrowing Instrument
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GMPCS	Global Mobile Personal Communications by Satellite
GNP	Gross National Product
GSM	Global System for Mobile Communications
HLFS	Household Labour Force Survey
IACS	Integrated Administration and Control System

IAS	International Auditing Standards
ICT	Information and Communication Technologies
IDA	Inter-Agency Electronic Data Exchange Program
IDABC	Interoperable Delivery of pan-European Services to Public Administrations, Businesses and Citizens
IDSS	Identification Data Sharing System
IFRS	International Financial Reporting Standards
ILO	International Labour Organization
IMF	International Monetary Fund
ISE	İstanbul Stock Exchange
İŞKUR	General Directorate of Turkish Employment Agency
JIM	Social Inclusion Document
JPY	Japanese Yen
KamuSM	Public Certification Center
KOSGEB	Small and Medium Industry Development Organization
LPG	Liquefied Petroleum Gas
LPIS	Land Parcel Identification System
MEDA	Euro-Mediterranean Partnership
MERNİS	Central Demographic Administration System
MTFP	Medium-Term Fiscal Plan
MTP	Medium-Term Program
NAIRU	Non Accelerating Inflation Rate of Unemployment
NUTS	Official Nomenclature of Territorial Units for Statistics
OECD	Organization for Economic Co-operation and Development
OIZs	Organized Industry Zones
PEP	Pre-Accession Economic Programme
PETKİM	Petrochemical Corporation
PHARE	Poland and Hungary: Action for the Restructuring of the Economy
PNDP	Preliminary National Development Plan
PPI	Producer Price Index
PSSP	Privatization Social Support Project
R&D	Research and Development
R&TTE	Radio and Telecommunication Terminal Equipment
RUSF	Resource Utilization Support Fund
SCT	Special Consumption Tax
SDIF	Savings Deposit Insurance Fund
SEEs	State Economic Enterprises
SFI	Special Finance Institutions
SIS	State Institute of Statistics
SMEs	Small and Medium Sized Enterprises
SNA	System of National Accounts

SPO	State Planning Organization
SSI	Social Security Institutions
SSK	Social Insurance Institution
STAP	Short-Term Action Plan
TA	Technical Assistance
TCDD	Turkish State Railways
TDİ	Turkish Maritime Transportation Company
TEDAŞ	Turkish Electricity Distribution Company
TEKEL	General Directorate of Tobacco, Tobacco Products, Salt and Alcohol Enterprises
TFP	Total Factor Productivity
TGNA	Turkish Grand National Assembly
TINA	Transport Infrastructure Needs Analysis
TPI	Turkish Patent Institute
TR52	Karaman and Konya Provinces
TR72	Kayseri, Sivas and Yozgat Provinces
TR82	Çankırı, Kastamonu and Sinop Provinces
TR83	Amasya, Çorum, Samsun and Tokat Provinces
TR90	Artvin, Giresun, Gümüşhane, Ordu, Rize and Trabzon Provinces
TRA1	Bayburt, Erzincan and Erzurum Provinces
TRA2	Ağrı, Ardahan, Iğdır and Kars Provinces
TRB1	Bingöl, Elazığ, Malatya and Tunceli Provinces
TUBITAK	the Scientific and Technological Research Council of Turkey
TURKAK	Turkish Accreditation Agency
TÜPRAŞ	Turkish Petroleum Refineries Corporation
UCTE	Union for the Coordination of Transmission of Electricity
UEKAE	National Research Institute of Electronics and Cryptology
USD	US Dollar
VAT	Value Added Tax
VEDOP II	Tax Office Full Automation Project
WPI	Wholesale Price Index
YTL	New Turkish Lira

INTRODUCTION

As a part of the requirements emanating from the Pre-Accession Fiscal Surveillance Procedure, Turkey has prepared the Pre-Accession Economic Programme (PEP) and submitted to the European Commission since 2001. The fifth Pre-Accession Economic Programme prepared in 2005 covers the recent economic developments of Turkey as well as projections and forecasts for the period of 2006-2008.[1]

Turkey has recently recorded a remarkable progress on the way of full membership to European Union (EU) and the negotiations with EU were officially launched on October 3, 2005. The main objective of implemented economic policies and structural reforms in Turkey is to complete the process of the full membership to EU in a rapid and successful manner. In this respect, determination of necessary priorities, and in order to put these priorities into action decisive implementation of specified policies are crucial; and the recent performance achieved by Turkey indicates that Turkey acts with this conscious. In this context, PEP 2005 is considered to contribute to the negotiation process especially in the framework of structural reforms.

Recent performance displayed by the Turkish economy is supportive for achieving persistent stability and thereby attaining a success in some implemented social policies. Therefore, economic policies presented in Pre-Accession Economic Programme have a significant role for both increasing the welfare of the society and completing the negotiation process successfully.

Economic policies presented in the Pre-Accession Economic Programme construct the base of the policies towards the long-term objectives and targets. In this respect, these economic polices aim at achieving sustainable growth performance, convergence of inflation, which has already declined to single-digit levels, to EU averages permanently and forming a sustainable fiscal structure. By reaching these targets introduced in the context of Copenhagen and Maastricht criteria, achieving an increase in the level of welfare of the society and a more balanced structure in the distribution of wealth are supported by certain social policies proposed in the programme. Therefore, real convergence process emphasized by the EU will be successfully fulfilled via convergence of per capita income and inter-regional development gaps of Turkey to EU averages.

Economic policies prepared in the framework of PEP 2005 are handled at three groups; fiscal policy, monetary policy, and income policy. The main target of the fiscal policy is to continue to the implementation of existing fiscal discipline decisively and thereby making the budget and debt structure in harmony with the Maastricht criteria. On the other hand, the main objective of the monetary policy is to ensure the price stability. In order to reach this target, Central Bank will shift to explicit inflation targeting as of January 1, 2006 and continue to implement floating exchange rate regime. Lastly, incomes policy will be continued in a way of supporting fiscal and monetary policies and consistent with inflation target.

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[1] The PEP 2005 has been prepared under the coordination of Undersecretariat of State Planning Organization (SPO) 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, Privatization Administration, Capital Markets Board of Turkey, Turkish Competition Authority, Banking Regulation and Supervision Agency, Saving Deposit Insurance Fund, Telecommunications Authority, Energy Market Regulatory Authority and Council of Higher Education.

The main objective of the structural reforms, the importance of which has increased further in the context of permanent stability, is to achieve structural transformation in the economy. In this framework, a restructuring of the public sector aiming at improving the efficiency, the rule of law, transparency and participation in the public administration is targeted. Moreover, the process of privatization is accelerated with a view to alleviating the dominance of the public sector in the economy. In this respect, functioning of the market economy, attainment of highly competitive economic structure and strengthening the regulatory and supervisory roles of the public sector are targeted. Furthermore, public services will be provided by local administrations in the context of decentralization, and hence the efficiency and productivity in the economy will increase. Besides, restructuring of the financial system, improving the investment environment and increasing the productivity in agricultural sector are among the other targets envisaged in the PEP 2005. The success of structural transformation process will also contribute to reducing of regional development gaps. In the programme, it is emphasized that the convergence of regional development gaps to EU averages can be achieved via implementing various social policies in areas such as education, health, justice and social security. Lastly, with the structural reforms in information and communication technologies and energy sectors, these areas are expected to open to competition.

The Pre-Accession Economic Programme for 2005 comprises of four chapters. In the first chapter, recent economic developments in the Turkish economy are summarized. In the second chapter, the macroeconomic targets for the period of 2005-2008 are stated and the economic policies to be implemented in order to attain these targets are presented. Furthermore, possible risks that may arise in achieving the envisaged macroeconomic policies and targets are determined and the impacts of these risks are evaluated. In the third chapter, fiscal policies as well as the projections and various risk analyses for the budget and debt management covering the PEP period are presented. In the fourth chapter, developments related to the structural reforms implemented in various fields as well as reform calendar and predicted costs are given for the PEP period.

1. RECENT ECONOMIC DEVELOPMENTS

1.1. Growth and Employment

Gross Domestic Product (GDP), which grew by 5.8 per cent in 2003, recorded an 8.9 per cent growth rate in 2004 as a result of considerable increases in private sector consumption and fixed capital investments. The 9.9 per cent growth rate of Gross National Product (GNP) in 2004 has been the highest growth rate achieved since 1966. According to sectoral composition of GDP, value-added in the agriculture increased by 2 per cent while the increases in industry and services sectors' value-added were 9.4 per cent and 10.2 per cent, respectively. Value-added of the construction sector, which had contracted since 2001, recorded a 4.6 per cent increase in 2004.

Total final domestic demand increased by 14.1 per cent in 2004. A 10.1 per cent increase in private consumption and a 45.5 per cent increase in private fixed capital investments have played an important role in this development. Increase in private machinery and equipment investments, which grew by 60.3 per cent, was the determinant of the rise in the private fixed capital investments.

Table. 1. 1: Growth Rates and Demand Components

(Percentage Change Compared to the Same Period of the Previous Year)

	Annual		By Quarters					
			2004				2005	
	2003	2004	I	II	III	IV	I	II
Agriculture	-2.5	2.0	2.7	4.3	-1.4	9.1	0.0	0.1
Industry	7.8	9.4	10.4	15.7	7.5	4.0	5.5	3.9
Services	6.7	10.2	13.3	15.0	6.9	7.0	4.8	4.9
GDP	5.8	8.9	11.8	14.4	5.3	6.3	4.8	4.2
GNP	5.9	9.9	13.9	15.7	5.7	6.6	5.3	3.4
Total Consumption	5.6	9.0	11.6	15.4	5.9	4.7	4.0	4.4
Public	-2.4	0.5	2.6	-7.8	-7.0	11.1	4.3	4.0
Private	6. 6	10.1	12.4	18.4	7.3	3.6	4.0	4.4
Gross Fixed Capital Formation	10.0	32.4	57.6	47.4	26.1	11.2	6.9	17.9
Public	-11.5	-4.7	-5.9	-8.7	-10.8	0.9	36.6	31.1
Private	20.3	45.5	65.5	63.1	38.9	17.7	4.8	15.8
Total Final Domestic Demand	6.5	14.1	19.8	22.9	9.9	6.3	4.7	8.2
Total Domestic Demand	9.3	14.1	20.6	21.4	8.1	8.5	4.4	6.4
Exports of Goods and Services	16.0	12.5	10.9	17.2	8.2	14.4	11.3	4.7
Imports of Goods and Services	27.1	24.7	31.3	32.7	16.1	19.6	9.3	9.2

Source: SIS

GDP growth, which was 13.2 per cent in the first half of 2004, declined to 5.7 per cent in the second half of the year primarily due to measures aimed at controlling the growth in the domestic demand. This moderate increase in domestic demand continued in the first half of 2005 and as a result a 4.5 per cent GDP growth was recorded. While the value-added in agricultural sector increased by 0.1 per cent, growth rates of value-added in industry and services sectors were 4.6 per cent and 4.8 per cent, respectively in the same period. A 19.7 per cent rise in the construction sector value added made a significant contribution to the growth in GDP.

Private consumption increased by 4.2 per cent in the first half of 2005, while the private sector fixed capital investments recorded a 10.8 per cent growth rate. During the same period, the public sector fixed capital investments, which had contracted since 2003, rose by 32.6 per cent and contributed to GDP growth significantly. Total domestic demand went up by 5.4 per cent in the same period. There was a 7.7 per cent increase in exports of goods and services while imports of goods and services increased by 9.2 per cent. Thus, net exports of goods and services declined by 1.5 per cent.

Scrutinizing the data of industrial production indicates that the upward trend observed in the industrial production since 2002 has continued in 2005. The capacity utilization rate in the manufacturing industry reached 81.3 per cent in the third quarter of 2005. Industrial production increased by 4.9 per cent in the January-September period of 2005 compared to the corresponding period of 2004. In light of these developments, GDP is expected to grow by 5 per cent in 2005.

When the developments in the labour market are considered, it is observed that the level of employment, which had decreased since 1999, tended to rise beginning from the second quarter of 2004. This development was a result of lagged effect of economic growth on employment arising from economic stability achieved in recent years. Growth elasticity of employment converged to its long-run level in 2004 and by a 3 per cent increase in employment, 644 thousands of new jobs were created.

In 2004, employment increased by 3.3 per cent in the agricultural sector, 3.7 per cent in industry, and 2.6 per cent in the services sector. The driving force behind the rise in employment in services sector was 6.6 per cent increase in the construction sector employment. The limited increase in employment observed in the construction sector in 2003 accelerated in 2004 and displayed a trend parallel to the rise in value added in that sector.

Table. 1. 2: Developments in the Labour Market

(15+ Age, Thousands of Persons)

	Annual		2004			2005		
	2003	2004	I	II	III	Feb.	May	August
Working Age Population	48,912	49,906	49,482	49,694	49,944	50,452	50,695	50,938
Labour Force Participation Rate (Per cent)	48.3	48.7	45.9	49.2	50.6	46.8	49.3	49.5
Female	26.6	25.4	22.5	26.0	27.7	23.3	26.2	25.6
Male	70.4	72.3	69.8	72.8	73.8	70.6	72.8	73.8
Labour Force	23,640	24,289	22,732	24,457	25,265	23,588	25,015	25,219
Employed	21,147	21,791	19,902	22,188	22,874	20,838	22,721	22,838
Unemployed	2,493	2,498	2,830	2,269	2,390	2,750	2,294	2,381
Unemployment Rate (Per cent)	10.5	10.3	12.4	9.3	9.5	11.7	9.2	9.4
Non-Agricultural Unemployment Rate	15.0	14.7	17.3	13.6	14.0	15.4	12.5	12.9
Employment Rate Among Young People	20.5	19.7	23.7	16.9	18.6	21.8	17.6	18.2
Employment by Sectors								
Agriculture	7,165	7,400	6,412	7,820	8,222	6,230	7,266	6,990
Industry	3,846	3,988	3,844	3,961	4,035	4,054	4,165	4,405
Services	10,136	10,403	9,646	10,407	10,618	10,554	11,290	11,443
Construction	965	1,029	723	1,073	1,184	924	1,252	1,291

Source: SIS

Besides, labour force participation rate, which was 48.3 per cent in 2003 increased to 48.7 per cent in 2004. Corresponding rates for male and female labour force were 72.3 per cent and 25.4 per cent, respectively. Employment rate, which stood at 43.2 per cent in 2003, went up to 43.7 per cent in 2004. Thus, unemployment rate declined by 0.2 percentage points compared to the figure of previous year, and realized as 10.3 per cent in 2004. Non-agricultural unemployment rate went down to 14.7 per cent in 2004 while unemployment rate among the young population receded to 19.7 per cent.

Despite the rapid rise achieved in total employment in 2004, a 2 per cent increase in working age population and the rise in the labour force participation rate prevented unemployment rate from declining further through increasing civilian labour force.

According to the results of 2005 Household Labour Force Survey (HLFS), a strong increase in employment, which started in 2004, has been continuing in 2005. In this context, employment rate rose by 4.7 per cent and 2.4 per cent in the first and second quarters of 2005, respectively. Even though no increase in the level of employment was recorded in the third quarter, the increase in employment in the first nine months of the year was realized as 2.2 per cent and 478 thousands of new jobs were created. The unemployment rate in Turkey fell by 0.7 percentage points in the first quarter of 2005 compared to the same period of the previous year and declined to 11.7 per cent, while it decreased by 0.1 percentage point in the second quarter of 2005 and was realized as 9.2 per cent. Unemployment rate in the third quarter was realized as 9.4 per cent through declining by 0.1 percentage point. Analysis of employment by sectors indicates that the increase in employment is largely owed to the rise in employment in services sector.

Box. 1. 1: Alignment with the EU in Household Labour Force Survey

State Institute of Statistics (SIS) has been following international standards in terms of definitions and concepts in its Household Labour Force Surveys since 1988. Efforts were initiated in 2002 with a view to eliminating the shortcomings of HLFS in order to ensure alignment with the EU. As a result of these efforts, a new questionnaire containing all variables requested by the European Union Statistics Office (EUROSTAT) was developed. This questionnaire meets all norms and standards of the EU' regarding labour force statistics. Thus, for the first time in 2004 the HLFS covered the variables requested by EUROSTAT and annual results were announced on the Statistical Regional Units Classification Level II (26 regions) bases.

The number of questions in the questionnaire was increased from 47 to 98 in 2004 and the criteria used for determining whether the people, who were not at work in the reference week should be regarded as employed or not, were defined more clearly in the questionnaire taking the norms and standards of EUROSTAT into account. According to those criteria, people, who are self-employed or employers, are regarded as employed even if they were not at work during the reference week, whereas wage or salary earners will be deemed to be employed only if they will return to their work within 3 months or they continue to receive minimum 50 per cent of their salaries and wages during their absence from work. In the surveys conducted before 2004, wage and salary earners who were still engaged with their workplaces were regarded as employed whether or not they received an income and independent of the period of absence from work. In line with the previous practices, unpaid family workers and causal workers, who did not work even for "one hour" during the reference week, are not deemed to be employed. There are definitional differences between EUROSTAT and ILO as to whether or not unpaid family workers, who did not work during the reference week, should be regarded as employed. While ILO suggests that unpaid family workers, who are absent from work during the reference week, should be regarded as unemployed irrespective of the period during which they are away from work, EUROSTAT suggests that unpaid family workers, who are away from work for a period shorter than 3 months, should be regarded as employed. SIS complies with the ILO criterion in this respect and regards unpaid family workers, who did not work even for one hour during the reference week, as unemployed.

In the beginning of 2005, HLFS questionnaire was revised to include new variables in line with recommendations of EUROSTAT. Since the beginning of 2005, HLFS statistics are published on a monthly basis covering three-month moving averages. In this data, the weights of the related quarterly period are calculated by reference to population projections related to the month in the middle of the period and projections are named after the month in the middle of the period for ease of reference. In this context, August 2005 data was published most recently.

1.2. Balance of Payments

Current Account

Deterioration in the current account balance since 2002 still continues and current account deficit rose to 15.6 billion dollar and its ratio to GDP went up to 5.2 per cent in 2004. Current account deficit realized as 16.4 billion dollars in the January-September period of 2005.

In 2004, an annual increase of 16.3 per cent in export prices, continuation of relatively low labour costs, substantial increases in labour productivity, diversification by sectors, penetration into new markets and continuing recovery in the world economy contributed to high increases in exports despite the real appreciation of the domestic currency. Exports went up by 33.6 per cent in 2004 to reach 63.1 billion dollars. An analysis of the sectoral composition of exports indicates that the biggest contribution to exports came from garments, textile products, motor vehicles and their parts and accessories, basic metal industry and radio-television and telecommunication devices sectors.

Table. 1. 3: Balance of Payments

(Billion Dollars)

	Annual		January-September	
	2003	**2004**	**2004**	**2005**
Current Account	**-8.0**	**-15.6**	**-10.6**	**-16.4**
Balance on Goods	-14.0	-23.9	-17.5	-24.6
Exports	51.2	67.0	47.9	55.4
Imports	-65.2	-90.9	-65.4	-80.0
Balance on Services	10.5	12.8	10.3	11.5
Credit	19.0	24.0	18.2	21.2
Tourism	13.2	15.9	12.7	14.6
Debit	-8.5	-11.2	-8.0	-9.6
Balance on Income	-5.6	-5.6	-4.3	-4.4
Credit	2.2	2.7	1.9	2.9
Debit	-7.8	-8.3	-6.2	-7.3
Current Transfers	1.0	1.1	0.9	1.1
Capital and Financial Account	**3.0**	**13.3**	**10.6**	**12.4**
Financial Account	3.0	13.3	10.6	12.4
Foreign Direct Investment	1.2	1.9	1.5	3.0
Portfolio Investment	2.5	8.0	4.5	9.0
Other Investment	3.4	4.2	6.1	9.0
Assets	-1.0	-7.0	-3.7	-1.9
Liabilities	4.3	11.1	9.8	10.8
Trade Credits	2.2	4.2	3.5	2.7
Credits	0.7	6.1	5.2	6.3
Monetary Authority	-1.5	-4.4	-3.9	-2.6
General Government	-0.8	-0.3	0.4	-3.6
Banks	2.0	5.7	3.6	6.6
Other Sectors	1.0	5.1	4.4	5.8
Currency and Deposits	1.4	0.6	1.0	1.6
Monetary Authority	0.5	-0.2	-0.1	-0.6
Banks	0.9	0.9	1.1	2.1
Other Liabilities	0.1	0.2	0.2	0.3
Official Reserves	-4.0	-0.8	-1.5	-8.6
Net Errors and Omissions	**5.0**	**2.3**	**0.0**	**4.0**

Source: CBRT

There was a moderate slowdown in the rate of increase in exports in the January-September period of 2005. Exports increased by 17.7 per cent with respect to the same period of 2004 and reached 52.9 billion dollars. Considerable increases in exports of motor vehicles and their parts and accessories, refined petroleum products, and food industries are recorded in this period.

Realization of the delayed demand for white goods and motor vehicles after the economic crisis in 2001, substantial increases in the private machinery and equipment investment, real appreciation of the domestic currency and sharp rises in oil prices caused imports to increase by 40.7 per cent in 2004 compared to previous year and to reach 97.5 billion dollars.

Parallel to the slow-down in economic growth, the upward trend in imports slowed down in the January-September period of 2005 and imports went up by 20.8 per cent compared to the same period of the previous year and reached 85.1 billion dollars. Despite the deceleration in imports, the realization of imports was beyond the expectations due to a 9.5 per cent increase in import prices compared to the same period of the previous year. Another factor contributing to the increase in imports was the rise in energy prices parallel to the increases in oil prices. During this period, additional cost incurred due to oil price increase was 3.7 billion dollars above the projections of the annual program.

The trade figures of Turkey with the EU shows that Turkey's exports to the EU countries rose by 33 per cent while imports from those countries increased by 35.7 per cent in 2004. The ratio of trade with the new EU-member countries to total trade volume increased in the January-September period of 2005 while the ratio of trade with other EU-member countries (EU-15) to total trade volume decreased. Turkey's share in global trade, however, rose in 2004 as a result of substantial increases in its exports and imports. According to the World Trade Organization data, Turkey ranked 22nd in terms of exports and 14th in terms of imports (excluding internal EU trade) in the world in 2004.

Table. 1. 4: Foreign Trade by Countries

(Million Dollars)

	Annual			January-September		
	2003	**2004**	**Percentage Change**	**2004**	**2005**	**Percentage Change**
Merchandise Exports	47,253	63,121	33.6	44,988	52,937	17.7
EU Countries	25,899	34,436	33.0	24,413	27,512	12.7
EU-15	24,484	32,574	33.0	23,101	25,769	11.5
New Member Countries	1,415	1,862	31.6	1,312	1,743	32.8
Other Countries	19,426	26,122	34.5	18,751	23,258	24.0
Turkish Free Zones	1,928	2,564	33.0	1,823	2,168	18.9
Merchandise Imports*	69,340	97,540	40.7	70,410	85,078	20.8
EU Countries	33,495	45,444	35.7	33,194	35,877	8.1
EU-15	31,696	42,359	33.6	31,035	33,183	8.1
New Member Countries	1,799	3,084	71.4	2,159	2,694	6.9
Other Countries	35,259	51,285	45.5	36,612	48,650	32.9
Turkish Free Zones	589	811	37.7	604	551	-8.7

Source: SIS

* Excluding monetary gold, including non-monetary gold.

The balance on services, which traditionally yields a surplus due to tourism revenues, also yielded a 12.8 billion dollars of surplus in 2004. Tourism revenues increased by 20.3 per cent in 2004 and amounted to 15.9 billion dollars. In the January-September period of 2005, tourism revenues showed a 15.2 per cent increase with respect to the same period of the previous year and amounted to 14.6 billion dollars

The deficit of income balance preserved its previous year level and realized as 5.6 billion dollars in 2004. Interest payments, which is the largest part of the balance on income, realized as 4.3 billion dollars in 2004 and 3.6 billion dollars in January-September period of 2005 by a 17.7 per cent increase compared to the same period of the previous year.

Worker remittances were 804 million dollars in 2004 while official transfers were realized as 323 million dollars and total current transfers were recorded as 1.1 billion dollars. Current transfers yielded a 1.1 billion dollars of surplus in the first nine months of 2005.

Capital and Financial Account

In recent years, a substantial amount of capital inflows was realized as a result of stability achieved in the economy and continuation of positive expectations. The capital and financial account balance, which gave 13.3 billion dollar surplus in 2004, yielded a 12.4 billion dollar surplus in the first nine months of 2005 and reserves increased by 8.6 billion dollars during the same period. Thus, the total amount of increase in official reserves since 2002 has reached 19.6 billion dollars.

Capital flow figures in 2004 show that dynamics of capital flow demonstrated different tendencies compared to 2003. Contrary to 2003, long-term capital inflows increased in 2004 while short-term capital inflows, which were the primary determinant of capital inflows in 2003, were relatively moderate. Long-term capital inflows were largely determined by long-term loans borrowed by the non-bank private sector, whereas short-term capital inflows were mainly determined by short-term loans borrowed by the banking sector.

In capital and financial account (excluding official reserves), 56.8 per cent of 14.1 billion dollars of net total capital inflows was accounted for by portfolio investments in 2004, whereas portfolio investments constituted 42.9 per cent of net total capital inflows of 21 billion dollars in the January-September period of 2005. This resulted from an increase in the share of other investments due to an increase in the amount of loans borrowed from abroad by the non-bank private sector.

Net capital inflows excluding official reserves was 21 billion dollars in the first nine months of 2005. Portfolio investments and long-term loans were the main determinants of the financing structure during this period. The Treasury borrowed 5.3 billion dollars by issuing bonds (Eurobonds) in the first nine months of the year while foreign investors purchased Treasury bills and bonds worth 3.7 billion dollars and real estate worth 1.4 billion dollars in Turkey.

It is observed that, the contribution of the private sector in financing the current account deficit has increased compared to previous years. In addition, the public sector became a net payer to foreign lenders as of August 2005 with the repayments to the International Monetary Fund (IMF).

Net errors and omissions, which were recorded as 2.3 billion dollars in 2004, rose to 4 billion dollars in the first nine months of 2005. A study to identify the reasons of the increase in the net errors and omissions has been initiated and possible reasons might be informal exports of goods and services, capital inflows from unidentified sources and sale of foreign exchange savings which were held as buffer stock.

Net foreign direct investments, which stood at 1.2 billion dollars in 2003, reached 1.9 billion dollars in 2004. The upward trend observed in the net direct investments continued in the January-September period of 2005 and net direct investments went up to 3 billion dollars from 1.5 billion dollars compared to the same period of 2004.

Net Direct investments in Turkey, which were 2.8 billion dollars in 2004, went up to 3.7 billion dollars in the January-September period of 2005. 984 million dollars of this amount was accounted for by purchases of real estate by foreigners.

Other investments in the capital and financial account were 4.2 billion dollars in 2004. In 2004 and the first nine months of 2005, the amount of trade credits from abroad borrowed by the non-bank private sector went up in parallel with the increase in imports. Although the ongoing tendency of the banking sector to borrow short-term loans from abroad continued in 2004, relative improvement in the structure of this sector led to a substantial increase in long-term loans from abroad. 2.4 billion dollars of a total net amount of 5.7 billion dollars borrowed by the banking sector from abroad in 2004 was long-term loans while short-term loans accounted for 3.3 billion dollars. This change in the maturity structure of loans borrowed by the banks continued in the first nine months of 2005. Hence, long-term loans accounted for 4.8 billion dollars of a total of 6.6 billion dollars borrowed during the same period while short-term loans stood at 1.8 billion dollars.

Decisively implemented macroeconomic stability program helped to create a favourable investment environment by reducing the uncertainties and risk premium in the economy. In this context, in line with the growth in domestic investment spending, non-bank private sector borrowed long-term loans amounting to 4.8 billion dollars from international markets in 2004. This item surpassed the total amount recorded in 2004 and reached 5 billion dollars in the January-September period of 2005.

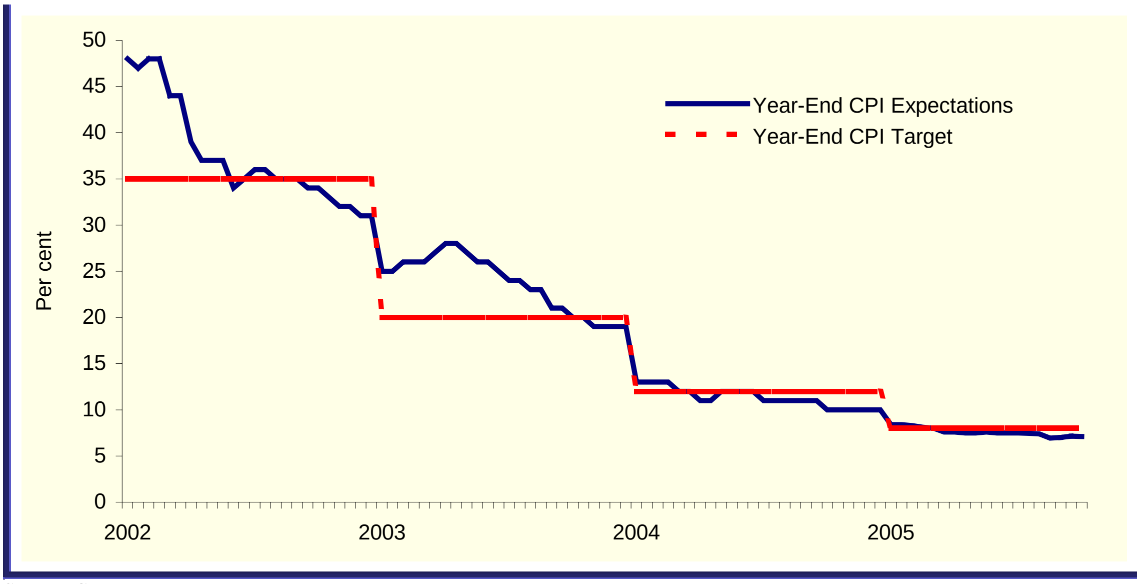
While repayment of loans to the IMF totalled 5.6 billion dollars in the first nine months of 2005, 833 million dollars were borrowed. Thus, net repayments to the IMF were 4.8 billion dollars.

1.3. Monetary and Exchange Rate Policies

Monetary Policy

In 2005, The Central Bank of the Republic of Turkey (CBRT) is continuing its implicit inflation targeting policy, which was initiated in 2002 in line with its primary objective of maintaining price stability. Considerable progress has been made in terms of attaining declared end-year targets, breaking inflation inertia, achieving price stability and enhancing the credibility of the monetary policy. In this context, the difference between the end-year Consumer Price Index (CPI) target and CPI expectations of economic agents which was 13 percentage points at the beginning of 2002 reduced to 0.4 percentage points in the beginning of 2005, confirming the confidence of the economic agents in the implemented policies.

Figure. 1. 1: CPI Targets and CPI Expectations of Economic Agents



Source: CBRT

Base money, net domestic assets and net international reserves, which are used as the main anchors of the implicit inflation targeting, were pursued as performance criteria and indicative targets in 2004 and 2005. Declining inflation and interest rates and the process of reverse money substitution led to a rapid increase in the money demand and base money targets were exceeded for some periods of 2004 and 2005. The structural change in money demand in parallel with declining inflation and interest rates and difficulties in estimating this change were the main reasons for not attaining the base money target. On the other hand, exceeding these limits for some periods did not negatively affect CPI target or inflation expectations.

Table. 1. 5: Performance Criteria, Indicators and Realizations

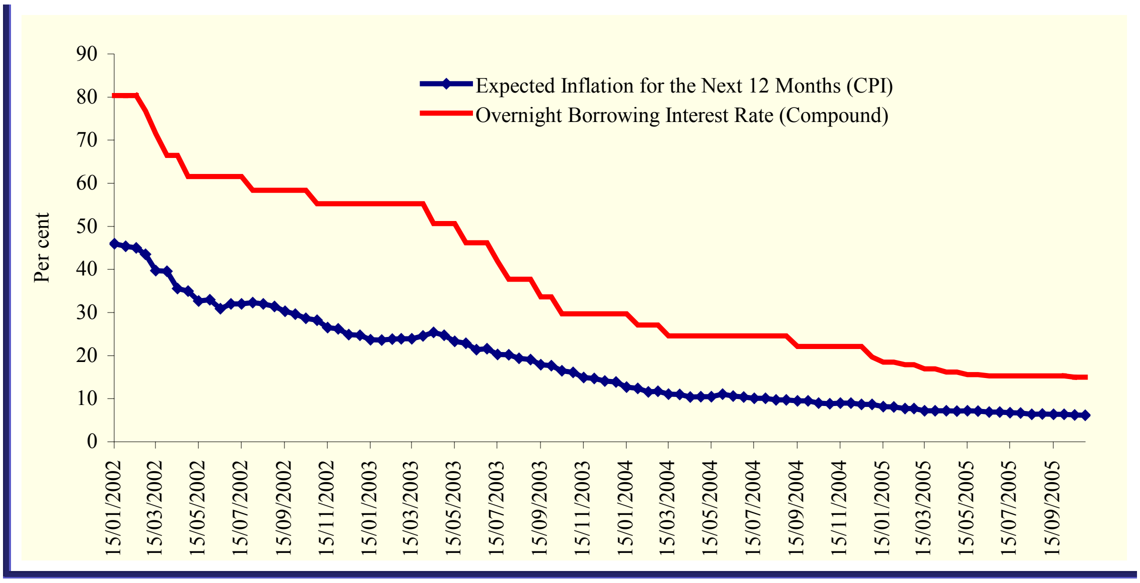
	Upper Limit for Monetary Base(1) (Million YTL)		Upper Limit for Net Domestic Assets(1) (Million YTL)		Lower Limit for Net International Reserves (Million Dollars)	
	Target	**Realization**	**Target**	**Realization**	**Target**	**Realization**
December 31, 2004	20.9 (P)	19.19	35.0(I)	30.12	-2.00(P)	1.29
May 31, 2005	23.6(P)	22.98	37.7(I)	31.32	2.00(P)	5.84
June 30, 2005	23.6(P)	22.60	37.7(I)	23.99	2.00(P)	10.46
September 30, 2005	24.7(P)	26.84	37.8(I)	23.70	2.75(P)	13.17
December 31, 2005	25.0(I)	---	36.4(I)	---	3.80(I)	---

Source: CBRT
(1) Upper limits will be calculated on average stocks in the last five working days that end-up with the above mentioned dates.
(P): Performance criterion, (I): Indicative Target.

In line with the implemented monetary policy strategy, short-term interest rates are used as the main policy tool with the objective of guiding expectations and affecting cost of funding. In 2005, Central Bank made its decisions on short-term interest rates by taking into account current level and future path of inflation, fiscal discipline, labour productivity, international developments and domestic demand. CBRT announced reductions in the short-term interest rates ranging between 0.25 and 1 percentage points in the period of January-November 2005. Thus, overnight lending rate, which was 22 per cent at the end of 2004, was reduced to 17.75 per cent as of November 2005 while overnight borrowing rate declined from 18 per cent to 13.75 per cent in the same period.

Excess liquidity in the market as a result of a monetization after the economic crisis in 2001 was sterilized by the Central Bank through open market operations. Depending on the borrower position of the Central Bank, borrowing rates were used as the reference funding rate by the market. Predicting that there would be a shortage of liquidity in 2005, the Central Bank launched weekly and daily repo auctions as a tool to be used in such a case. As a matter of fact, liquidity shortages actually occurred during certain periods of 2005 and the Central Bank loaned to the market through weekly repo auctions. The role of the Central Bank as a lender in the coming period will increase its influence on short-term lending interest rates. In addition, in order to ensure efficient and flexible liquidity management of banks, the Central Bank started a new implementation entailing the reserve requirements in YTL, which is 6 per cent, will be fulfilled on a two week average basis.

Figure. 1. 2: Short Term Interest Rates and Inflation Expectations



Source: CBRT

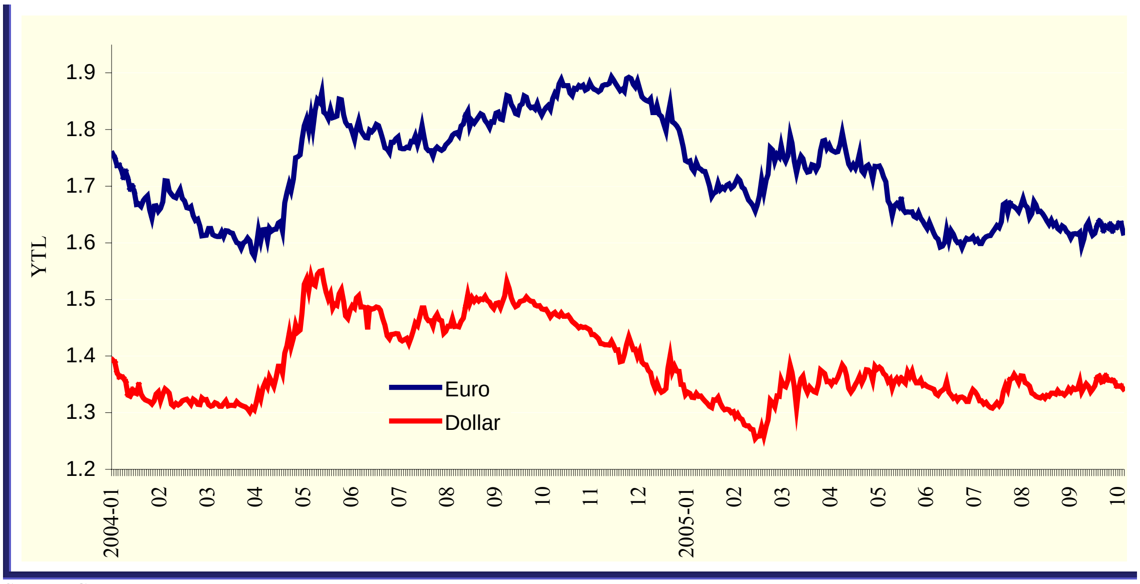
Exchange Rate Policy

In line with the policies pursued in the recent years, the floating exchange rate policy was maintained in 2005 and the Central Bank assumed two different roles in the foreign exchange market as in previous years. In this context, on the one hand the Central Bank held foreign currency auctions in order to strengthen its foreign reserves due to developments regarding reverse money substitution and capital inflows and on the other hand the Central Bank intervened directly in the foreign exchange market in the case of substantial fluctuations in exchange rates or of developments that could potentially lead to substantial fluctuations.

Enhanced confidence in the economic program and policies being implemented, the start of negotiations with the EU for full membership and favourable circumstances for developing countries in the international markets led to an increase in foreign capital inflows in 2005. The continuation of reverse money substitution as well as increasing portfolio investment and foreign direct investment inflows created an excess supply in the foreign exchange market. With a view to preventing the downward excessive volatility in foreign exchange rate and strengthening foreign exchange reserves, the

Central Bank intervened in the foreign exchange market through direct purchases on March 9, June 3, July 22, October 4 and November 18, 2005.

Figure. 1. 3: Developments in Exchange Rates



Source: CBRT

In addition, the Central Bank holds regular foreign exchange purchase auctions to strengthen its foreign exchange reserves in a way not to affect long-term equilibrium level of exchange rate. In 2005, in order to minimize the effects of these purchase auctions on the foreign exchange market, a program for foreign exchange purchases, which was committed not to change the amounts to be purchased unless there is an extraordinary situation, was announced. According to this program, the daily amount to be purchased in an auction was limited to 15 million dollars and the winners of the auction will have an option to sell up to 30 million dollars. In the January-October period of 2005, the Central Bank purchased foreign currency worth 6.3 billion dollars from the foreign exchange market through regular auctions. These purchases also contributed to the fall in the sovereign risk premium in international markets by strengthening the Central Bank's foreign exchange reserves. The Central Bank purchased foreign currency worth 34.5 billion dollars between 2002 and October 2005, from the foreign exchange market, of which 16.9 billion dollars purchased through regular auctions and 17.6 billion dollars purchased through foreign exchange interventions. The Central Bank's foreign exchange reserves, which were 18.4 billion dollars at the end of 2001, went up to 35.2 billion dollars at the end of 2004 and 44 billion dollars at the end of October 2005.

Table. 1. 6: FX Purchases of the Central Bank

(Million Dollars)

	FX Purchase Auctions	Direct FX Purchases	Total
2002	795	16	811
2003	5,653	4,808	10,461
2004	4,104	1,283	5,387
2005 January - October	6,327	11,448	17,809
Total	16,879	17,555	34,468

Source: CBRT

1.4. Financial Sector

Banking Sector

Turkish banking sector, which has undergone an extensive restructuring process within the scope of the program initiated in the first half of 2001, has made a significant progress depending on the success at maintaining economic stability and implemented policies. In this context, total assets of the banking sector, which was 117.7 billion dollars at the end of 2001, displayed a significant performance by increasing to 252.9 billion dollars in the first half of 2005 and a noteworthy improvement in profitability indicators of the banking sector was also observed in the same period. A considerable decrease was recorded in non-performing loans of the banking sector during the same period owing to the stability attained in the economic growth and the affirmative results of the policy tools such as Istanbul Approach.

As a result of falling inflation and interest rates and the improvements in public finance, banks started to concentrated more on their principal duty of intermediation. In this context, the credit stock of banking sector has demonstrated a significant increase in dollar terms and reached 90.7 billion dollars in the first half of 2005.

Since 2004, especially the rise in the loans given by private banks and the differentiation in the composition of bank assets as a result of this rise have caused a change in the risk profile, which is used in the calculation of the capital adequacy ratio. As a matter of fact, due to these developments, a moderate decline in the capital adequacy ratio of the banking sector was realized in the corresponding period. Additionally, the levels of foreign exchange open position of the banking sector were reasonable in 2004 and in the first half of 2005.

Table. 1. 7: Overview of the Banking Sector

	2001	2002	2003	2004	2005 June
Main Aggregates					
Assets (Billion Dollars)	117.7	130.1	178.9	228.3	252.9
Loans (Billion Dollars)	23.4	30.0	47.4	74.0	90.7
Deposits (Billion Dollars)	76.6	84.4	111.3	143.0	152.5
Number of Banks (1)	61	54	50	48	47
Number of Employees (Thousands)	139.0	123.9	124.0	127.9	130.6
Performance Indicators					
Net Profit (Billion Dollars)	-8.2	1.8	4.0	4.5	3.2
Return on Assets (Per cent)	-7.0	1.4	2.2	2.1	1.2
Rate of Return for Equity Capital (Per cent)	-77.0	9.2	15.8	14.0	9.0
Loans/Deposits (Per cent)	30.5	35.5	42.6	51.7	59.5
Risk Indicators					
Capital Adequacy Ratio (Per cent)	20.8	26.1	30.9	28.8	25.0
FX Position in the Balance Sheet (Billion Dollars)	-1.6	- 0.6	-0.0	-1.4	-1.2
Net General Position (Billion Dollars)	-0.5	-0.4	0.3	-0.1	-0.4
Non-Performing Loans/Gross Loans (Per cent)	29.3	17.6	11.5	6.0	5.4
Securities Portfolio/Assets (Per cent)	35.0	40.5	42.8	40.4	39.0

Source: BRSA
(1) The number of banks for 2005 is reported as of September 2005.

In the context of banking sector restructuring, the number of banks has substantially decreased through the withdrawal of insolvent banks out of the banking system and later encouragement of private banks for mergers and acquisitions. In this context, the number of banks, which was 61 at the end of 2001, has declined to 47 as of September 2005.

The program for restructuring the public banks which was put into effect after 2001 crisis has aimed at financial and operational restructuring of these banks and minimizing the adverse effects of these banks on the system. In this scope, the number of branch of public banks, whose duty loses were eliminated, has declined from 2,494 to 1,688 and the number of the employees has decreased from 61,601 to 31,061 throughout the period from December 2000 to September 2005.

With the removal of full guarantee on deposits, which prevents functioning of the banking sector in an efficient and competitive environment, the deposit insurance was limited to 50 thousand YTL on July 5, 2004 after a transition period of one year. The positive developments and increasing confidence in the banking sector after the crisis ensured the proper realization of this transition without incurring additional costs.

Capital Market

Improvements in macroeconomic indicators since 2002 and especially falling interest rates had positive effects on capital markets. As a result of these developments, ISE National 100 Index increased by 292.3 per cent on dollar basis at the end of September 2005 compared to its level in 2002. Meanwhile, market capitalization went up from 33.8 billion dollars at the end of 2002 to 130 billion dollars at the end of September 2005 for all the companies that are quoted in the Istanbul Stock Exchange (ISE).

There are 302 incorporated companies traded in the stock exchange as the end of September 2005. By the same date, there are a total of 37 investment trusts registered to the Capital Market Board (CMB). The number of investment funds investors, went up from 2,632,462 in 2004 to 2,907,988 at the end of September 2005, while the total value of portfolios rose from 18.1 billion dollars to 21 billion dollars. The number of financial intermediaries in the capital market at the end of September 2005 is 150. With the establishment of private pension funds at the end of 2003, not only corporate investment companies were diversified but also demand in the capital market has revived.

Insurance Sector

There were 48 companies in operation in the Turkish insurance sector, including 47 insurance and 1 reinsurance company by the end of 2004. Among these companies, 9 of them are life-insurance companies, 10 of them are private pension and life insurance companies, 1 of them is private pension companies, 15 of them are non-life insurance companies and 12 of them are composite companies functioning in various fields. Turkish insurance sector is a highly concentrated sector. In this respect, in terms of premium generation, the share of the largest 10 companies in the sector was 64.5 per cent as of the end of 2004. These companies have 64.5 per cent of total assets and 69.4 per cent of total equity capital. It is observed that concentration in the sector is much higher when the fact that some of these companies belong to the same capital group is taken into account.

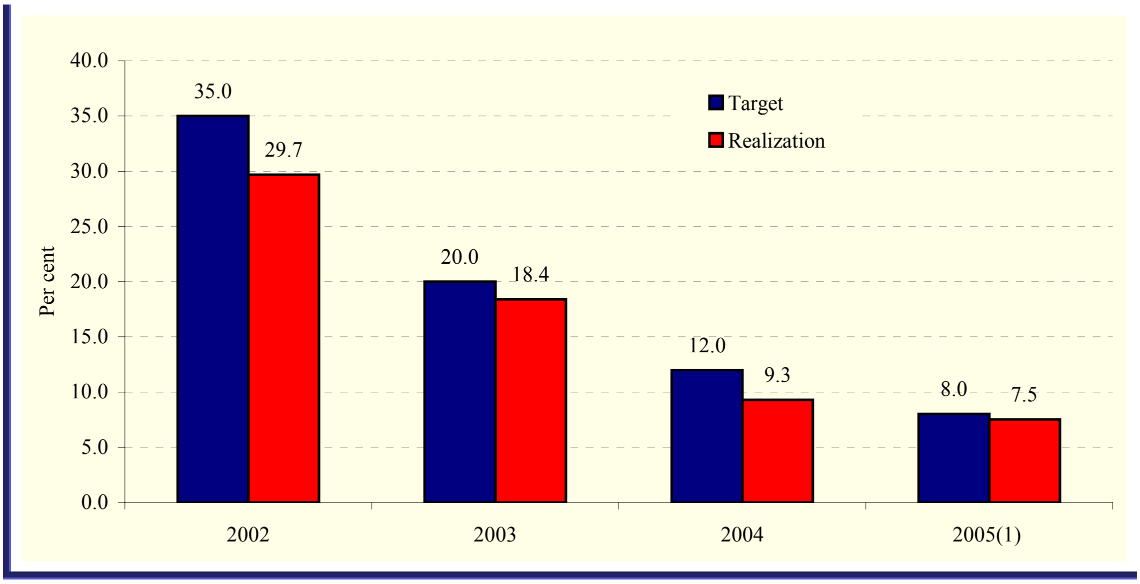
As compared with EU countries, main indicators of Turkish insurance sector imply that the sector is still at the stage of development. Nevertheless, performance of the sector in the last decade gives crucial signals about the potential of the sector. As a matter of fact, between the years of 1994 and 2004, sector's direct premium generation, in terms of dollar, increased by 335 per cent and was realized as 4.7 billion dollars.

Meanwhile, private pension system, which is considered as a complement of public social security system and is expected to play an important role in building long-term funds in the economy, was launched as of October 2003. There are total of 11 private pension companies in the corresponding system and number of investors in the system and premium generation has shown considerable improvements. In this respect, as of November 14, 2005, number of participants and number of contracts have reached 623,564 and 659,276 respectively and the size of funds directed to investment was realized as 908.5 million YTL (669 million dollars).

1.5. Inflation

Considering the price indices based on 1994, annual increase in CPI realized as 9.3 per cent while Wholesale Price Index (WPI) increased by 13.8 per cent by the end of 2004. Annual inflation in consumer prices fell by 9.1 percentage points compared to 2003. Thus, CPI inflation remained below the target also in 2004 as in the years 2002 and 2003. The implemented tight monetary policy and strict adherence to fiscal discipline were effective in this development. Incomes policy compatible with the program, high productivity increases in the economy and strong domestic currency were the other factors that contributed to the realization of the inflation target in 2004.

Figure. 1. 4: CPI Targets and Realizations



Source: SIS, CBRT
(1) 2005 realization figure is as of October.

The downward trend of inflation continued in the first ten months of 2005. The annual increase in consumer prices declined to 7.52 per cent as of October 2005 (Figure 1.4). Annual increase in Producer Price Index (PPI) decreased to 2.57 per cent during the same period. The expectation of year-end CPI inflation dropped below the year-end inflation target since March 2005. An annual increase of 6.41 per cent in Indicators for The CPIs Having Specified Coverages as of October, which is calculated by excluding energy, alcoholic beverages and tobacco products, other products with administered prices and indirect taxes, indicates that indirect taxes and energy prices made a substantial contribution to the increase in consumer prices in the previous year.

While CPI inflation realized as 5.79 per cent in January-October period of 2005, PPI inflation was 3.69 per cent. The realized rate of inflation in the first ten months of the year indicates that CPI inflation may remain below 8 per cent, which is the end-year inflation target of 2005. In terms of consumer price inflation, the leading developments were the upward trend in international prices of oil and raw materials, persisting price rigidity in the services sector and the appreciation of domestic currency in the corresponding period.

Box. 1. 2: Price Indices Based on 2003: Scope and Method

The State Institute of Statistics (SIS) has started publishing Producer Prices Index (PPI) and Consumer Price Index (CPI) based on 2003 as of February 2005 instead of Wholesale Price Index (WPI) and CPI based on 1994. With these new indices, it is aimed at representing the changing consumer preferences more correctly and measuring inflation more accurately by using new methods and procedures.

With the new indices, major changes in the scope of items and their weights, the way of compilation of prices and calculation method were made,. The number of main expenditure groups, which was 10 in the CPI based on 1994, increased to 12 in the CPI based on 2003 as expenditure on food, alcoholic beverages, and tobacco were divided into two groups and communication services were defined as a separate group. Other significant changes in CPI were the inclusion of technology intensive goods such as cellular phones, digital cameras, etc., the exclusion of relative house rent item, which constitutes an important part of the housing group and the increase in the weights of energy items such as electricity, natural gas, and fuel oil products. In addition, Indicators for The CPI's Having Specified Coverages has started to be published together with CPI based on 2003 in order to purge the index from temporary or external effects. Meanwhile, the distinction between the private and the public sector, which was the case in WPI, has been removed with PPI. More importantly, sales prices excluding VAT and similar taxes have started to be compiled.

Consumer Prices Index

CPI based on 2003, which has been published since February 3, 2005, is calculated in accordance with the Council Regulation No. EC/2494/95 of the EU. In this context, while the demographic scope of the index consists of households, tourists and institutional population, expenditures consist of all final monetary expenditures for domestic consumption. Thus, CPI comprises all goods and services purchased by consumers to satisfy their needs excluding goods and services produced by households and relative expenditures within the boundaries of Turkey. Classification of Individual Consumption by Purpose (COICOP), which is a sub-category of System of National Accounts (SNA) has been used for the calculation of CPI in line with the EU practices.

The new index is calculated for 26 Official Nomenclature of Territorial Units for Statistics (NUTS II) and there are 12 main groups in the classification of the index for goods and services. These main groups and their weights are presented in Table 1.

Table. 1: CPI Weights

	1994	2003
Food and non-alcoholic beverages	31.09	29.42
Alcoholic beverages and tobacco		4.67
Clothing and footwear	9.71	8.09
Housing, water, electricity, gas and other fuels	25.80	16.90
Furnishings, household equipment, routine maintenance of the house	9.35	6.47
Health	2.76	2.71
Transport	9.30	10.42
Communications	---	4.82
Recreation and culture	2.95	3.60
Education	1.59	2.15
Hotels, cafes and restaurants	3.07	5.87
Miscellaneous goods and services	4.38	4.87
Total	100.00	100.00

Source: SIS

The prices of the items included in the consumer prices index are their sale prices in advance including taxes. The weight structure of fresh fruits and vegetables and garments group, which is calculated by using changing weights, is maintained in the new index. Meanwhile, the new index differs from the previous one in that it uses geometric average rather than arithmetic average in calculation of the average value of prices compiled from goods and services with high price differentiation and substitution.

In addition, together with indices based on 2003, Indicators for the CPI's Having Specified Coverages, which are called as core inflation indicators, have started to be published in order to eliminate temporary effects in consumer prices and to measure medium and long-term inflationary trends. Seven different special CPI indicators with a special scope were formed in order to identify potential shocks to inflation and to assess possible effects on inflationary trends depending on the period. These indicators are defined as CPI excluding seasonal products (A); CPI excluding unprocessed food (B); TUFE excluding energy (C); CPI excluding energy and unprocessed food (D); CPI excluding energy, alcoholic beverages and tobacco products (E); CPI excluding energy, alcoholic beverages, tobacco products, other products with administered prices and indirect taxes (F); and CPI excluding energy, alcoholic beverages, tobacco products, other products with administered prices, indirect taxes and unprocessed food (G).

Indicators for the CPI's Having Specified Coverages are also regarded as a major tool for informing the public about the sources of variations in prices. Depending on the characteristics of temporary shocks affecting inflation, different indicators of the CPI's Having Specified Coverages may occasionally stand out in different periods. For instance, the impact of a variation in unprocessed food resulting from climatic conditions on consumer prices can be announced by using CPI index excluding the prices of unprocessed food.

Producer Prices Index

Producer Prices Index is an indicator, which was for the first time calculated as an index based on 2003 and has been announced to public since February 3, 2005. According to definitions of EUROSTAT, producer prices index must comprise the prices of all products produced in the country so as to ensure the consistency with national production index. The EU countries are required to calculate PPI and provide these data to the EUROSTAT in accordance with the Council Regulation EC/1165/98 regarding short-term statistics. PPI of Turkey is calculated at international standards in accordance with this objective.

In the PPI calculations, Prodcom 2002 product classification and Statistical Classification of Economic Activities in the European Union (NACE Rev.1.1).based on International Standard Industry Classification of All Economic Activities are used.

Prices in the PPI are calculated as ex-factory prices of products, which are manufactured in the national economy within a certain reference period and sold in the country, excluding taxes, transportation costs, retail and wholesale trade costs. PPI based on 2003 consists of agriculture, mining and stone quarrying, manufacturing industry, and electricity, gas, water sectors (Table 2). In addition, the new index does not make any distinction between the private and public sectors.

Table. 2: PPI Weights

	1994	2003
Agriculture	22.22	20.65
Mining and Stone Quarrying	2.47	1.51
Manufacturing Industry	71.12	72.07
Electricity, gas and water	4.19	5.77
Total	100	100

Source: SIS

As in the CPI, chained Laspeyres index formula is used in PPI. By this way, it is possible to update the index basket and its weight structure in the beginning of every year. The periods of price compilation in the new and the previous indices are the same. Ex-factory prices and prices in advance excluding Value Added Tax and other taxes are compiled without taking into account special discounts. Prices are collected from firms on certain days of each month and the simple average of these days is calculated as the monthly current price.

1.6. Public Finance

Developments in the Consolidated Budget Revenues and Expenditures

The budget for 2004 was aimed at achieving a high primary budget surplus with a view to ensuring sustainability of public debt stock. In order to attain this objective, structural reforms were continued and measures to increase revenues and to reduce expenditures were taken when necessary throughout 2004.

A new budgetary classification was introduced for the agencies under the consolidated budget at the beginning of 2004. The new system called Analytical Budgetary Classification, allows functional classification, international comparisons, enhancement of fiscal transparency, improvement of accountability and identification of those responsible for programs through a detailed institutional coding.

In 2004, special communication tax was extended to cover telecommunication services provided by Turkish Telecom and made permanent. Special transactions tax was abolished, but a part of transactions subject to this tax was converted to stamp duty and charges and fees while the remaining part was included in the tax on games of chance thereby became permanent. In order to compensate for the revenue loss arising from abolishment of fund levy on income and corporate tax, the corporate tax rate was raised to 33 per cent only for income obtained in 2004 and income and corporate tax withholding rates were increased. A fixed Special Consumption Tax (SCT) was put into effect in addition to proportional SCT on tobacco products, while the SCT rates on motor vehicles were adjusted and the taxation system was rearranged. In addition, Resource Utilization Support Fund (RUSF) levy imposed on consumer loans was raised from 10 per cent to 15 per cent while RUSF levy imposed on commercial loans was lowered to zero.

Box. 1. 3: IMF-Defined Primary Budget Surplus

Primary consolidated budget surplus, which was defined under the IMF stand-by agreements, is obtained by making a series of adjustments to income and expenditure items. The adjusted items and IMF-defined primary budget surplus figures are presented in the following table.

Table: IMF-Defined Primary Budget Surplus

(Per cent of the GDP)

	2001	2002	2003	2004
Primary Surplus	**6.29**	**3.67**	**5.12**	**6.08**
Profits of CBRT (-)	0.26	1.08	0.00	0.00
Interest Receipts (-)	0.29	0.56	0.35	0.82
Privatization Revenues (-)	0.86	0.00	0.00	0.00
Tax Arrears (+)	0.00	0.10	0.00	0.00
Risk Account (+)	0.00	0.00	0.26	0.11
Revaluation Difference (-)	0.49	0.01	0.01	0.00
SSI Adjustment (Previous Year Debts) (-)	0.00	0.00	0.09	0.00
SSI Adjustment (Payments Credit to Budget) (+)	0.00	0.34	0.00	0.00
SSI Adjustment (Appropriation – Cash Difference) (+)	0.00	0.00	0.00	0.01
Seniority Allowance (+)	0.00	0.07	0.00	0.00
Dividend Payments of State Banks (-)	0.00	0.00	0.00	0.26
IMF-Defined Primary Surplus	**4.39**	**2.53**	**4.93**	**5.13**

Source: SPO, Ministry of Finance
SSI: Social Security Institutions

In addition to measures to increase revenues, some expenditure-decreasing measures were also taken in 2004. New civil servant recruitment was limited to 40,000 under the Budget Law and increases in salaries and wages were determined in accordance with inflation target. Value Added Tax (VAT) rate on medical drugs was reduced and a reference pricing system was launched.

As a result of these developments, in 2004, the ratio of consolidated budget revenues to GDP stood at 27.9 per cent, while the ratio of expenditures to GDP was 35 per cent. Thus, in 2004, the ratio of budget deficit to GDP was 7 per cent, while the ratio of the primary budget surplus to GDP was 6.1 per cent. Furthermore, IMF-defined primary budget surplus target was achieved in 2004 and its ratio to GDP was realized as 5.1 per cent.

Table. 1. 8: Consolidated Budget Balance

(Per cent of the GDP)

	2001	2002	2003	2004	2005*
Expenditures	45.5	42.2	39.0	35.0	34.4
Non-Interest Expenditures	22.5	23.5	22.7	21.8	22.7
Current Expenditures	11.4	11.0	10.7	10.4	10.4
Personnel	8.5	8.3	8.4	8.5	8.1
Other	2.9	2.7	2.3	1.9	2.2
Investment	2.7	3.0	2.0	1.8	2.0
Transfer	31.4	28.2	26.3	22.8	22.0
Non-Interest Transfer	8.4	9.5	10.0	9.7	10.3
Interest Payments	23.0	18.7	16.3	13.1	11.7
Revenues	28.8	27.2	27.9	27.9	28.4
General Budget	28.4	26.9	27.4	27.5	27.9
Tax Revenues	22.3	21.5	23.4	23.1	24.2
Non-Tax Revenues	4.2	3.9	2.8	3.9	3.5
Special Revenues and Funds	2.0	1.5	1.1	0.5	0.2
Annexed Budget	0.3	0.4	0.5	0.4	0.4
Primary Surplus	6.3	3.7	5.1	6.1	5.7
IMF-Defined Primary Surplus	4.4	2.5	4.9	5.1	5.0
Budget Deficit	-16.7	-15.0	-11.2	-7.0	-6.0

Source: SPO, Ministry of Finance
Note : The figures given for 2004 are not based on analytical budget code system in order to make them comparable with the figures of the previous years.
* The figures for budget

The budget for 2005 was also aimed at reducing public debt stock by achieving a high primary budget surplus and thus ensuring debt sustainability. It is intended that the ratios of consolidated budget revenues, consolidated budget expenditures, and consolidated budget deficit to GDP will be 28.4, 34.4, and 6 per cent, respectively. Besides, IMF-defined primary budget surplus to GDP was targeted as 5 per cent. Measures aimed at increasing revenues and reducing expenditures in line with these objectives, are listed below:

Measures to increase revenues:

- SCT rates on motor vehicles were raised in November 2004 in order to increase budget revenues while coping with current account deficit.
- SCT rates on alcoholic beverages and tobacco products was increased in February 2005. Taxation of cigarettes based on their oriental tobacco content, which prompted cigarette manufacturers to use different pricing and product diversification strategies in a way to cause loss of tax revenues, was abandoned in July and a single proportional SCT (58 per cent) was adopted for all products. In addition, it was stipulated that the tax to be computed by using proportional SCT rate could not be less than the minimum fixed tax (YTL 0.06 per unit/gram). Thus, harmonization with EU acquis communautaire was ensured in taxation of tobacco products.
- SCT rate on some durable consumer goods and other goods included in List SCT IV was raised from 6.7 per cent to 20 per cent.

- A revenue of 363 million YTL was raised through the sale of hotels owned by the Civil Servants Pension Fund.

Measure to decrease expenditures:

- New civil servant recruitment was limited to 48 thousands under the Budget Law for 2005.
- Wages and salaries in the public sector were raised by 10.7 per cent annually on average in line with inflation target.
- A Budget Implementation Directive, which determines the medical treatment prices excluding VAT, was put into effect at the beginning of 2005, while average prices of medical treatment were not increased compared to 2004. As of 2005, patients holding green cards were allowed to get their medications from pharmacies free of charge, but in order to prevent cases of fraud, .patients holding green cards were required to pay 20 per cent of the price after May 2005
- Prices of medical drugs were reduced around 10 per cent in average in accordance with a protocol signed among the Ministry of Finance, the Ministry of Labour and Social Security and the Turkish Pharmacists' Association and put into effect in February 2005. In addition, prices of medicines were reduced by 8.8 per cent to be effective from July 2005 in parallel with the depreciation of foreign currencies and the scope of equivalent medicine system was extended in order to increase the number of equivalent groups from 77 to 135.

In addition to revenue-increasing and expenditure-decreasing measures, some arrangements were made with a view to increasing employment and to eliminating regional development disparities. The number of provinces covered by the Law No. 5084 on Promotion of Investments and Employment was raised from 36 to 49. VAT rates on educational materials and services, medicines and health care services and some basic food was reduced. The highest tariff rate for income tax decreased from 40 per cent to 35 per cent in wage incomes and from 45 per cent to 40 per cent in other income categories. Concurrently with these reductions, corporate tax rate was brought down from 33 per cent to 30 per cent.

The ratio of budgetary transfers to social security institutions to GDP remained unchanged as compared with 2003 due to measures taken in 2004. The ratio of budgetary transfers to social security institutions to GDP is expected to rise as a result of a decrease in premium collection rate in BAG-KUR due to expectations that outstanding premiums would be restructured and transfers of some public health facilities, including SSK hospitals, to the Ministry of Health on February 19, 2005 as a phase of the transition to a universal health insurance system.

By a legislative arrangement put into effect on July 7, 2005, the monthly allowances paid to disabled persons who have no income or property were increased by 100 per cent, while the monthly allowances of such disabled persons who cannot survive without help were raised by 200 per cent. In addition, monthly allowances were allocated to those who have a disabled relative under the age of 18. In addition, the amount of expenses up to the twice of net the minimum wage incurred by disabled persons in need of care will be reimbursed by the government. Due to these changes, public expenditures allocated to these parties are expected to rise by 244 million YTL in 2005.

Table. 1. 9: Consolidated Budget Balance in the January-October Period

(Percentage Change)

	January-October		
	2003	**2004**	**2005**
Expenditures	26.2	7.5	4.6
Non-Interest Expenditures	34.3	14.9	22.1
Current Expenditures	27.6	12.4	13.2
Personnel	33.0	19.3	11.8
Other	5.9	-22.4	24.3
Investment	-7.9	-6.0	42.4
Transfer	28.1	6.3	-0.5
Non-Interest Transfer	52.2	20.4	28.6
Interest Payments	17.4	-1.8	-20.9
Revenues	30.1	19.5	21.9
General Budget	29.6	19.9	21.9
Tax Revenues	42.6	18.5	21.2
Non-Tax Revenues	-16.0	63.4	33.5
Special Revenues and Funds	-14.0	-55.1	-43.0
Annexed Budget	60.5	-3.0	22.9
Primary Surplus	17.4	35.4	21.2
Budget Deficit	17.5	-22.6	-62.2
Memo item:			
Rate of Increase in CPI (January-October Average (1))	26.3	8.4	8.3

Source: SPO, Ministry of Finance
(1) The increase in CPI for 2003 is calculated using CPI based on 1994, while the increase in CPI for the other years are calculated using the CPI based on 2003.

As a result of these developments, in the January-October period of 2005, consolidated budget revenues went up by 21.9 per cent compared to the same period of 2004 and reached 117.1 billion YTL, while consolidated budget expenditures rose by 4.6 per cent and reached 126.5 billion YTL. Thus, consolidated budget deficit dropped by 66.2 per cent in the first ten months of 2005 with respect to same period of previous year and dwindled to 9.4 billion YTL and primary consolidated budget surplus increased by 21.2 per cent and reached 29.4 billion YTL. Interest payments in the first ten months of 2005 was 20.9 per cent less than interest paid in the corresponding period of the preceding year.

Developments in the General Government Revenues and Expenditures

General government balance is obtained through consolidation of the revenues and expenditures of local governments, extra-budgetary funds, social security institutions, revolving funds and the consolidated budget.

The ratio of general government revenues to GDP, which was 40.7 per cent in 2003, rose 1 percentage point and reached 41.7 per cent as a result of increases recorded in revenues of social funds, privatization and factor revenues. The ratio of general government tax revenues to GDP kept its previous year level of 23.6 per cent in 2004. The ratio of general government tax revenues to general government total revenues declined from 58 per cent to 56.5 per cent compared to 2003. As a consequence of measures taken with a view to attaining economic program goals, the ratio of indirect taxes to GDP went up. The share of direct taxes in GDP dwindled due to negative effects of a nominal fall in interest rates and inflation-adjusted accounting initiated in

2004. In addition, base-effect resulting from additional wealth tax levied in 2003 caused a decline in the share of wealth tax in GDP in 2004 compared to the preceding year.

Table. 1. 10: Revenues and Expenditures of the General Government (1)

(Per cent of the GDP)

	2001	2002	2003	2004
Taxes	25.6	22.2	23.6	23.6
Direct	10.4	7.8	7.6	7.3
Indirect	14.9	14.0	15.1	15.7
Wealth	0.3	0.4	0.9	0.6
Non-Tax Revenues	2.5	3.2	3.1	3.1
Factor Incomes	6.3	7.4	6.4	6.9
Social Funds	7.4	6.9	7.4	7.8
Total	41.7	39.7	40.6	41.3
Privatization Revenues	0.9	0.2	0.1	0.4
Total Revenues	42.6	39.9	40.7	41.7
Current Expenditures	18.2	18.1	18.0	18.2
Investment Expenditures	4.8	4.6	3.6	3.2
Fixed Investment	4.7	4.6	3.6	3.1
Change in Stocks	0.0	0.0	0.0	0.0
Transfer Expenditures	35.6	30.8	29.0	25.6
Current Transfers	34.3	29.7	28.4	24.8
Capital Transfers	1.2	1.0	0.6	0.7
Stock Revaluation Fund	0.0	0.0	0.0	0.0
Non-Interest Expenditure	34.9	34.2	33.9	33.5
Total Expenditures	58.5	53.5	50.7	46.9
Borrowing Requirement Excluding Interest Payment	-7.8	-5.7	-6.8	-8.2
Adjusted Borrowing Requirement Excluding Interest Payment (2)	-4.9	-3.0	-5.5	-6.0
Borrowing Requirement	15.9	13.6	10.0	5.2
Borrowing Requirement Compatible with Fiscal Notification	29.8	12.4	9.6	3.8

Source: SPO

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

(1) Tax rebates/refunds are not included in the figures for revenues and expenditures.

(2) Borrowing requirement excluding interest payment figures are calculated by adjusting the interest receipts, privatization revenues, CBRT profits, risk account, revaluation difference, etc. General government primary surpluses agreed with the IMF for 2001-2004 period were 5.5 per cent, 3 per cent, 5.5 per cent and 6.1 per cent, respectively. Total primary surpluses including SEEs were 5.7 per cent, 4.3 per cent, 6.6 per cent and 7.1 per cent, respectively.

The ratio of total general government expenditures to GDP, which was 50.7 per cent in 2003, dwindled to 46.9 per cent in 2004 especially due to the decline in interest payments. During the same period, the share of expenditures excluding interest payments in GDP decreased by 0.4 percentage points due to falling investment expenditures.

As a result of these developments, the share of general government borrowing requirement in GDP retreated from 10 per cent in 2003 to 5.2 per cent in 2004. The ratio of primary surplus to GDP increased by 1.4 percentage points and reached 8.2 per cent during the same period. Borrowing requirement, compatible with the fiscal notification, was below the general government borrowing requirement and accounted for 3.8 per cent of GDP in 2004, down from 9.6 per cent in 2003.

Box. 1. 4: Adjustments in General Government Balance in the Context of Fiscal Notification

Through various adjustments, the deficit of the general government and the scope of the debt stock and accounting records are being harmonized with the budget deficit and debt definitions of the European Union and every year on 1 March, these are communicated to the relevant units of the European Union in the form of fiscal notification tables.

During preparation of fiscal reporting tables;

- Revenues and expenditures (duty losses of the state banks, etc.) which are defined as such in the ESA 95 rules but not included in the consolidated budget deficit are added to the budget; and accounts which do not comply with the definition of revenue (privatization, revaluation differences, revenue of issuing coins, etc.) or expenditure (risk account, etc.) but which are included in the consolidated budget are eliminated from the budget,
- Revenues and expenditures, which are reported in the consolidated budget on a cash basis, are changed to the required values on an accrual basis. Therefore, an adjustment is made to correct for accrual and collection differences,
- Interest expenditures on the public debt stock are calculated on an accrual basis and allocated to the year to which they belong.

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

Table: General Government Borrowing Requirement Compatible with Fiscal Notification

(Per cent of the GDP)

	2001	2002	2003	2004
General Government Borrowing Requirement	**15.9**	**13.6**	**10.0**	**5.2**
Privatization Revenues	0.9	0.0	0.0	0.0
Risk Account	0.0	0.0	-0.3	-0.1
Claims and Credits (Net)	-3.6	-1.3	-2.5	-2.3
Paid and Accrued Interest Rate Differences	4.5	0.3	2.2	1.0
Duty Loss of State Banks	12.9	0.0	0.2	0.0
Other	-0.8	-0.2	0.0	0.0
General Government Borrowing Requirement (Compatible with Fiscal Notification)	**29.8**	**12.4**	**9.6**	**3.8**

Source: SPO, Ministry of Finance, The Undersecretariat of Treasury

Public Debt Stock

In 2003 and 2004, structural measures to resolve the problems in the financial system and decisive implementation of the economic program launched in 2002 have yielded positive results. Thus, achievement of political stability and fiscal discipline as well as the implemented borrowing strategy led to a fall in the borrowing requirement and borrowing costs. Consequently, the ratio of general government gross debt stock to GDP fell by 5.4 percentage points to 74.8 per cent at the end of 2004.

Table. 1. 11: General Government Gross Debt Stock

(Per cent of the GDP)

	2001	2002	2003	2004
Domestic Debt	69.3	54.7	54.8	52.9
External Debt	33.3	34.8	25.4	21.9
Total General Government	102.6	89.5	80.2	74.8

Source: SPO, The Undersecretariat of Treasury

Note: Debt stock includes gross debt of general government (total public sector excluding SEEs). Therefore, the definitional difference should be taken into account when comparing these figures with the net public debt stock including SEEs which is announced by the Undersecretariat of Treasury.

The consolidated budget domestic debt stock, which was 194.4 billion YTL, 54 per cent of GDP, at the end of 2003 increased to 224.5 billion YTL at the end of 2004 while the consolidated budget domestic debt stock to GDP ratio fell approximately by 2 percentage points to 52.1 per cent in the same year. The consolidated budget domestic debt stock reached 242.8 billion YTL as of October 2005.

Table. 1. 12: Composition of Consolidated Budget Domestic Debt Stock

	2001	2002	2003	2004	2005 Oct.	2001	2002	2003	2004	2005 Oct.
	At Current Prices, Billions YTL					Percentage Distribution				
Cash	58.4	89.3	130.5	165.6	188.8	47.8	59.6	67.1	73.8	77.8
Fixed Rate	17.7	37.6	68.6	94.9	97.2	14.5	25.1	35.3	42.3	40.1
Floating Rate	11.4	17.4	29.1	36.3	56.7	9.4	11.6	15.0	16.2	23.4
FX Denominated	7.1	16.5	16.8	26.6	30.3	5.8	11.0	8.7	11.9	12.5
FX Indexed	22.1	17.8	16.0	7.7	4.5	17.6	11.9	8.2	3.4	1.8
IMF Credits	13.8	9.7	8.5	3.7	0.4	11.3	6.5	4.4	1.6	0.2
Swap	7.7	7.6	7.5	4.0	4.0	6.3	5.1	3.8	1.8	1.7
Others	0.5	0.5	0.0	0.0	0.0	0.4	0.3	0.0	0.0	0.0
Non-Cash	63.8	60.6	63.9	58.9	54.0	52.2	40.4	32.9	26.2	22.2
Fixed Rate	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Floating Rate	49.5	46.7	54.1	53.8	49.7	40.5	31.2	27.8	24.0	20.5
FX Denominated	12.4	11.9	7.9	3.4	2.7	10.1	7.9	4.1	1.5	1.1
FX Indexed	1.9	2.0	1.9	1.7	1.6	1.6	1.3	1.0	0.8	0.6
Total Stock	122.2	149.9	194.4	224.5	242.8	100.0	100.0	100.0	100.0	100.0

Source: The Undersecretariat of Treasury

The share of YTL denominated government domestic borrowing instruments in the consolidated budget domestic debt stock was 82.4 per cent at the end of 2004 and 83.9 per cent at the end of October 2005. The corresponding increase in this ratio mainly stemmed from a higher use of YTL denominated instruments in the context of the borrowing strategies which aimed at alleviating exchange rate risk. The share of floating rate instruments in the domestic debt stock declined to 48.5 per cent at the end of 2004 since fixed rate instruments were mainly used for borrowing and non-cash floating rate instruments were redeemed. The share of floating rate instruments in the domestic debt stock increased to 56.2 per cent in October 2005 as a result of the issuance of 5-year YTL denominated floating rate instruments.

Table. 1. 13: Interest Composition of Consolidated Budget Domestic Debt Stock

	2002	2003	2004	2005 Oct.	2002	2003	2004	2005 Oct.
	At Current Prices, Billions of YTL				Percentage Distribution			
Fixed Rate	54.4	85.0	115.6	106.3	36.3	43.7	51.5	43.8
Floating Rate	95.5	109.4	108.9	136.5	63.7	56.3	48.5	56.2
Total	149.9	194.4	224.5	242.8	100.0	100.0	100.0	100.0

Source: The Undersecretariat of Treasury

In 2001, the share of the borrowing instruments held by the public sector in the domestic debt stock reached 66 per cent due to borrowing instruments issued in order to dispose of duty losses of the public banks and to recapitalize these banks as well as instruments issued to Savings Deposit Insurance Fund (SDIF) for the restructuring of the banking sector. This share fell after redemption of these instruments through borrowings from the market over years and it dropped by 11 percentage points to 37.1 per cent at the end of 2004 and realized as 32.5 per cent in October 2005.

Table. 1. 14: Domestic Debt Stock Composition by Lenders

	2001	2002	2003	2004	2005 Oct.	2001	2002	2003	2004	2005 Oct.
	At Current Prices, Billions of YTL					Percentage Distribution				
Total	122.2	149.9	194.4	224.5	242.8	100.0	100.0	100.0	100.0	100.0
Public	80.6	79.1	92.6	83.3	78.9	66.0	52.8	47.7	37.1	32.5
CBRT	18.8	18.4	18.4	18.4	18.4	15.4	12.3	9.5	8.2	7.6
State Banks	22.7	24.3	27.2	27.5	27.2	18.6	16.2	14.0	12.2	11.2
SDIF Banks	15.1	11.0	15.1	8.3	5.9	12.3	7.4	7.7	3.7	2.4
IMF Credits	13.8	9.7	8.5	3.7	0.4	11.3	6.5	4.4	1.6	0.2
Other	10.3	15.7	23.4	25.4	27.0	8.4	10.5	12.1	11.3	11.1
Market*	41.5	70.8	101.8	141.1	163.9	34.0	47.2	52.3	62.9	67.5

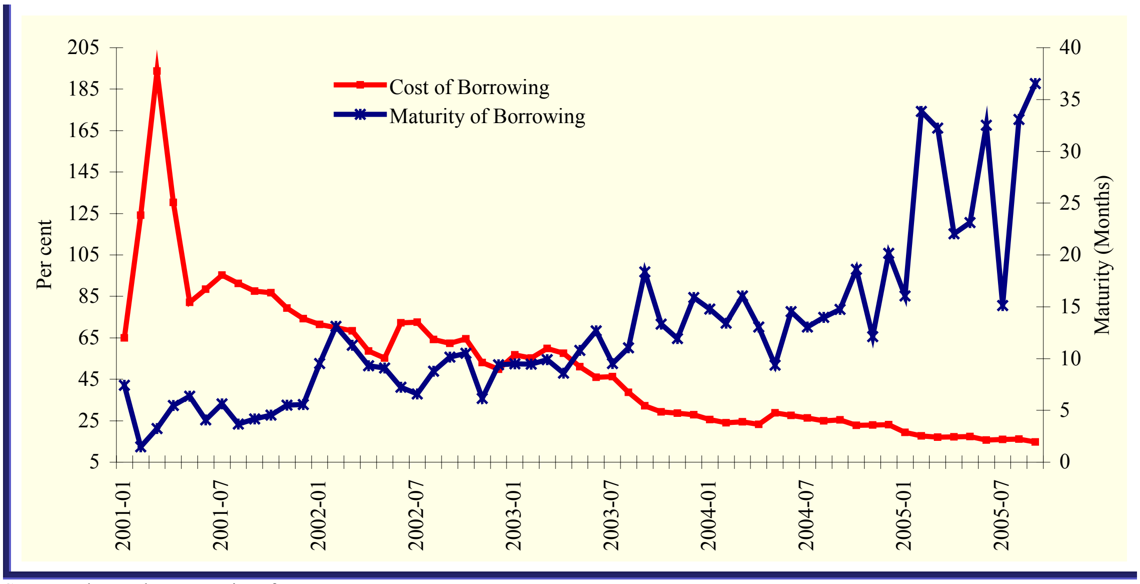
Source: The Undersecretariat of Treasury
* The figure which indicates market includes SDIF Banks' deposit transfers (4.4 billion of YTL) for December 2001.

The cost of borrowing in YTL, which was 28.5 per cent in December 2003, fluctuated as a result of the referendum held in Cyprus in 2004 and announcements of the US Federal Reserve Bank about interest rates increases, but tended to decline in compliance with completion of the review of the economic program and strengthening positive expectations about EU membership and it fell to 23.1 per cent in December 2004.

In 2005, beginning of the negotiations with the EU, a new stand-by agreement with the IMF, continuation of structural reforms in the context of the implemented economic program and developments in the field of privatization maintained the existing positive environment in the markets and thereby borrowing costs has continued to fall and the cost of domestic borrowing in YTL dwindled to 15.7 per cent in October.

The average real interest rate of domestic debt stock, which was 11.9 per cent at the end of December 2003, declined to 9.5 per cent at the end of 2004 and to 7.8 per cent as of September 2005.

Figure. 1. 5: Maturity and Cost of Treasury's Borrowing



Source: The Undersecretariat of Treasury

The average maturity of cash domestic borrowing, which was 11.5 months in 2003, increased to 14.7 months in 2004 and 27.7 months in the first ten months of 2005 as a result of policies aiming to reduce the Treasury's liquidity risk. In this context, average borrowing maturity was lengthened considerably through 5-year YTL denominated instruments with both fixed and floating rate, which were issued in 2005 for the first time.

The remaining term of domestic debt stock to maturity, which was 25.1 months in 2003, declined to 20.6 months at the end of 2004 and was realized as 23.2 months in October 2005. The corresponding decline in the maturity structure resulted from a fall in the share of non-cash instruments in the total debt stock through their redemption. The remaining term of cash instruments to maturity declined from 12.4 months at the end of 2003 to 11.8 months at the end of 2004 and it increased to 18.9 months in October 2005 as a result of attained confidence environment.

Table. 1. 15: The Structure of General Government External Debt Stock

	Million Euros					Percentage Distribution				
	2001	2002	2003	2004	2005 June	2001	2002	2003	2004	2005 June
By Maturity	46,806	56,755	52,417	51,669	52,284	100.0	100.0	100.0	100.0	100.0
Short-Term	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0
Medium-Long Term	46,806	56,755	52,417	51,669	52,284	100.0	100.0	100.0	100.0	100.0
By Lender	46,806	56,755	52,417	51,669	52,284	100.0	100.0	100.0	100.0	100.0
International Organizations	7,681	20,175	19,141	19,619	19,246	16.4	35.5	36.5	38.0	36.8
Government Institutions	7,609	6,797	5,730	4,896	4,493	16.3	12.0	10.9	9.5	8.6
Commercial Banks	18,475	17,213	15,578	15,947	15,598	39.5	30.3	29.7	30.9	29.8
Other Private Creditors	13,041	12,570	11,968	11,207	12,948	27.9	22.1	22.8	21.7	24.8
By Currency	46,806	56,755	52,417	51,669	52,284	100.0	100.0	100.0	100.0	100.0
USD	23,959	22,913	21,269	21,881	24,525	51.2	40.4	40.6	42.3	46.9
DEM	81	0	0	0	0	0.2	0.0	0.0	0.0	0.0
JPY	4,984	4,203	2,993	2,110	1,980	10.6	7.4	5.7	4.1	3.8
EUR	15,112	14,847	13,858	13,389	12,102	32.3	26.2	26.4	25.9	23.1
SDR	526	13,385	13,389	13,557	13,017	1.1	23.6	25.5	26.2	24.9
Other	2,143	1,406	908	732	661	4.6	2.5	1.7	1.4	1.3

Source: The Undersecretariat of Treasury

Contrary to 2004 in PEP 2005, foreign debt stock figures were given in compliance with the general government definition (Table 1.15).

After the crisis in 2001, the share of loans borrowed from international institutions in the foreign debt stock almost doubled in 2002 and remained unchanged in 2003-2005 period. Besides, the shares of commercial banks and other private creditors in foreign debt stock in the second quarter of 2005 were 29.8 per cent and 24.8 per cent, respectively.

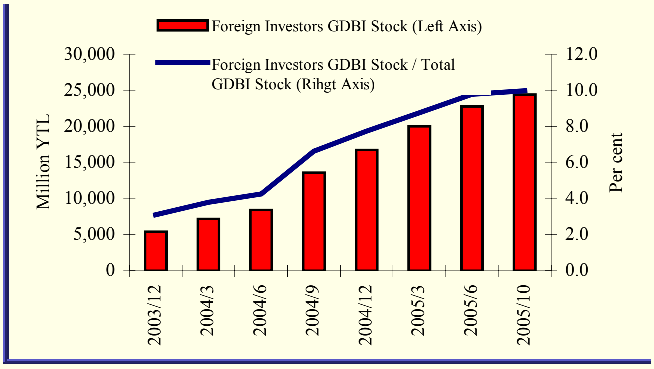
The foreign exchange composition of foreign debt stock denotes that the share of US dollar denominated debts in the foreign debt stock, which was 51.2 per cent in 2001, declined to around 40 per cent in the following years. Moreover, in the period of 2001-2004, the share of SDR denominated debt stock in the total external debt stock was 1.1 per cent, 23.6 per cent, 25.5 per cent, and 26.2 per cent, respectively, and it was realized as 24.9 per cent as of the second quarter of 2005.

Box. 1. 5: Issuance of YTL Denominated Bonds by Foreign Banks and Its Effects

There has been a rapid increase in the demand of foreign investors in global markets for borrowing instruments denominated in domestic currencies of emerging economies recently. This increase mainly resulted from the building of indices for bonds denominated in domestic currencies of the emerging economies and development of comparative yield analyses; increase in the number of foreign investors who have a tendency to prefer long-term investments, such as pension funds and insurance companies; and introducing new borrowing instruments and lengthening their maturity by many countries in order to attract the demand of such investors. This process may lead to an increase in the share of borrowing instruments denominated in national currencies in their debt stock and thus reduce exchange rate risk[1].

Tight monetary and fiscal policies strictly implemented in Turkey after the economic crisis in February 2001 and realization of structural reforms have improved expectations for the future and reduced risk premiums. This development enabled the Treasury to reduce its borrowing costs and considerably eliminated concerns about debt rollover risk. In order to emphasize the determination to preserve gains from economic stability, six zeroes were eliminated from the Turkish Lira in the beginning of 2005. This development also removed technical obstacles in the way of using Turkish Lira in international clearing systems. This process, which facilitated transactions in many areas and enhanced confidence in Turkish Lira, was completed successfully.

Table: The Amount of GDBI Held by Foreign Investors and Its Ratio to Total Cash GDBI in the Market



Source: CBRT

All these developments led to increased confidence in the Turkish economy and enhanced the credibility of Turkish Lira in international markets. YTL denominated bonds issued by foreign banks for their institutional and individual clients are among the signs reflecting this trend. Not only environment in favour of the emerging countries in international markets but also macroeconomic performance of Turkey were the main factors prompting issuance of YTL denominated bonds by foreign banks. YTL denominated bonds, which started to be issued in December 2004, has amounted to 7.6 billion YTL (5.6 billion dollars) as of November 15, 2005[2]. These bonds, either discounted or with fixed rate coupons, were issued with maturities ranging from 1 to 15 years. These bonds issued by foreign banks were mainly demanded by pension funds which, as a requirement of their business principles, have to invest in the borrowing instruments issued by institutions with high credit ratings, as well as by many institutional and individual investors. Interest rates of YTL denominated bonds issued by foreign banks with high credit ratings were lower than YTL denominated domestic bonds of Treasury with same maturities.

Purchases of domestic bonds and bills by foreign banks issuing YTL denominated bonds in order to hedge themselves against foreign exchange risk have led to an increase in the demand for government domestic borrowing instrument (GDBI) and a rise in GDBI stock held by foreign investors. Thus, GDBI stock of foreign investors, which was 16.8 billion YTL (12.4 billion dollars) at the end of 2004, increased to 24.5 billion YTL (18.3 billion dollars) at the end of October 2005. The ratio of GDBI stock held by foreign investors to the total cash debt stock, which stood at 3.1 per cent in 2003, increased to 10 per cent as of October 2005. This development had a positive effect on the borrowing of Treasury with longer terms and lower interest rates.

Bonds issued by foreign banks were also a milestone in terms of enhanced credibility of YTL in international markets. As a result of these developments, investment banks, which issue borrowing instruments or take the exchange rate risk by making intermediary transactions after the issuance, manage their exchange rate risks by taking advantage of the instruments in the domestic market. Thus, foreign banks only take credit risks arising from YTL denominated GDBI. The investors, who hold these instruments in their portfolios, reduce their credit risks as they purchased these bonds from institutions with high credit ratings, but undertake the exchange rate risk. These investors would demand GDBI and undertake the credit risk as they acquire more information about Turkey in time. This development would enable the Treasury to reach a larger client base and reduce foreign exchange risk as a result of the increase in YTL denominated instruments in the debt stock.

Notes:

1. IMF, Financial Stability Report, September 2005, pp. 40-42
2. Reuters, November 15, 2005, The amounts given in dollars were calculated by using exchange rates declared by Central Bank in the related dates.

2. MACROECONOMIC FRAMEWORK

Main Objectives of the Macroeconomic Policy

The main objective of the economic policy is to increase the welfare of the society during the period of 2005-2008. In this respect, along with the implementations strengthening macroeconomic stability, social policy implementations will be continued within budgetary limitations.

Negotiations for Turkey’s full membership to the EU were officially initiated on October 3, 2005. Economic policies in this process will be implemented in compliance with the main perspective of improvement of the current market economy and attaining a more dynamic and competitive economic structure in the context of Copenhagen economic criteria. In this context, the economic policies will secure the continuation of the convergence process towards fulfillment of Maastricht criteria, in which a substantial improvement has been recorded especially in recent years. The basic priorities of Turkey’s macroeconomic policies during PEP 2005 period are to attain the price stability completely, to fulfill Maastricht criteria in terms of public finance by reducing the ratio of the budget deficits and public debt stock to GDP and to continue the converge process to the EU averages in terms of per capita income by maintaining the sustainable growth environment in the economy.

In this context, in order to strengthen the market economy and to increase the competitiveness of the economy, reducing the role of the state in the economy through privatization, efficient implementation of the market regulation function by independent regulatory authorities, encouraging private entrepreneurship and eliminating legal and economic uncertainties that have a negative impact on the functioning of the free market, are of special importance. Reducing the imbalances in education, health, and social security areas, improving the quality of the labour force and minimizing the development gaps among regions and between Turkey and the EU, are the other prior subjects of the ongoing economic policies.

Fiscal Policy

The main objectives of the fiscal policy implemented since 2001 have been to secure a permanent reduction in the ratio of the public debt stock to national income and in the fiscal deficits, to achieve a balanced budget structure, to contribute to the sustainable growth environment and to support the struggle against inflation. The results of the decisively implemented economic program towards attaining these goals started to be obtained and thereby a substantial improvement in the fiscal balances have been achieved.

The basic framework of the fiscal policy will be preserved during the period of 2005-2008. In this context, as in previous years, tight fiscal policy implementations will be continued towards achieving primary surplus targets during the 2005-2008 period. In this respect, efforts to increase the tax revenues by widening the tax base and registering the unrecorded economy and to maintain efficiency in public expenditures will continue. As a result of these policies, Maastricht criteria regarding the budget deficit will be fulfilled as of the end of 2005.

Monetary and Exchange Rate Policy

The main responsibility of the Central Bank is to ensure price stability. In this context, the Central Bank has been implementing implicit inflation targeting policy to attain price stability so far and it was announced that the Central Bank would shift to explicit inflation targeting policy as of 2006.

The success in decreasing the chronic inflation to single digits, in the process of accession to the EU, has brought up a considerable progress in terms of nominal convergence towards Maastricht criteria. The continuation of this convergence during the PEP 2005 period and thereby, bringing inflation closer to the EU average is targeted.

On the other hand, during the period ahead, the exchange rate will continue to be determined by supply and demand in the market in the framework of the floating exchange rate regime. The Central Bank, when necessary, may intervene in the foreign exchange market in case of excessive fluctuations without affecting the long-term level of the exchange rate. Furthermore, the Central Bank will continue to hold regular foreign currency purchase auctions in order to sterilize the excess supply in the foreign exchange market and strengthen its international reserves.

Incomes Policy

The implementation of incomes policy in line with the inflation target has great importance to make the success achieved in the struggle against inflation, permanent. Especially, taking into account the upturn observed in the domestic demand in recent years, importance of the incomes policy further increases. For this reason, incomes policy is needed to be determined by considering the parameters such as the inflation targets in the short-term and price stability, productivity and profitability in the medium-term. Therefore, forward-looking indexation policy will be continued in the public sector wage policy. The government will continue to benefit from the Economic and Social Council and similar platforms, to secure consensus among social partners with the aim of ensuring that the private sector also follows a wage policy in conformity with the inflation target.

Structural Reform Policies

With the help of structural reforms implemented to date, an important progress has been achieved in establishing a sustainable growth environment and developing a market oriented and competitive economic structure. Structural reforms, which are important to secure objectives of economic and social development and macroeconomic stability permanently, became more important for the integration with the EU as the negotiations began officially.

In this context, it is aimed at strengthening the market mechanism and increasing the role of private sector in the economy by decreasing the share of public sector, developing a financial sector that efficiently meets the funding needs of the real sector and increasing the quality of labour force considering the requirements of the current era. Besides, reforms in the administrative field will be continued for the purposes of increasing the efficiency in the public services, preventing the resource dissipation and strengthening the regulatory and supervisory role of the public sector by withdrawing from production in some sectors. By increasing the shares of education, health, R&D and other social expenditures as the public finance improves, it is aimed at increasing the living standards of the society, fighting against poverty, improving income distribution and decreasing the regional development gaps. Additionally, structural reforms in agricultural sector aiming at increasing productivity and competitiveness and ensuring the efficient utilization of resources will be continued.

External Factors

Assumptions about the world economy used in the macroeconomic analysis and forecasts of the Pre-Accession Economic Program are based on the most recent forecasts of institutions like the European Commission and the International Monetary Fund.

The world economy grew by 5.1 per cent in 2004 in line with expectations. However, the fact that oil prices are substantially higher than the estimations in the recent period, brought about the idea that 2005 growth performance will be lower. On the other hand, it is expected that the rate of high increases in oil prices will tend to decline in the forthcoming period. World output is estimated to increase by 4.3 per cent annually on average in the 2006-2008 period. Parallel to the growth developments, world trade volume, which grew by 10.3 per cent in 2004, is expected to increase by 7 per cent in 2005 and by 6.6 per cent annually on average in the 2006-2008 period.[2]

In this respect, the growth rate of EU-25 countries, which have more than 50 per cent share in our exports, is assumed to increase by 2.2 per cent in 2005, 2.3 per cent in 2006 and 2.5 per cent annually on average in the 2007-2008 period.[3]

The growth rate of import demand of developing countries was realized as 16.4 per cent in 2004 and is estimated as 13.5 per cent and 11.9 per cent in 2005 and 2006, respectively. Import demand of developing countries is foreseen to increase by 9.9 per cent annually on average in the 2007-2008 period. World import price index increased by 9.3 per cent in 2004 and is assumed to rise by 6.5 per cent and 1.5 per cent in 2005 and 2006, respectively.[3]

Because of the upward trend in oil prices, crude oil price per barrel is assumed to be 51.2 dollars and 58.3 dollars in 2005 and 2006, respectively. In 2007 and 2008, a limited decrease in crude oil price is assumed.

The European Commission estimated euro/dollar parity as 1.31 in 2005 and 1.32 in 2006. However, since euro/dollar parity was realized around 1.26 in the first ten months of 2005, euro/dollar parity is assumed to be 1.25 in 2005 and 1.26 annually on average in the 2006-2008 period.

2.1. Growth and Employment

The Turkish economy has remarkably displayed a stable structure since 2002. The general economic outlook for 2005 signals that the stability in the economy has become permanent and the expectations and projections of economic agents has become more harmonized. As a result of this joint perspective, confidence to the economy has clearly strengthened. The economic outlook for 2005 is substantially consistent with the framework of PEP 2004.

It is observed that the tight monetary and fiscal policies being implemented have had no restrictive effects on economic growth also in 2005. On the contrary, the improvement in fiscal balances and the progress recorded towards price stability; improved expectations, reduced the risk premium, increased the predictability in the economy, enabled economic agents to take their decisions in a longer time perspective and thereby, these policies have positively contributed to the economic growth process.

[2] IMF World Economic Outlook, September 2005.
[3] European Commission DGECFIN Spring 2005 Forecasts.

In the period of 2006-2008, no significant change is expected in the framework and the priorities of the economic policy. Depending on this policy framework, significant progress has been achieved to overcome the fundamental problems of Turkish economy such as high inflation and budget deficits, low investment ratios, boom-bust cycles, which emerged especially during 1990s. It is considered that the positive developments in these areas will continue during the PEP 2005 period and that the structure of the economy will be stronger and less fragile against external shocks.

In 2005, the growth rate displayed a slow-down compared to 2004. The main reasons of this situation are satisfaction of the postponed investment and consumption demands in 2004 and the unusually high growth rate realized in 2004. The Turkish economy is expected to grow by 5 per cent at around its potential due to the diminishing growth rate in postponed investment and consumption demand and the continuing improvement in macro balances in 2005.

It is estimated that the production will be realized around its potential level and the average growth rate of GDP will be around 5 per cent in the period of 2006-2008. It is anticipated that the main sources of economic growth will be the increases in private consumption, investment and exports. On the other hand, the continuation of tight fiscal policy and designing of incomes policy consistent with the inflation target will be the restrictive factors on consumption in the period of 2006-2008. Thus, it is estimated that the growth rate of consumption demand will be lower than the economic growth rate.

In the period of 2005 Pre-Accession Economic Program, it is expected that the export increases will be supported by increases in production capacity through fixed capital investments and that the export performance will continue. The labour productivity increases recorded in recent years has continued. It is considered that the expected labour productivity increases in the coming periods will support the export performance.

In accordance with the expected growth and investment increases, it is expected that the average increase in employment level will continue in the last quarter, the labour force participation rate will be realized as 48.5 per cent and unemployment rate will decline to 9.8 per cent in 2005. In the 2006-2008 period, it is expected that significant number of new jobs will be created and, in this context, employment will increase by 1.7 million persons, however, there will be a limited decrease in the unemployment rate because of the expected increase in the labour supply.

The positive impacts of the progress achieved in structural reforms have started to be observed in the economy. Throughout 2005, significant progress has been achieved regarding privatization, which has so far been one of the structural reform areas with poor performance. Thereby, the significant improvement towards reducing the share of public sector and increasing the share of private sector in the economy has been achieved. Moreover, it has been observed that Turkey is entering into a new phase in terms of attracting foreign direct investments. It is expected that, in the coming periods, there will be a significant amount of foreign direct investment inflows to the Turkish economy, which has so far received very small share of global foreign direct investments. It is predicted that this development will significantly contribute to the realization of the macroeconomic performance, which is foreseen in the PEP 2005. It is considered that the developments attained in other structural reform areas will also contribute to the realization of PEP 2005 forecasts via increasing economic efficiency.

Demand Components of Growth

In 2004, GDP growth was realized as 8.9 per cent and remained slightly below the level predicted in the 2004 Pre-Accession Economic Programme. However, growth rates of private consumption and private fixed capital investment were above expectations. As a result of high growth rates in consumption and fixed capital investment, growth rate of imports also turned out to be above the level predicted in the PEP 2004. Public sector consumption did not significantly increase in real terms and public sector investment contracted as a result of the tight fiscal policy that has been implemented.

Table. 2. 1: Demand Components of Growth

(Real Percentage Change)

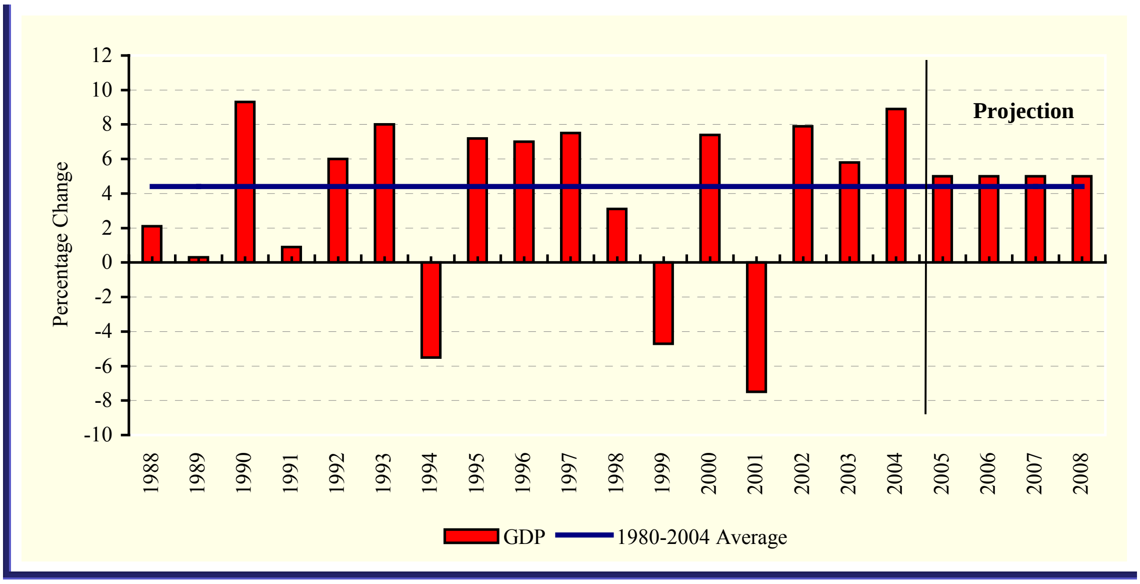
	2004	2005	2006	2007	2008
Total Consumption Expenditures	9.0	4.6	4.2	4.1	4.1
Private	10.1	5.2	4.1	4.6	4.6
Public	0.5	1.0	5.2	0.8	0.5
Total Investment Expenditures	27.4	9.0	6.7	7.1	6.9
Gross Fixed Capital Formation	32.4	14.6	8.7	7.4	7.7
Private Fixed Investment	45.5	12.0	10.0	9.7	8.9
Public Fixed Investment	-4.7	23.3	4.6	0.1	3.6
Changes in Inventories (1)	1.2	-0.5	0.0	0.4	0.2
Exports of Goods and Services	12.5	6.8	8.6	10.3	9.8
Imports of Goods and Services	24.7	8.6	7.9	9.5	9.0
Gross Domestic Product	8.9	5.0	5.0	5.0	5.0
Gross National Product	9.9	5.0	5.0	5.0	5.0

Source: SPO, SIS
(1): Reported as the contribution to GDP growth.

It is estimated that GDP will grow by 5 per cent in 2005. Postponed consumption, which significantly contributed to growth in 2004, is observed to have a declining impact on growth in 2005. Private consumption, which increased by 10.1 per cent in 2004, is estimated to grow by 5.2 per cent in 2005. Together with the enhanced predictability in the economy, continuation of real appreciation of the YTL and falling interest rates have ensured appropriate climate for private fixed capital investments in 2005. In 2005, upward trend of private sector fixed capital investments has continued especially with the beginning of recovery in the construction sector. On the other hand, as a requirement of the long-term growth perspective, public sector fixed capital investments which were low in previous periods, were increased in real terms in 2005 in line with the improvements in fiscal balances and budgetary constraints. In this context, it is estimated that private sector fixed capital investments and public sector fixed capital investment will increase by 12 per cent and 23.3 per cent in real terms, respectively, in 2005.

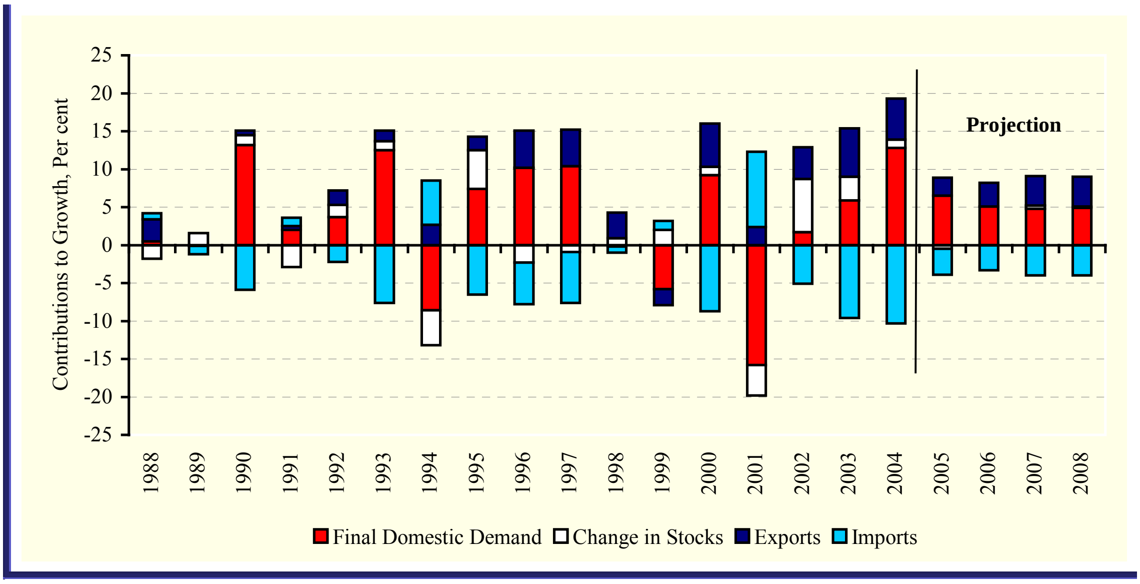
It is estimated that high increase in exports of goods and services, which was one of the main driving forces of growth in 2004, will moderately slow down and exports of goods and services will increase by 6.8 per cent in real terms in 2005. Growth rate of imports started to decline in 2005, in parallel with the slowdown of economic growth. In this respect, it is predicted that real imports of goods and services will increase by 8.6 per cent in 2005.

Figure. 2. 1: GDP Growth Rate



In the period of 2006-2008, GNP and GDP are expected to grow by an annual average of 5 per cent. It is considered that growth will be driven mainly by increases in private consumption, private sector fixed capital investment and exports in PEP 2005 forecasts. In 2006-2008 period, private consumption is estimated to grow by 4.4 per cent annually on average, whereas public consumption is estimated to increase by 2.1 per cent annually on average. On the other hand, it is expected that total fixed capital investments, private fixed capital investments and public fixed capital investments will increase by 7.9 per cent, 9.5 per cent and 2.7 per cent annually on average, respectively. In the same period, exports and imports of goods and services are predicted to increase by 9.6 per cent and 8.8 per cent annually on average, respectively.

Figure. 2. 2: Contributions to GDP Growth



Savings-Investment Balance

Remarkable real increases have been recorded in private investments since 2003 as a result of the stability achieved in the economy after the crises and declining cost of investment both in terms of financing and opportunity costs, which has resulted from decrease in financial repression of public sector, in parallel with the improvements in public finances and thereby falling interest rates. The ratio of private fixed capital investment to GDP, which was 11.3 per cent in 2003, increased to 14.1 per cent in 2004. It is expected that this trend in recent years will also continue in the period of 2005-2008 and private fixed capital investment will grow more rapidly than GDP. In light of these developments, it is expected that the ratio of private fixed capital investment to GDP will realize as 15.3 per cent in 2005 and reach 17.4 per cent as of 2008.

Tight fiscal policy implemented in recent years have negatively affected public sector fixed capital investments. As a result of these policies, the share of public sector fixed capital investments in GDP has declined consistently and was realized as 3.7 per cent in 2004. In the 2005 budget, a significant real increase in public sector fixed capital investments was planned and considerable increases in public sector fixed capital investment were recorded in the first half of the year. Thus, the share of public sector fixed capital investments in GDP is expected to reach 4.5 per cent as of 2005. In the 2006-2008 period, this ratio is predicted to maintain this level.

It is expected that the ratio of total fixed capital investment to GDP, which was realized as 17.8 per cent in 2004, will be 19.8 per cent in 2005 and increase to 21.6 per cent in 2008.

As seen in the Table 2.2, connected with confidence and stability obtained in the economy, public sector savings-investment balance improved considerably in the period of 2002-2004 due to the decrease in the ratio of interest payments to GDP and increase in the public disposable income. This improvement is expected to continue in 2005 and thereby public sector is anticipated to have positive savings for the first time for a long period.

Table. 2. 2: Total Savings-Investment Balance

(Per cent of the GDP)

	Average		Realization			Forecast			
	90-94	**95-99**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total Investment	23.1	23.2	21.3	22.8	25.8	26.8	27.2	27.8	28.5
Fixed Capital Formation	24.2	22.9	16.6	15.5	17.8	19.8	20.5	20.9	21.6
Public	6.3	5.5	5.3	4.2	3.7	4.5	4.5	4.2	4.2
Private	17.9	17.4	11.3	11.3	14.1	15.3	16.0	16.7	17.4
Change in Stocks	-1.2	0.3	4.7	7.3	7.9	7.0	6.7	6.9	6.9
Total Savings	23.1	23.2	21.3	22.8	25.8	26.8	27.2	27.8	28.5
Domestic Savings	21.3	19.2	19.8	19.5	20.0	20.0	20.5	21.3	22.2
Public	-6.5	-8.0	-13.0	-11.8	-2.5	1.4	2.1	1.6	2.9
Private	27.8	27.1	32.8	31.4	22.5	18.6	18.4	19.7	19.4
Foreign Savings	1.8	4.1	1.5	3.3	5.8	6.8	6.7	6.5	6.3

Note: 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 SEEs in addition to those of the general government.

Scrutinizing the savings-investment balance, it is observed that, there have been considerable increases in foreign savings in 2004 and 2005. High growth rates realized in 2004 and 2005 and decline in the savings rate of the private sector has aggravated the foreign savings need of the economy.

Sources of Growth

As it is well-known, Turkish economy could not record any increase in the level of employment in the years 2002 and 2003, despite the substantial economic growth achieved since 2002. In 2004, employment increased by 3 per cent firstly as a result of productivity gains reaching its limits; secondly, lagged response of employment to the considerable increases in private fixed investment in 2003 and 2004 and thereby the arising necessity to create more employment so as to grow further; and lastly, rising confidence to the permanence of the economic stability. Accordingly, in terms of contributions to growth by factors of production, a much more balanced structure appeared compared to the recent years. In 2004, the contributions to growth by capital stock, employment and total factor productivity (TFP) were recorded as 39.7 per cent, 21.7 per cent, and 38.6 per cent, respectively.

Table. 2. 3: Growth Rates of Factors of Production

(Per cent)

Period	GDP	Capital Stock	Employment	TFP
1990-2000	4.1	7.6	1.5	0.3
2001-2004	3.6	4.5	0.2	1.7
2004	8.9	4.9	3.0	5.0
2005	5.0	5.4	2.0	1.7
2006	5.0	5.8	2.5	1.2
2007	5.0	5.8	2.5	1.2
2008	5.0	6.2	2.5	1.1
2005-2008	5.0	5.8	2.4	1.3

In the PEP 2005 period, anticipated growth rates are expected to be supported by the increases in the factors of production beside productivity increases. Depending on the expectations for high growth rate of investment, capital stock is predicted to grow by 5.8 per cent, annually on average. In parallel with the increase in the capital stock, labour demand is foreseen to grow, as well. In this frame work, in the 2005-2008 period, employment and TFP are estimated to grow by 2.4 per cent, and 1.3 per cent, respectively, annually on average.

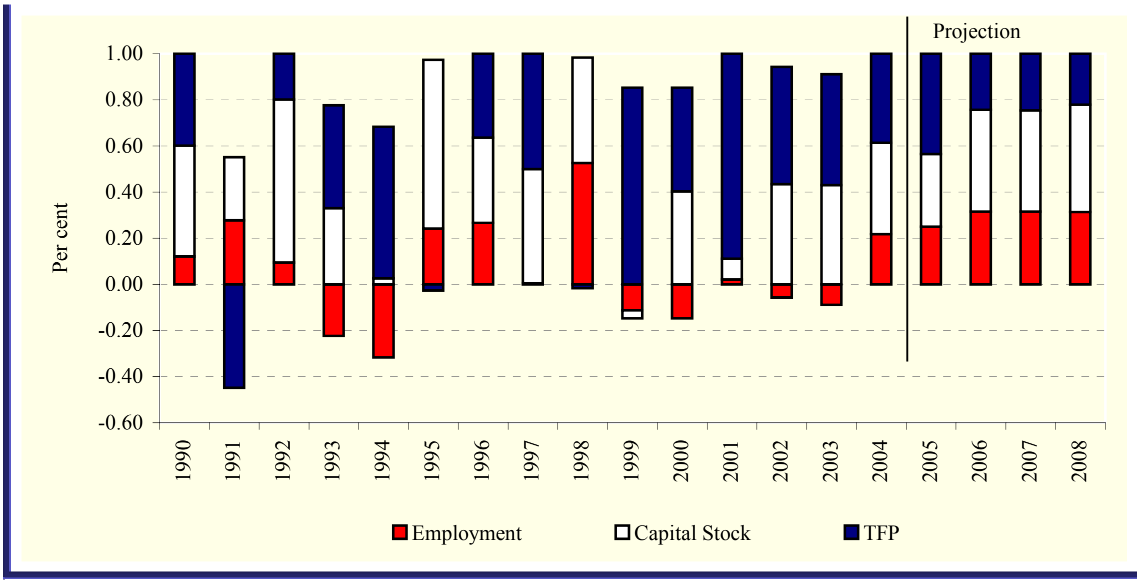
Table. 2. 4: Contribution to Growth by Factors of Production

(Per cent)

Period	Capital Accumulation	Employment Increase	TFP Increase
1990-2000	73.2	23.5	3.3
2001-2004	66.9	4.3	28.9
2004	39.7	21.7	38.6
2005	31.6	24.9	43.5
2006	44.2	31.5	24.3
2007	43.9	31.5	24.6
2008	46.6	31.4	22.0
2005-2008	41.6	29.8	28.6

As a result of these expected developments regarding the factors of production, the contributions to growth by capital stock, employment and TFP during the Pre-Accession Economic Programme period are estimated to be 41.6 per cent, 29.8 per cent and 28.6 per cent, respectively.

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

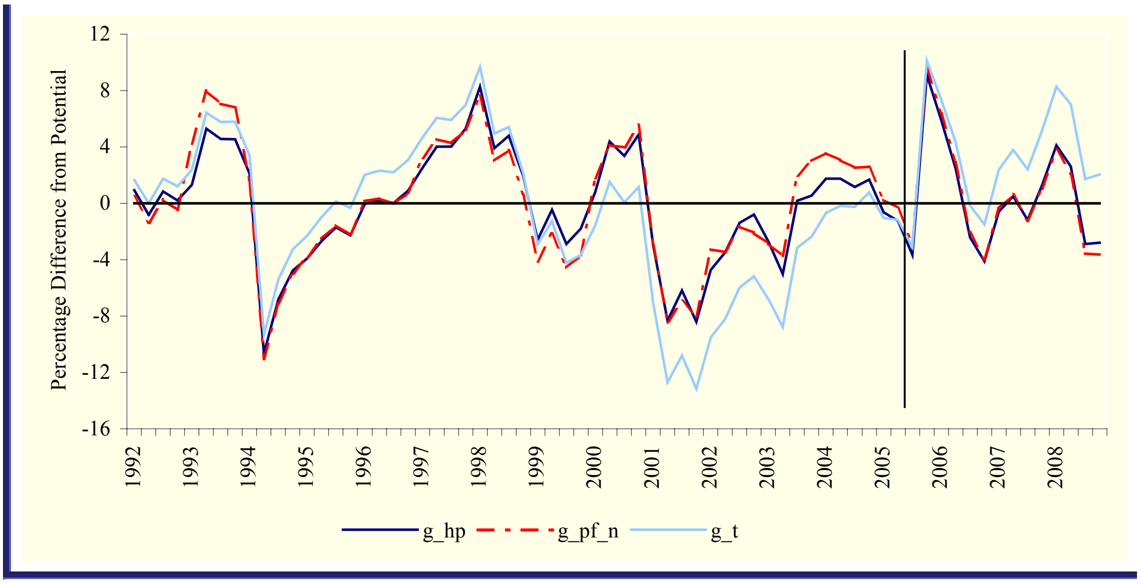


Potential Output

In line with the success at overcoming the chronic boom-bust cycles and progress towards economic stability, economic growth is estimated to be around its potential. Figure 2.4 shows the output gap series calculated by three different methods: the linear method, the Hodrick-Prescott method and the production function method. In the figure, it is observed that the output gap calculated by the linear method is diminishing as of 2004 and a warming-up tendency becomes evident in the period of 2005-2008. This is mainly due to the fact that the low growth performance in the past has pulled the trend growth rate down.

On the other hand, the output gap figures calculated by the production function and Hodrick-Prescott methods do not point out a warming-up in the economy. In the PEP period, with the expected increase in investment and in the level of employment, it is predicted that the production potential will rise, and the foreseen growth path will have no inflationary effect. Moreover, no inflationary risk is anticipated since the expected growth rate for the period 2006-2008 is 5 per cent annually on average which is not much higher than the long-term average growth rate of Turkey.

Figure. 2. 4: Output Gap

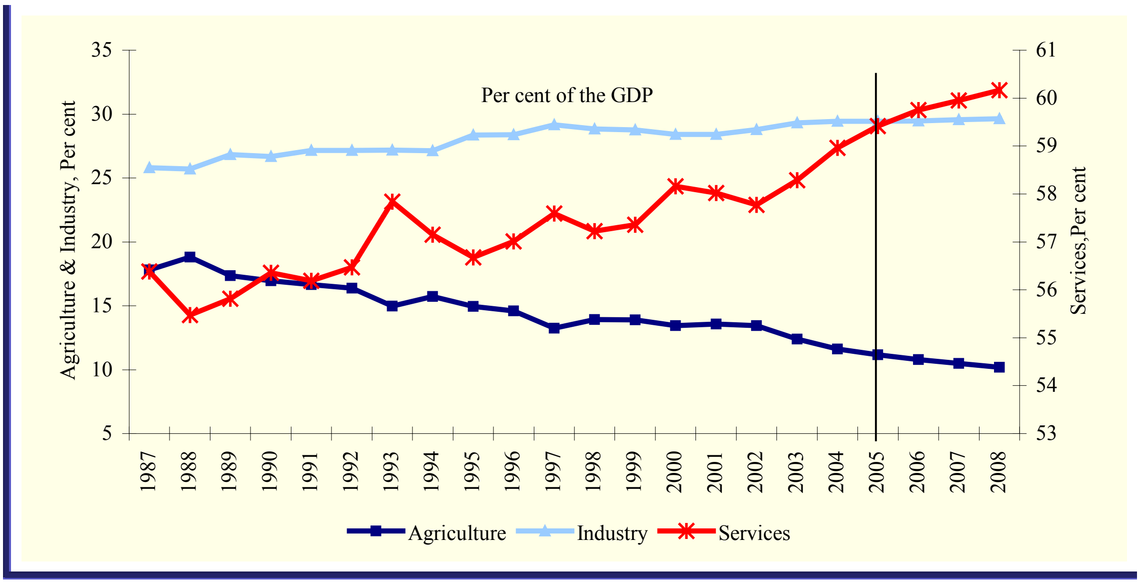


g_hp : Output gap calculated by Hodrick-Prescott method.
g_pf_n : Output gap calculated by using production function and variable NAIRU assumption.
g_t : Output gap calculated by linear method.

GDP Growth by Sectors

Analyzing the sectoral production structure of the Turkish economy in a long-term perspective, it is seen that while average growth rates of industry and services sectors are above the GDP growth, growth rate of agricultural sector is below the GDP growth. Thus, it is noted that sectoral composition of production changes in favour of industry and services sectors, disfavour of agricultural sector. 1987-2004 realizations and 2005-2008 estimations of sectoral composition of production are presented in the Figure 2.5.

Figure. 2. 5: Production by Sectors



In the period of 2006-2008, GDP is expected to rise by 5 per cent, annually on average. During this period, it is foreseen that long term sectoral tendencies will be maintained and thereby shares of industry and services sectors will continue to increase. In this framework, the shares of industry and services sectors in GDP are estimated to reach 29.6 and 60.2 per cent, respectively in 2008. In this period, the share of agriculture in GDP is expected to decrease further and decline to the level of 10.2 per cent by the year 2008.

Table. 2. 5: Value Added by Sectors

(At 1987 Prices, Per cent)

	Realization			Forecast			
	2002	2003	2004	2005	2006	2007	2008
	Growth Rates						
Agriculture	6.9	-2.5	2.0	1.0	1.5	2.2	2.0
Industry	9.4	7.8	9.4	5.0	5.1	5.3	5.3
Services	7.5	6.7	10.2	5.8	5.7	5.3	5.4
GDP	7.9	5.8	8.9	5.0	5.0	5.0	5.0
	Shares in the GDP						
Agriculture	13.4	12.4	11.6	11.2	10.8	10.5	10.2
Industry	28.8	29.3	29.4	29.4	29.5	29.5	29.6
Services	57.8	58.3	59.0	59.4	59.8	60.0	60.2
GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Developments in the Labour Market

In 2002 and 2003, no increase was recorded in the level of employment, despite a considerable output growth in both years. Nevertheless, starting from the second quarter of 2004 an upward trend in employment began to be observed and the growth elasticity of employment approached its long-term level in 2004. Thus, employment increased by 3 per cent in parallel with a GDP growth rate of 8.9 per cent. Productivity increases in industry recorded in 2002 and 2003 reaching its limits, lagged response of employment to the considerable increases in private sector fixed capital investments in 2003 and 2004 and capacity utilization rates reaching historically high levels were determinants of this development and accordingly, a 3.7 per cent increase was recorded in industrial employment.

In the first half of 2005, a considerable increase was recorded in employment. In this period, the growth elasticity of employment went beyond its long-term level and a 4.7 per cent employment increase was recorded corresponding to a 4.8 per cent increase in output in the first quarter, while a 2.4 per cent employment increase was recorded corresponding to a 4.2 per cent increase in output in the second quarter. When the sectoral composition of employment is analysed, in the third quarter of 2005, it is noticed that the high employment increase in non-agricultural sectors just compensates the 1.23 million decline in agricultural employment. Hence, no increase was recorded in total employment in the third quarter of 2005. Accordingly, in the employment structure there is a positive shift from low productive agricultural sector to high productive non-agricultural sectors, which provide regular income earnings. Depending on these developments, a 2 per cent employment increase is projected in 2005 as a whole.

In the period of 2006-2008, it is predicted that the growth elasticity of employment will be around its long-term level and the level of employment will increase by an average annual rate of 2.5 per cent. Thus, it is estimated that about 1.7 million new jobs will be created over the period in question. Depending on these developments, it is projected that the unemployment rate will recede to 9.8 per cent in 2005 and display a limited decrease in the period of 2006-2008.

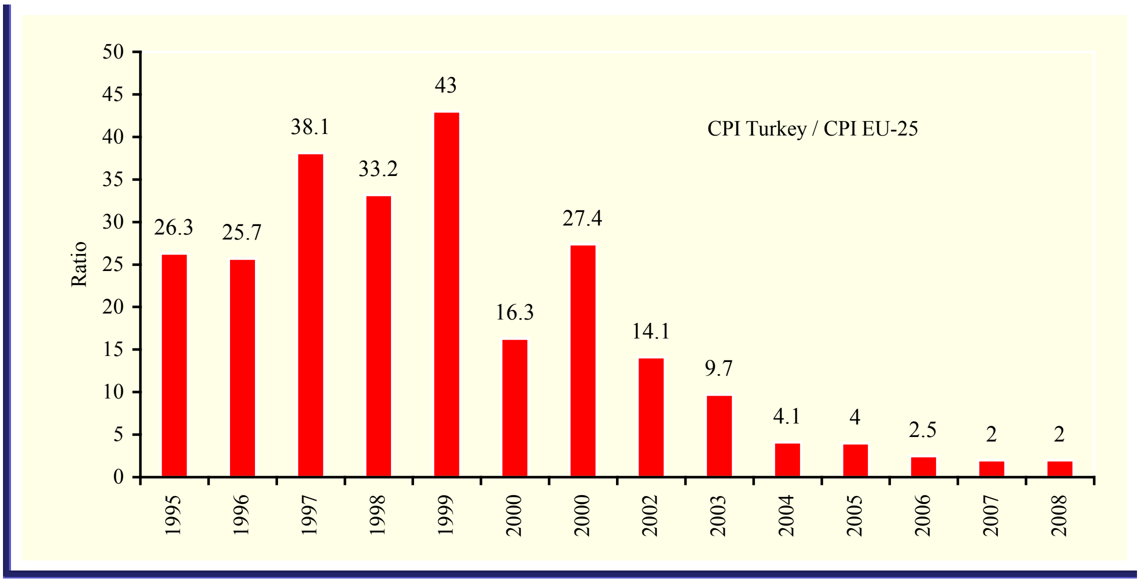
Table. 2. 6: Developments in the Labour Market

	Realization	Forecast			
	2004	2005	2006	2007	2008
Working Age Population (Thousand Persons)	49,906	50,813	51,738	52,647	53,561
Labour Force Participation Rate (Per cent)	48.7	48.5	48.8	49.1	49.4
Employment Level (Thousand Persons)	21,791	22,225	22,781	23,350	23,934
Employment (Percentage Change)	3.0	2.0	2.5	2.5	2.5
Unemployment Rate (Per cent)	10.3	9.8	9.8	9.7	9.6

2.2. Inflation

Disinflation is critical both for the success of the ongoing stabilization programme and for convergence to the EU countries. The target is to reduce the annual level of inflation to 5 per cent in 2006 and to keep it at around 4 per cent in 2007 and 2008. Inflation will considerably approach to the EU averages with the realization of end-year CPI target and prospects for the GDP deflator in 2005. The ratio of inflation in Turkey to the average inflation of the EU can be seen in Figure 2.6. According to this figure, significant progress has been achieved in terms of convergence towards EU averages.

Figure. 2. 6: The Ratio of Turkish Inflation to EU-25 Inflation



Fulfillment of some prerequisites will be of critical importance in order to continue the disinflation process in the forthcoming periods. In this context, providing the efficiency of the tax system, implementation of incomes policy in accordance with the programme, compliance to the primary surplus target and thus maintaining sustainable debt levels are of prior importance. In fact, continuation of positive expectations and reduction of risk premiums hinges on these prerequisites. Additionally, completion of structural reforms will contribute to the improvement of the competition environment through facilitating the functioning of the market mechanism. Another important factor for maintaining price stability is backing up of production increases by productivity gains and thus enabling the expansion of the productive capacity of the economy benefiting from economies of scale.

Beside these internal factors, external developments that have a potential to affect price stability will also be observed carefully. In this context, especially developments regarding oil prices will be kept eye closely on.

Table. 2. 7: Price Targets and Projections

(Percentage Change)

	2005	2006	2007	2008
CPI (1)	8.0	5.0	4.0	4.0
GDP Deflator (2)	7.7	6.0	4.5	3.5

(1) End-year target.
(2) Projections for average annual increase.

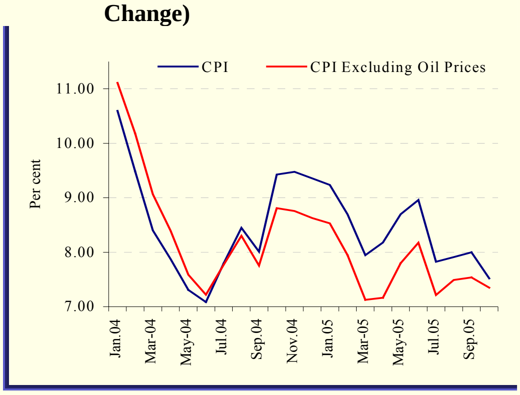
Box. 2. 1: The Effects of Oil Prices on Consumer and Producer Prices

International crude oil prices have entered into a fast increasing trend since the second half of 2004 and started to make pressure on domestic prices. The effects of jumps in crude oil prices on the increases in consumer and producer prices in 2004 and 2005 can be analyzed in two steps, as direct and indirect effects.

The direct effects arise via the prices of fuel oil products, which are first affected by the international crude oil prices. While the fuel oil products in CPI were classified under the two main sub-groups as housing and transportation, the fuel oil products in PPI were under the group of manufacturing of refined petroleum products, which is a sub-group of manufacturing industry. The direct effects of crude oil prices on consumer and producer prices are different. The relation between international oil prices and domestic fuel oil price increases become more apparent in PPI. In this development, the compilation of producer prices from prices free of tax was effective. As a matter of fact, during the process of fuel oil price formation, the largest share belongs to the taxes, and in this perspective, the fuel oil prices under CPI are relatively less affected from the increase in crude oil prices. In 2004, the increases of fuel oil prices under CPI has gone up at a rate which is closer to the increase in international crude oil prices, while in 2005, the increase of fuel oil prices was significantly under the rate of increase in crude oil prices. In this development, contrary to 2004, in 2005, the limited increase in Special Consumption Tax (SCT) that mainly determines the pump price was effective.

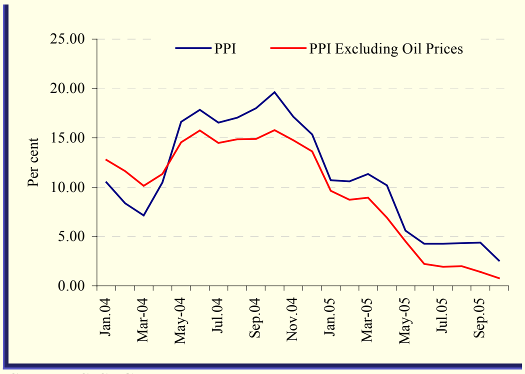
When the direct effects of crude oil prices over CPI and PPI are excluded, in other words, crude oil prices are eliminated from these indices, it is observed that a lower inflation trend was reached particularly after the second half of 2004 where the rate of increase in crude oil prices has started to accelerate (Figure 1 and Figure 2).

Figure.1: CPI and CPI Excluding Direct Effects of Oil Prices (Annual Percentage Change)



Source: SIS, CBRT.

Figure.2: PPI and PPI Excluding Direct Effects of Oil Prices (Annual Percentage Change)

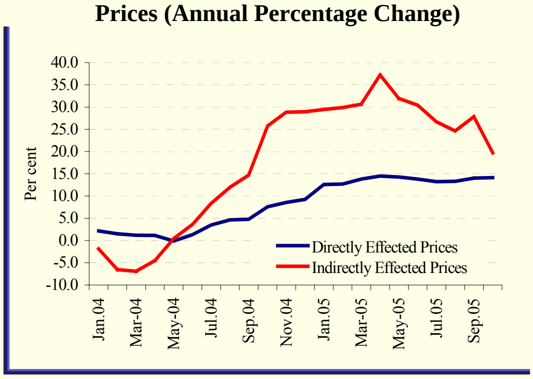


Source: SIS, CBRT.

The direct effects are only a small part of the total effects of international crude oil prices on inflation. The large part of the effects comes from indirect ways. The indirect effects arise from the impact of international crude oil price increases on the prices of products except fuel oil products, via input costs.

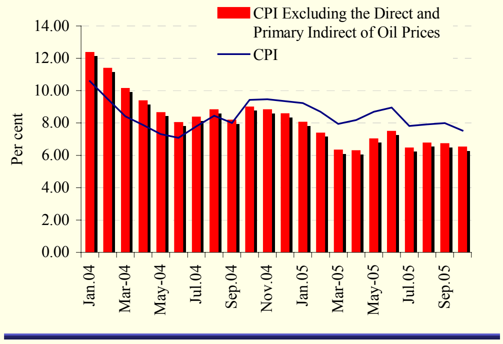
The first indirect effects (primary indirect effects) are observed on the prices of goods and services in which fuel oil products are used as inputs intensively. The annual rate of increase of the index, which is built for the prices under consumer prices that are affected initially and indirectly from the international crude oil prices, has started to go up since the middle of 2004. However, this increase has been below the rate of increase of the fuel oil product prices which are directly affected from oil prices (Figure 3).

Figure.3: Prices Under CPI That Are Directly and Primary Indirectly Affected From Oil Prices (Annual Percentage Change)



Source: SIS, CBRT

igure.4: CPI Excluding the Direct and Primary Indirect Effects of Oil Prices (Annual Percentage Change)



ource: SIS, CBRT

When the direct and primary indirect effects are aggregated, the net effects of oil prices on consumer prices are better understood (Figure 4). According to calculations, the impact of the direct and primary indirect effects of international crude oil prices to the annual CPI inflation was 0.81 percentage points in 2004. Thus, it is observed that the corresponding effects have increased the annual consumer inflation by 1.44 percentage points as of October 2005.

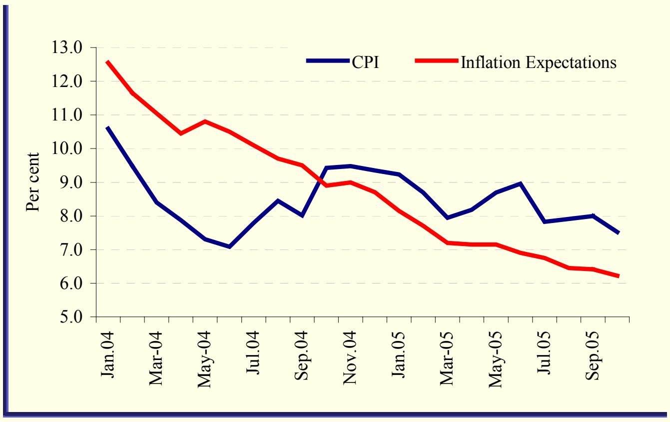
Table: Impact of Direct and Primary Indirect Effects of Oil Prices on CPI Inflation

October 2004 - October 2005	Annual Percentage Change	Impact on Annual Inflation (Percentage Points)
Prices Directly Affected	19.72	0.53
Prices Primary Indirectly Affected	14.13	0.80
Prices Directly and Primary Indirectly Affected	15.69	1.44

Note: The percentage contribution points obtained by multiplication of annual price increases with the weights in the CPI are different from those reported in the table. This is due to fact that, for any index, the percentage change in the sub-indices and multiplication of these indices with the corresponding weights in the general index are not equal to percentage change in the general index. That is why, the percentage contribution points are computed by excluding the increases in the direct and indirect indices from CPI inflation.

Besides the direct and primary indirect effects on consumer prices, when input costs in other sectors and the effect of expectations are taken into account, there is a possibility that the effects of international crude oil prices on inflation can go up. On the other hand, continuing downward trend of inflationary expectations for the year ahead indicates that the expectation impact which can affect the general pricing behaviour has not arisen (Figure 5).

Figure.5: Annual CPI Inflation and Inflation Expectations For the Forthcoming 12 Months



Source: SIS, CBRT

2.3. Monetary and Exchange Rate Policies

The Central Bank takes into account the future inflation expectations while forming monetary policy decisions and the analysis towards these expectations are made in the light of developments in capital, money and foreign exchange markets, besides total supply-demand equilibrium, the fiscal policy indicators, the pricing behaviour in public and private sectors and the developments in international markets. The Central Bank implements its monetary policy by using short-term interest rates to affect the level of medium and long-term interest rates. With the ongoing fiscal discipline, the reduction in public borrowing requirement and thereby dwindling of the risk premiums, which decrease the effectiveness of short-term interest rates, provided tapering in the level of public sector’s financial repression over financial markets, which is one of the main preconditions of the inflation targeting regime. Although there are indicators showing that the relationship between short-term and long-term interest rates is becoming stronger in 2005, the continuation of the structural reforms and implemented economic policies will keep its importance in the forthcoming period in order to enhance the influencing capacity of short-term interest rates on long-term interest rates.

In the context of the strategy, which was put into effect after the 2001 crisis, the Central Bank will complete the transition period for monetary policy at the end of 2005 and explicit inflation targeting policy will be put into implementation as of 2006. In this framework, the Central Bank has completed its institutional and technical base to shift to explicit inflation targeting. In addition to legislative amendments in the Central Bank Law, which allow the Central Bank to focus on price stability and make the Central Bank independent, reporting system and economic data base were strengthened and inflation forecasting models were developed. Furthermore, breaking the backward-looking price and wage indexation behaviour except for some services sector prices, weakening pass through from exchange rates to inflation, completing the technical base towards inflation forecasting and increasing credibility of the monetary policy have created the appropriate environment to implement explicit inflation targeting regime. As a result, the Central Bank announced that it will shift to explicit inflation targeting regime at the beginning of 2006.

In order to make monetary policy decisions much more predictable and transparent in the context of the transition to inflation targeting regime, in 2005, interest rate decisions were discussed in the Monetary Policy Committee meetings and the decision taken by the Governor was announced on the following business day morning. Moreover, by shifting to explicit inflation targeting in 2006, there will be an important institutional change in the interest rate decision process. In this context, interest rate decisions will be voted in the Monetary Policy Committee and summary reports of the committee meeting will be announced to the public. In addition, to increase the predictability of monetary policy, the quantified forecasts will be shared with public via quarterly published Inflation Report.

By shifting to explicit inflation targeting as of 2006, the implementation of anchoring monetary base and net domestic assets will be abandoned and instead, inflation itself will be the main anchor of the monetary policy.

Due to the ongoing fiscal discipline in the context of implemented economic program and realized structural reforms in the financial sector, the effectiveness of monetary transmission mechanism has significantly increased in recent periods. Besides, enhanced predictability in the course of monetary policy in the new period, management of expectations and increasing confidence towards implemented policies are seen as factors that will further strengthen the effectiveness of the monetary transmission mechanism.

Although the primary objective of the Central Bank is to ensure price stability, it is thought that providing financial stability has facilitating role in this regard. In this framework, the Central Bank closely observes the liquidity conditions in the markets and the liquidity policy is formed in a way to support the financial stability. Moreover, continuation of budgetary discipline in 2005, the reduction in the financial repression of public sector and thereby declining real interest rates have directed the banks to concentrate on consumer loans, specifically housing credits, in order to preserve their profitability. The Central Bank, in the context of a medium-term perspective, will closely monitor the developments in banking loans, specifically housing credits in the forthcoming periods.

As a summary, PEP 2005 period will be an episode in which the transition period towards explicit inflation targeting will be completed by the Central Bank, stability in the financial market will be regarded and floating exchange rate regime will be pursued.

2.4. Balance of Payments

Current Account

Export revenues in 2004, which were predicted as 62 billion dollars in PEP 2004, have performed beyond the expectations and by increasing 33.6 per cent compared to the previous year, were realized as 63,1 billion dollars. The relatively low level of labour costs, increase in the sectoral diversity, penetration to new markets, the continuation of upward trend in growth of the world economy, and increase in the world export prices are the factors which provide the opportunity for good export performance despite the appreciation of real exchange rate. Meanwhile, imports which were estimated to amount 95.5 billion dollars for 2004, increased by 40.7 per cent compared to previous year and reached 97.5 billion dollars depending on the recovery in the economy and appreciation of real exchange rates. On the other hand, in line with the expectations, tourism revenues have continued its good performance since 2003. As a result of these developments, current account deficit, which was estimated to be 14.6 billion dollars in the PEP 2004, was realized as 15.6 billion dollars in 2004.

Depending on the external factors such as increasing competition in textiles and clothing sectors due to the removal of quotas applied to China, the reduction in the import demand of United States for iron and steel and diminishing favourable effects of factors that contribute to the export growth, the growth rate of exports is expected to slowdown in 2005. As a matter of fact, the indicators for the first nine months of 2005 have revealed that the considerable increases in exports registered in 2004 were replaced by moderate increases in 2005.

The share of Turkey in the world export volume is still less than 1 per cent, although the share has gradually increased. Exports to North America, Asia, Middle East, transition economies and Africa have risen as a result of the efforts of systematic advertising and marketing activities in the recent years in order to increase the export performance of Turkey. The share of Turkey in the world export volume is expected to increase along with penetrating to new regions and continuing advertisements. In light of these developments, it is estimated that export revenues, which are expected to be

72.4 billion dollars in 2005, will reach 95.9 billion dollars in 2008 in parallel with the expectations of the PEP 2004.

In the period of PEP 2005, it is evident that imports will be realized beyond the forecasts of PEP 2004 due to the continuation of appreciation of domestic currency contrary to PEP 2004 projections, and high increase in oil prices in the international markets. In this context, it is anticipated that imports will be realized as 115 billion dollars in 2005 and reach 146.9 billion dollars in 2008.

Tourism revenues have displayed a rapid and stable increase for a long period of time. Turkey started to utilize her tourism potential more efficiently with the help of active advertising campaigns in recent years. Thus, tourism revenues increased by 15.2 per cent in the first nine months of 2005, as a result of these recent developments. Moreover, the number of arriving visitors has reached a historically high level in 2004 and in the period of January-September 2005, the number of arriving visitors rose by 22.4 per cent compared to the same period of the previous year and reached 17.1 million visitors. In this respect, tourism revenues, which are estimated to be 18.5 billion dollars in 2005, are expected to reach 24.8 billion dollars in 2008.

In this context, current account deficit, which is estimated to be 21.3 billion dollars in 2005, is expected to display slight differences during the Pre-Accession Economic Programme period and realize around 23.2 billion dollars in 2008. The ratio of current account deficit to GDP, which is foreseen to realize as 5.9 per cent in 2005, is expected to decline to 5.3 per cent in 2008.

Capital and Financial Account

The net capital inflow, which was estimated to be 12.7 billion dollars in the PEP 2004, was realized as 13.3 billion dollars in 2004. It is expected that in 2005 and in the forthcoming years, capital inflows will continue to follow the trend observed in 2004. It is anticipated that the forms of capital inflows consist of foreign direct investments, portfolio investments and long-term credits of banking and private sectors from abroad. As a result of these, despite repayments to the IMF which will be 14.7 billon dollars in the period of 2006-2008, it is anticipated that current account deficit could be financed and official reserves will increase moderately in the corresponding years. Depending on this, official reserves are expected to increase only by 2.5 billion dollars in 2008.

Foreign direct investments in Turkey have remained rather low compared to the other emerging economies. In the forthcoming period, with a view to increasing foreign direct investments in Turkey, important steps have been taken towards improving the investment environment. With the arrangements put into effect and parallel to stability achieved in the economy, foreign direct investments have entered into an upward trend. As a matter of fact, with the inflow of 2.8 billon dollars worth foreign direct investment in 2004, Turkey improved its ranking in the world by 22 steps and ranked 35th from its previous ranking of 57th. It is thought that optimistic environment created by the beginning of negotiations with the EU will support the upward trend of foreign direct investment inflows. Especially, in 2005, remarkable interests of foreign companies to privatization auctions in Turkey is an indicator for expected increase in foreign direct investments. In this context, foreign direct investments are expected to be around 5.4 billion dollars annually on average throughout the period of 2005-2008.

Net portfolio investments, which were expected to be 5.6 billion dollars in the PEP 2004, were realized as 8 billion dollars in 2004 due to the increasing interest in Treasury bonds from abroad. In addition, increasing confidence in international markets towards the continuation of economic stability in Turkish economy, ongoing relative appreciation of domestic currency and existence of high interest arbitrage despite the declining risk premium have led to keep high level of portfolio investment inflows. During the PEP 2005 period, net portfolio investments in Turkey are expected to decline in consequence of convergence of interest rates to international market rates arising from the improvements in macroeconomic balances in the Turkish economy. In this respect, it is estimated that net portfolio investments, which are expected to be 11.1 billion dollars in 2005, will be realized as 5 billion dollars in 2008.

Table. 2. 8: Balance of Payments Forecasts

(Billion Dollars)

	Realization			Forecast			
	2002	2003	2004	2005	2006	2007	2008
Current Account	-1.5	-8.0	-15.6	-21.3	-22.0	-22.7	-23.2
Balance on Goods	-7.3	-14.0	-23.9	-32.0	-34.3	-36.6	-38.7
Exports	40.1	51.2	67.0	76.0	82.7	90.6	99.3
Exports (fob)	36.1	47.3	63.1	72.4	79.0	87.1	95.9
Imports	-47.4	-65.2	-90.9	-108.1	-117.0	-127.2	-138.1
Imports (cif)	-51.6	-69.3	-97.5	-115.0	-124.4	-135.3	-146.9
Balance on Services	7.9	10.5	12.8	15.1	16.8	18.5	20.6
Credit	14.8	19.0	24.0	28.2	30.5	34.1	37.6
Tourism	8.5	13.2	15.9	18.5	20.4	22.5	24.8
Debit	-6.9	-8.5	-11.2	-13.1	-13.8	-15.6	-17.0
Balance on Income	-4.6	-5.6	-5.6	-5.7	-6.0	-6.1	-6.5
Credit	2.5	2.2	2.7	3.4	4.1	4.4	4.4
Debit	-7.0	-7.8	-8.3	-9.1	-10.1	-10.5	-10.9
Current Transfers	2.4	1.0	1.1	1.3	1.5	1.4	1.4
Workers' Remittances	1.9	0.7	0.8	0.8	0.8	0.8	0.8
Capital and Financial Account							
Financial Account (Including Reserves)	1.4	3.0	13.3	16.4	22.0	22.7	23.2
Foreign Direct Investment	0.8	1.2	1.9	4.2	4.2	4.3	4.4
Direct Investment Abroad	-0.2	-0.5	-0.9	-1.0	-1.1	-1.2	-1.3
Direct Investment in Turkey	1.0	1.7	2.8	5.2	5.3	5.5	5.6
Portfolio Investments	-0.6	2.5	8.0	11.1	7.4	5.9	5.0
Assets	-2.1	-1.4	-1.4	-1.3	-1.2	-1.0	-0.9
Liabilities	1.5	3.9	9.4	12.4	8.7	7.0	5.9
Equity Securities	0.0	1.0	1.4	5.0	2.5	2.8	3.0
Debt Securities	1.5	2.9	8.0	7.4	6.2	4.2	2.9
Other Investments	7.3	3.4	4.2	12.1	12.1	14.4	16.3
Assets	-0.8	-1.0	-7.0	0.1	0.0	-0.1	-0.2
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	-0.8	-1.0	-7.0	0.1	0.0	-0.1	-0.2
Liabilities	8.1	4.3	11.1	12.0	12.1	14.5	16.5
Monetary Authority	-4.8	-1.0	-4.6	-3.3	0.0	-0.6	-0.7
General Government	11.8	-0.8	-0.3	-3.3	-3.2	-2.2	-1.3
Banks and Other Sectors	1.1	6.1	16.0	18.6	15.3	17.3	18.5
Official Reserves	-6.2	-4.0	-0.8	-11.1	-1.7	-1.9	-2.5
Net Errors and Omissions	0.2	5.0	2.3	5.0	0.0	0.0	0.0

Source: SPO, CBRT

The commercial loan claims of the non-bank private sector from abroad is expected to increase in parallel to the volume of foreign trade and long-term loan utilization of the non-bank private sector in the domestic market is also expected to rise depending on increasing domestic investments. The long and short-term loan claims of banking and private sectors are foreseen to realize as 10.9 and around 1.9 billion dollars annually on average, respectively, in the period of 2006-2008.

The net contribution of general government to capital flows is expected to be 4.5 billion dollars in 2005. Also, it is expected to be 2.9 billion dollars, 2 billion dollars and 1.5 billion dollars in 2006, 2007, and 2008, respectively.

Box. 2. 2: Impacts of Developments in Oil Prices on Current Account Balance

Petroleum and petroleum products are used as a significant intermediate input in production activities and demand for oil is almost met by imports in Turkey. In this respect, developments in crude oil prices are important because of its effects not only on growth and but also on current account balance. World crude oil prices had kept its high level for some time after the crises in 1979, but it started to decline in line with the release in the effects of crisis. After 2000, crude oil prices, which stayed at low levels since the second half of 1980s, has increased due to uncertainties experienced following the second Gulf crisis and increasing demand of developing economies like China and crude oil prices has reached very high levels in 2005.

When this situation is analyzed from the perspective of Turkey, it is the fact that current account balance is negatively affected by the increases in crude oil price. While Turkey imported 16.7 million tons of crude oil in 1986, this amount reached 23.9 million tons in 2004. In this respect, the annual average growth rate of crude oil imports in quantity was realized as 2 per cent in 1987-2004 period. On the contrary, while the amount paid for oil imports was 1.8 billion dollars in 1986, this amount reached 6.1 billion dollars in 2004 by increasing 7 per cent as on average annually. Although, in the first nine months of 2005 in terms of quantity, imports of oil decreased by 3.7 per cent compared to the same period of 2004, it increased in terms of value by 43 per cent compared to the same period of 2004 and rose up to 6.3 billion dollars. The basic reason for this increase is the 48.5 per cent increase in the oil prices in the same period.

It is expected that total imports of crude oil would realize as 8.6 billion dollars in 2005, if it is assumed that the corresponding growth rates in first nine months of 2005 with respect to the same period of 2004 will remain the same for the rest of the period of 2005, When the figures of 2004 and projection for 2005 are analyzed, it is observed that additional total cost of oil price increase, which have started in 2004, on current account balance via the increasing the crude oil imports, is 5.4 billion dollars in consecutive two years. While 1.3 billion dollars of this additional cost is realized in 2004, 4.1 billion dollars of this cost is realized in 2005.

When the historical path of Turkish economy is analyzed, it is observed that current account deficit increases during the economic growth periods. While it is expected that existing growth performance of Turkey will continue in the following years, it is not expected that there will be a significant decrease in crude oil prices in the short-run. In this case, keeping the level of high prices in crude oil constitutes an extra burden on current account balance. In this framework, the impacts of change in crude oil prices on current account balance are investigated under several assumptions. The goal of these analyses is to show that certain part of current account deficit, which reached substantial levels, resulted from the cost of energy that is an important factor for growth. As a matter of fact, taking into account not only Turkey's natural gas importer position but also oil importer position, the relation between energy prices and current account balance become more crucial.

In the scenarios presented here, growth elasticities are employed in calculating the crude oil imports demand. The growth elasticity of crude oil imports is 0.54 for the period of 1987-2004 and corresponding to 5 per cent GDP growth rate, the increase in crude oil imports in quantity is calculated as 2.7 per cent. Furthermore, in the econometric analysis, where price-quantity nexus is endogenously determined, the price and growth elasticity of crude oil import demand are estimated as -0.1 and 0.52, respectively. Scenarios, which analyze the effects of possible developments in crude oil prices on current account balance, are presented below.

In the baseline scenario, it is assumed that for the period of 2006-2008 the growth elasticity of crude oil import demand for the 1987-2004 period will remain same and there will be no increase in crude oil prices with respect to 2005. Thus, the crude oil imports are realized as 27.2 billion dollars for the period of 2006-2008. Alternative scenarios were built to make comparison with this baseline scenario.

- Scenario 1: It is assumed that in the 2006-2008 period, the growth elasticity of crude oil import demand calculated for the period of 1987-2004 will be preserved and crude oil import prices increase by 10 per cent annually on average. Thus, total crude oil import will realize 5.9 billion dollars higher than the baseline scenario.

- Scenario 2: It is assumed that in the 2006-2008 period, the growth elasticity of crude oil import demand calculated for the period of 1987-2004 will be preserved and crude oil import prices decrease by 10 per cent annually on average. Thus, total crude oil import will realize 5.1 billion dollars lower than the baseline scenario.
- Scenario 3: The growth elasticity, estimated from the econometric analysis where price-quantity nexus is endogenously determined, is used for the period of 2006-2008 and it is assumed that the crude oil prices increase by 10 per cent annually on average. Thus, quantity of crude oil import increases by 1.6 per cent annually on average in the period of 2006-2008 and total crude oil import will realize 5.1 billion dollars higher than the baseline scenario.
- Scenario 4: The growth elasticity, estimated from the econometric analysis where price-quantity nexus is endogenously determined, is used for the period of 2006-2008 and it is assumed that the crude oil prices decrease by 10 per cent annually on average. Thus, quantity of crude oil import increases by 3.6 per cent annually on average in the period of 2006-2008 and total crude oil import will realize 4.8 billion dollars lower than the baseline scenario.

The results of the scenarios are presented in the table below. The results of this analysis show that a change in crude oil prices has significant impacts on the current account balance. Especially, the impact aggravates during high growth environment. In order to maintain projected growth path in the PEP 2005 period, no significant decline in oil demand is expected. Thus, predicted current account deficit for the period of 2006-2008 will be affected by the additional cost caused by oil imports depending on the increases in oil prices. It is considered that such negative external factors should also be taken into account while evaluating the current account performance.

Table: The Results of Scenarios

	2006	2007	2008	2006-2008*
Baseline Scenario				
Demand for Crude Oil Imports (Annual Increase, Per cent)	2.7	2.7	2.7	2.7
Crude Oil Import Price (Annual Increase, Per cent)	0.0	0.0	0.0	0.0
Crude Oil Imports (Billion Dollars)	8.8	9.1	9.3	27.2
Crude Oil Imports / GDP (Per Cent)	2.3	2.2	2.1	2.2
Scenario 1				
Demand for Crude Oil Imports (Annual Increase, Per cent)	2.7	2.7	2.7	2.7
Crude Oil Import Price (Annual Increase, Per cent)	10.0	10.0	10.0	10.0
Crude Oil Imports (Billion Dollars)	9.7	11.0	12.4	33.1
Crude Oil Imports / GDP (Per Cent)	2.5	2.7	2.8	2.7
Scenario 2				
Demand for Crude Oil Imports (Annual Increase, Per cent)	2.7	2.7	2.7	2.7
Crude Oil Import Price (Annual Increase, Per cent)	-10.0	-10.0	-10.0	-10.0
Crude Oil Imports (Billion Dollars)	7.9	7.3	6.8	22.1
Crude Oil Imports / GDP (Per Cent)	2.1	1.8	1.5	1.8
Scenario 3				
Demand for Crude Oil Imports (Annual Increase, Per cent)	1.6	1.6	1.6	1.6
Crude Oil Import Price (Annual Increase, Per cent)	10.0	10.0	10.0	10.0
Crude Oil Imports (Billion Dollars)	9.6	10.7	12.0	32.4
Crude Oil Imports / GDP (Per Cent)	2.5	2.6	2.7	2.6
Scenario 4				
Demand for Crude Oil Imports (Annual Increase, Per cent)	3.6	3.6	3.6	3.6
Crude Oil Import Price (Annual Increase, Per cent)	-10.0	-10.0	-10.0	-10.0
Crude Oil Imports (Billion Dollars)	8.0	7.5	7.0	22.5
Crude Oil Imports / GDP (Per Cent)	2.1	1.8	1.6	1.8

* Annual average increase in the 2006-2008 period for the demand for crude oil import and crude oil import price and total of 2006-2008 for crude oil imports.

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

Appreciation in the Real Exchange Rate

An exchange rate shock was analyzed in the baseline scenario of the PEP 2005 in order to see its impacts on exports, imports and current account balance relative to baseline scenario in a case of real appreciation in exchange rate. In this framework, a 5 per cent real appreciation of YTL relative to baseline scenario, decreases exports and increases imports and thus current account balance deteriorates. On the other hand, while real appreciation has negative effect on the growth for the first year, it has positive effects on growth in the forthcoming years as a result of positive effects of appreciation on consumption and investment. Hence, effects of exchange rate shock disappear within the three years and the production level approaches to the level of baseline scenario as of 2008. The results of this analysis are presented in the Table 2.9 in a way of reporting the differences with respect to baseline scenario.

Table. 2. 9: The Effects of an Appreciation in Real Exchange Rate

	The Baseline Scenario			Difference from the Baseline Scenario		
	2006	**2007**	**2008**	**2006**	**2007**	**2008**
GDP Growth (Per cent)	5.0	5.0	5.0	-0.6	0.2	0.4
Exports (fob, Billion Dollars)	79.0	87.1	95.9	-1.2	-1.2	-1.0
Imports (cif, Billion Dollars)	124.4	135.3	146.9	2.1	1.9	2.0
Current Account Balance / GDP (Per cent)	-5.8	-5.5	-5.3	-0.8	-0.7	-0.7

3. PUBLIC FINANCE

The budget for 2006 has been prepared in the format of central government budget pursuant to the Public Financial Management and Control Law No. 5018 dated December 10, 2003.

Box. 3. 1: Central Government Budget

By the central government budget, the scope of the budget is being expanded both in respect of the number of institutions and organizations and the details of revenues and expenses, thus the right of Turkish Grand National Assembly (TGNA) in budget is strengthened. Further, the principle of transparency and accountability is enhanced in the public.

The central government budget includes the budgets of the following:

I. General budget: public administrations included in the legal personality of the state (Turkish Grand National Assembly, Prime Ministry, Ministries, Higher Judiciary Bodies etc.)

II. Special budget: public administrations which are established under a ministry or to perform a specific public service, to which revenues are allocated, which is authorized to make expenditure out of such revenues, and for which the organization and working principles are laid out in a special law (Council of Higher Education, Universities, Student Selection and Placement Center etc.),

III. Budgets of regulatory and supervisory agencies: agencies which are organized as board, authority, or higher board by special laws (CMB, Radio and Television Supreme Council, Energy Market Regulatory Authority etc).

The central government budget which is prepared within the framework of principles and basic sizes indicated in the Medium-term Program and Medium-term Financial Plan, includes, for coming two years in addition to the current year, revenue and expense estimates, the amount of budget deficit or surplus if any, how the deficit will be made up or the surplus will be utilized, and the revenues waived due to such practices as tax exemption, exception and discounts and similar practices, and introduces the multi-year budgeting approach to our country.

Further, the central government budget has been prepared to indicate the shares and funds transferred to the local governments, funds or other institutions and organizations out of the revenues.

The central government budget differs from the consolidated budget in respect of fiscal size in that it has a wider scope than that of the consolidated budget and also the fund shares are indicated in the revenues and expenses. According to the 2006 Central Government Budget Draft Bill proposal, when the share of local governments and funds are not included, expenditures are 1,3 percentage points higher than the previous year, because of the extension in the scope.

Table: Central Government Budget Balance

(Percentage of the GDP)

	2006	2007	2008
Total Revenues	29.7	28.0	27.2
Total Expenditures	32.2	30.0	28.0
Total Non-Interest Revenues	23.6	22.6	22.0
Primary Surplus	6.1	5.4	5.2
Budget Balance	-2.5	-2.0	-0.8

Source: Ministry of Finance

3.1. Objectives of Fiscal Policy

Fiscal Policy

The basic objectives of the fiscal policy in practice are to contribute to creating a sustainable growth environment by adhering to fiscal discipline in harmony with the monetary policy within the framework of sustaining macroeconomic stability created, support fight against inflation, and generate non-interest surplus at significant rates that would maintain the process of reducing the ratio of debt stock to national income. The public revenue, expense and borrowing policies will be effectively implemented in the period of 2006-2008 in accord with the aforesaid basic objectives.

Public Revenues Policy

The following objectives will be pursued in implementing the public revenues policy:

- Carry out revenue policies in accord with the targeted non-interest surplus and take necessary measures on the matter,
- Take informal economy under control by strengthening the implementation, monitoring and supervision functions of the Revenue Administration and rationalizing the tax system,
- Implement tax policies effectively to enhance investment and employment,
- Re-evaluate the provisions of exception, exemption, tax discount and similar provisions in the tax laws within the framework of economic and social policies and simplify tax legislation,
- Enhance self-revenues of local governments.

Some legislation was made for these objectives as follows.

The Law No. 5345 on Organization and Duties of Revenue Administration dated May 5, 2005 went into effect which related to restructuring of the Revenue Administration so that it would manage the tax system more effectively. By this legislation:

- The General Directorate of Revenues was restructured as an organization under the Ministry of Finance on the basis the functions.
- The Revenue Administration was made more independent and effective in implementing the revenue policies.
- The function of collecting revenues being performed by the fiscal offices in the provinces was transferred directly to the Revenue Administration. Tax Office Presidencies were established in 29 provinces. Thus, it was made possible that the Revenue Administration’s central and field units had direct relation.

The second part of the Tax Office Full Automation Project (VEDOP II) which aims to enhance effectiveness and efficiency of tax administration and tax collection was implemented in the end of April 2004. Studies are underway to strengthen technological infrastructure for tax supervision, including mainly the creation of a data warehouse, in order to take informal economy under record within the scope of VEDOP II Project. It is planned to implement at the end of 2005 the Project of Capacity Building in Tax Administration in Selecting Taxpayers Based on Risk Analysis in Tax Audit which is supported by EU funds and prepared to improve tax collection and taxpayer compliance as a support to VEDOP II Project.

The practice of e-declaration started as of October 1, 2004. The requirement was established to submit tax declarations in electronic medium for the annual and provisional tax declarations of income and corporate taxpayers taxed by actual method as of December 31, 2004 considering their assets total and business volume total, and for those taxpayers of special consumption tax, special communications tax and games of chance tax regardless of their assets total and business volume total.

The taxing system for securities was rearranged by the Law No. 5281 dated 30 December and the practice of differential taxing by different types of revenues was terminated. It was provided that from the beginning of 2006, all revenues of securities stock would be finally taxed by making a withholding of 15 per cent.

It is planned that the Unit of Big Taxpayers will be established by mid 2006 in order to closely monitor the tax obligations and activities of big taxpayers and enhance the service quality provided to such taxpayers.

It is planned to finalize by the end of 2005 the studies of redrafting the Corporate Tax Law and rearranging its system, reducing the corporate tax rate and narrowing the scope of exceptions and exemptions in order to rationalize and simplify the tax system.

Within the principle of separating the stages of determining revenue policies and implementation of such policies, studies are underway to establish a separate unit to determine revenue policies within the Ministry of Finance.

Public Expenditures Policy

The basic objective of the expenditure policy in practice is to enhance efficiency in public expenditures, ensure discipline and hold the impact of expenditures on the need of borrowing at a minimum level.

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

- It is envisioned that a comprehensive reform of personnel regime will be made and the public personnel system will be reorganized. On this matter a draft bill was prepared and circulated for the opinion of relevant parties.
- In order to reduce excessive employment in the public sector, the limitation on recruitment of new personnel included in the Budget Laws of Fiscal 2004 and 2005 is also included in the 2006 Central Government Budget Law.
- Wages and salaries in the public sector shall be determined in line with inflation, the public financing balance and so as to ensure equity of compensation among employees.
- Disciplining of the health expenditures of social security organizations will be continued. Implementation of measures will be continued to reduce health expenditures including mainly increasing the collection of premiums and treatment expenditures.
- Arrangements will be continued which will re-determine the division of duties and power between the central government and local governments and increase powers and responsibilities of local governments in order to take expenditures under control, distribute resources by strategic priorities and effective use.
- Budgeting works on the basis of strategic planning and performance will be continued.
- The share of social expenditures in the total public expenditures will be increased.
- Studies to rationalize the public investments will be continued and real increase will be obtained in the public investments.

- The share allocated from the budget for agricultural support and the distribution of this support among support instruments will be determined within the framework of the Agriculture Strategy Document.

Public Finance Projections (2006-2008)

The general government balance is obtained by consolidating the revenues and expenses of the consolidated budget, funds, social security organizations, revolving funds and local governments. While shifting to the practice of central government budget, some of the analyses were made on the basis of consolidated budget to allow comparison of data relating to 2006-2008 to those of the past years.

In the forecast of general government accounts, the following assumptions were considered in addition to the general assumptions relating to growth, inflation, interest rates, balance of payments and nominal wage rises projected for 2006-2008:

Assumptions regarding revenues:

- It is assumed that the impact of the reductions that may be made in the income and corporate taxes in the period of 2006-2008on the revenues will be neutral. In other words, any likely loss of revenue will be compensated by enlargement in the tax base and narrowing in the exemptions.
- It is assumed that inflationary accounting will not be practiced based on the forecast that circumstances warranting such practice will not materialize in the period of 2006-2008.
- The fiscal impact of the Provincial Special Administration and Municipal Revenues Draft Bill which is a component of the local governments reform and expected to go into effect in the period of 2006-2008 on the balances is not reflected.
- It is assumed that the rates of Banking and Insurance Transactions Tax (BITT) will be reduced to the extent allowed by conditions.
- Increase is expected in the premium revenues of Bağ-Kur and SSK in the period of 2006-2008 by the restructuring of premium debts.
- Revenue of 600 million YTL is expected from the sale of property of the Pension Fund (Emekli Sandığı) in the period of 2006-2008.
- Since the process of completing the method for privatization of lottery games and privatization actions are not fully clarified, no significant change is assumed in the period of 2006-2008 in the revenues and expenses of National Lottery Administration which is included among the organizations with circulating capital.
- It is assumed that the shares transferred to the budget from the proceeds and dividends of SEEs will go down due to privatization.
- A total of 12 billion dollars of privatization proceeds is expected in the period of 2006-2008, with 9 billion dollars in the privatization fund and approximately 3 billion dollars in the budget.
- It is assumed that no change will be made to SCT amounts charged on the petroleum and natural gas products.

Under such assumptions, it is expected that the total general government revenues which is expected to be at 43.3 per cent of GDP in 2005 will recede to 41.9 per cent of GDP in 2008.

Assumptions regarding expenditures:

- It is assumed that the policy of limiting recruitment of new public personnel will continue and the wages and retirees' salaries will be increased according to the targeted inflation.
- It is assumed that decreases observed in transfer expenditures due to decrease in interest payments from the budget will continue.
- By the projection that the agricultural support budget in 2010 will be 1 per cent of GNP according to the Agricultural Strategy Document, it is assumed that agricultural support budget will rise gradually to be 0.75 per cent, 0.79 per cent and 0.84 per cent respectively in the period of 2006-2008.
- No changes are assumed in the rights and obligations regarding the conditions of eligibility in the Unemployment Insurance.
- The fiscal impact which will arise under the Universal Health Insurance and Retirement Insurance which are expected to go into effect in 2007 is reflected on the balances. Although significant increase occurs in the health expenditures due to expansion of coverage and facilitation of access, the additional revenue coming from the inclusion of all compensation items in the scope of premium particularly for the public servants will cover for a large part of the expenditures. Therefore, by the promulgation of the Universal Health Insurance and Retirement Insurance, an increase is expected at 0.1 per cent in the budget transfers in 2007 compared to the current situation, and 0.2 per cent in 2008.
- There will be an increase in the premium expenses from the consolidated budget allocated for public servants because of the inclusion of all compensation items in the scope of premium for the public servants. To compensate for this decrease in the salaries of public servants, it is planned to place a separate allotment for the public servants to the consolidated budget. Its fiscal effect is expected to be at 0.5 per cent of GDP for 2007 and 2008.

As a result of projections made considering such assumptions, it is predicted that the general government expenditures that are expected to be at 44.7 per cent of GDP in 2005 will recede to 41.9 per cent of GDP in 2008, that the non-interest expenditures that are expected to be at 34.9 per cent of GDP in 2005 will rise to 35.9 per cent in 2008. Thus, the biggest factor in decrease of general government expenditures is the significant reduction expected in the interest payments from the consolidated budget.

General Government Borrowing Requirement

It is expected that the ratio of the general government primary surplus to the GDP will be 8.9 per cent, 6.1 per cent and 6 per cent respectively in the years 2006 to 2008.

It is expected that the ratio of general government borrowing requirement to the GDP that is expected to be 1.3 per cent in 2005 will recede by 1.5 percentage points and return a surplus of 0.2 per cent points due to both increase in privatization proceeds and decrease in interest expenses. On the other hand, the general government will return a deficit at 0.9 per cent of GDP in 2007 due to the impact of the decrease expected in dividend revenues and privatization proceeds due to privatizations, reductions contemplated in BITT, decreases in collection of VAT charged on imports due to exchange rates expected to follow a downward trend, low increase predicted in SCT collection and the onset of universal health insurance in 2007.It is predicted that the general state borrowing needs will get to equilibrium due to decrease expected in the interest expenses in 2008.

Table. 3. 1: General Government Revenues and Expenditures (1)

(Percentage of the GDP)

	2005	2006	2007	2008
Taxes	24.9	24.8	24.0	23.5
Direct	7.2	7.1	7.1	7.0
Indirect	16.9	16.9	16.2	15.8
Wealth	0.8	0.8	0.7	0.7
Non-Tax Revenues	2.9	2.9	2.6	2.6
Factor Incomes	7.0	6.5	5.7	5.6
Social Funds	7.8	8.2	9.7	9.5
Total	42.5	42.4	42.0	41.2
Privatization Revenues and Asset Sales	0.8	1.7	0.7	0.7
Total Revenues	43.3	44.1	42.7	41.9
Current Expenditures	18.0	17.8	18.6	18.1
Investments	3.8	3.7	3.7	3.7
Fixed Investment	3.8	3.7	3.7	3.7
Change in Stocks	0.0	0.0	0.0	0.0
Transfers	22.9	22.3	21.3	20.1
Current Transfers (net)	22.0	21.4	20.7	19.4
Capital Transfers	0.9	0.9	0.7	0.7
Stock Revaluation Fund	0.0	0.0	0.0	0.0
Non-interest Expenditure	34.9	35.2	36.6	35.9
Total Expenditures	44.7	43.9	43.6	41.9
Borrowing Requirement Excluding Interest Payments	-8.4	-8.9	-6.1	-6.0
Adjusted Borrowing Requirement Excluding Interest Payments (2)	-5.5	-6.2	-4.5	-4.4
Borrowing Requirement	1.3	-0.2	0.9	-0.0

Source: SPO
(+) refers to deficit and (-) refers to surplus.
(1) Tax refunds are not included in revenue and expenditure figures.
(2) The figure for non-interest borrowing need has been calculated by adjusting for interest gains, privatization, CBRT profit, risk calculation, revaluation difference etc. The general state non-interest surplus agreed upon with IMF is 5.5 per cent in 2005, 6 per cent in 2006, and including SEEs, the total public sector non-interest surplus is 6.3 per cent and 6.5 per cent respectively.

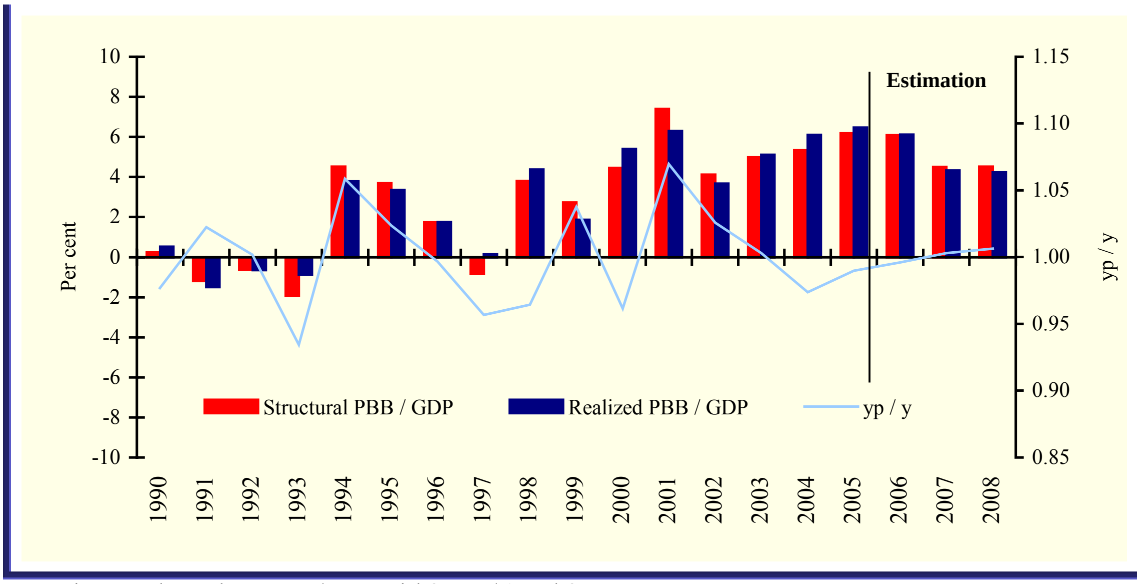
The borrowing requirement in the Pre-Accession Economic Program of 2004 were predicted as 4.4 per cent, 2.1 per cent and 0.5 per cent for years 2005 to 2007 respectively. However, due to such reasons as resolute implementation of the economic program, rapid decrease in interest rates, high performance experienced in privatization activities, the decrease in borrowing needs will be faster than the forecast made in the past year.

Structural and Cyclical Consolidated Budget Balance

The structural and cyclical budget for Turkish economy is examined in the framework of the methodology used by the European Commission and OECD.

The calculated non-interest structural budget balance is given in Figure 3.1. Accordingly, the ratio of the non-interest structural budget balance which was 5 per cent in 2003 occurred at 5.3 per cent in 2004 maintaining its horizontal course of progress. It is expected that the non-interest surplus rate freed of cyclical effects should maintain its level of 2004 in the period of 2005-2008.

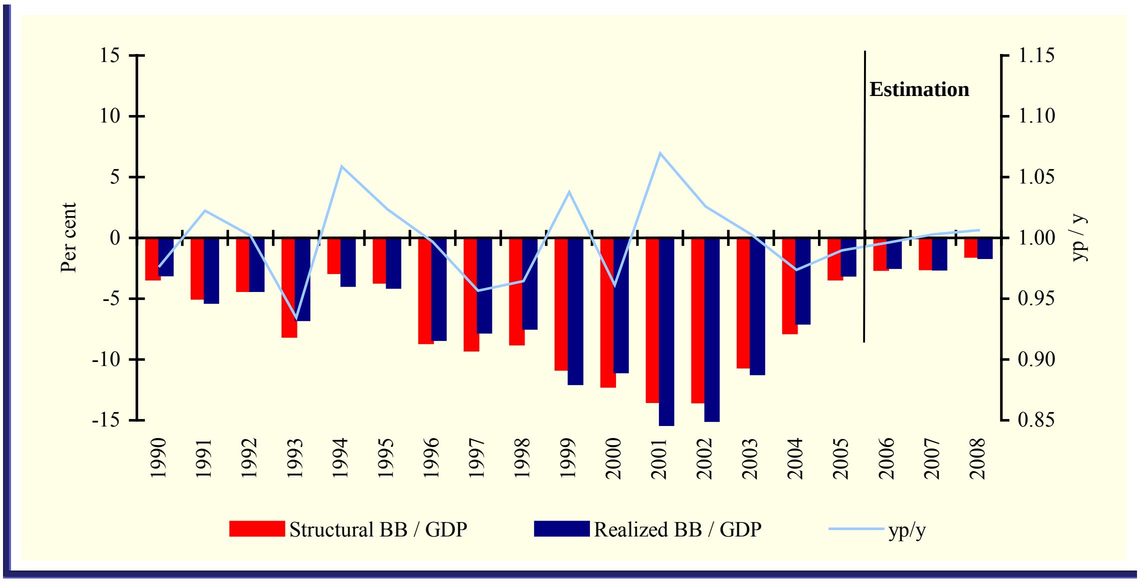
Figure. 3. 1: Actual and Structural Primary Budget Balances



PBB: Primary Budget Balance yp/y: Potential Output / Actual Output

As could be seen in Figure 3.2, the structural budget balance moves in the positive direction. The fact that interest rates went down and high rate of non-interest was obtained was influential in this development. Further, this trend is predicted to continue in the period of 2005-2008 during which the strict fiscal policies will be maintained.

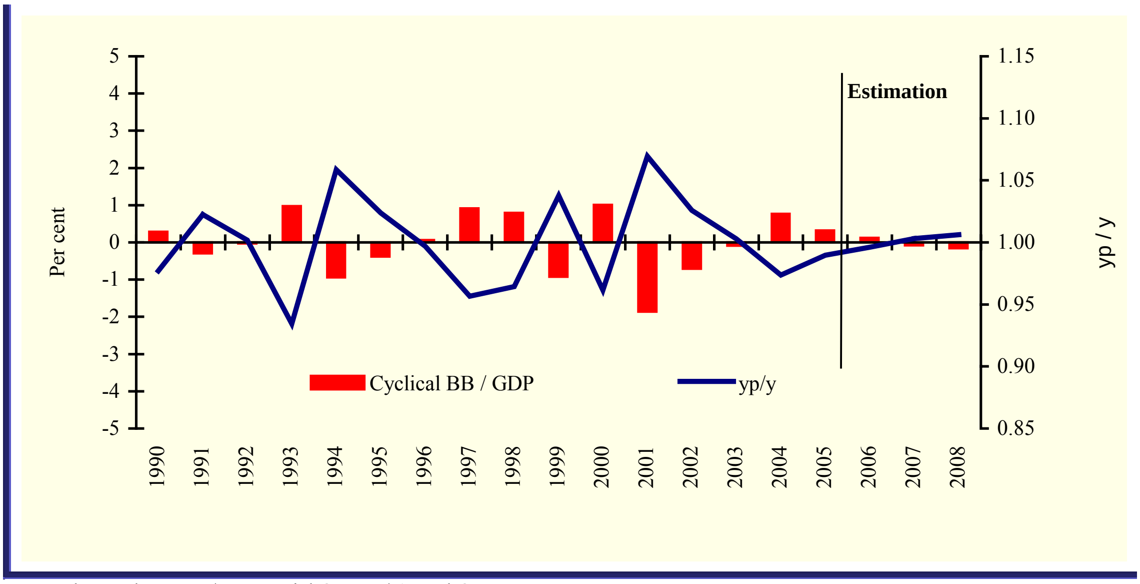
Figure. 3. 2: Actual and Structural Budget Balances



BB: Budget Balance yp/y: Potential Output / Actual Output

Examining the cyclical budget graphic given in Figure 3.3, it is observed that the cyclical budget balance (difference between the actualized budget balance and the structural budget balance), fiscal policies move in harmony with the cyclical movement of economy.

Figure. 3. 3: Cyclical Budget Balance



BB: Budget Balance yp/y: Potential Output / Actual Output

3.2. Public Debt Management

Institutional Responsibilities For Debt Management and Borrowing Limits

The debt management is conducted within the limits of borrowing specified pursuant to Article 5 of the Law No. 4749 on Regulating Public Financing and Debt Management promulgated on April 9, 2002.

The basic principles of public borrowing and risk management were laid down in the said Law as follows:

- Follow a borrowing policy that is in accord with monetary and fiscal policies considering macroeconomic balances, sustainable, transparent and accountable
- Meet financing needs at the lowest possible cost in the mid to long run within the framework of risk level identified considering domestic and international market conditions and cost items.

The borrowing limit is defined as the difference between the sum of the initial allotments indicated in the budget law of a fiscal year and the sum of estimated revenues for that year. Within the framework of the said Law, the net borrowing limit can be increased by up to 5 per cent in the year by a decree of the Council of Ministers considering the borrowing management needs and developments.

Debt Management Strategy

The practice of strategic benchmarks which were identified dependent on cost and risk calculations was continued in 2005 which started from 2004 in order to ensure that transparency would be enhanced in public debt management and performance-based effective borrowing would be realized at minimum cost and reasonable risk level. In this context it was contemplated that:

- Total borrowing would be made mostly in YTL,
- Domestic cash borrowing would be made mostly with fixed interest YTL instruments,

- Lengthening the average maturity of cash domestic borrowing including foreign exchange denominated and indexed instruments in line with the market conditions,
- Adequate level of reserves would be maintained throughout the year to minimize the liquidity risk that might occur in cash and debt management.

It is envisioned that the atmosphere of confidence and positive expectations in the domestic and international markets which will be preserved by a continuation of reforms in the period of 2006-2008 will reduce borrowing costs. Thereby, it is expected that the ratio of the public debt stock to GDP will continue to decrease.

On the other hand, a high level of primary surplus contemplated within the framework of the economic program being implemented will help preserve the atmosphere of confidence ensuing in the markets and reduce the public debt stock.

It is envisioned in the future period that the investor base will be developed for the Government Domestic Borrowing Instruments (GDBI) and policies aiming to ensure effectiveness in secondary markets will be continued. In this context, the practice of Primary Dealer System will be continued. On the other hand, it is planned that the practice of benchmark bill will be continued in order to create a healthy yield curve in secondary markets and ensure liquidity in GDBI trading transactions.

Further, in the context of maintaining transparency in debt management, it will be continued beyond 2005 that information on financing programs and loans will be disclosed to the public. As for the domestic borrowing which constitutes a large part of the annual financing needs, the repurchase and exchange transactions being practiced currently as active debt management tools will be continued in order to make the current repayments more orderly and compliant with strategic benchmarks. Developing the GDBI investor base by diversifying the domestic instruments to be issued according to different investor preferences is among the priorities of the future period.

Contingent Liabilities

Contingent liabilities are those which are not by nature public debts but may become public debts upon occurrence of the risk for debt assumption and constitute costs. While the liabilities which are under contract or indicated in the law are called explicit contingent liabilities, the others are called implicit contingent liabilities.

Such risks as default of public agencies and local governments in their debts not covered under Treasury guarantee constitute the implicit contingent liabilities that should be taken into account in the case of Turkey.

In addition, the third party limited liability guarantee extended to the civil aviation sector and the deposit guarantee provided at 50 thousand YTL per person in the banking sector are currently important explicitly contingent liabilities that should be taken into account.

The Undersecretariat of Treasury provides repayment guarantee for such purposes as to keep the investment financing costs at minimum for the public organizations outside the general and annexed budget, ensure sustainability of growth and meet funding needs of investments spread over years. Further, the Treasury provides investment guarantee to public agencies outside the general and annexed budget which have buy-or-pay agreements with the BOT-BO company under the scope of financing for the projects realized by the Build-Operate-Transfer (BOT) and Build-Operate (BO) models.

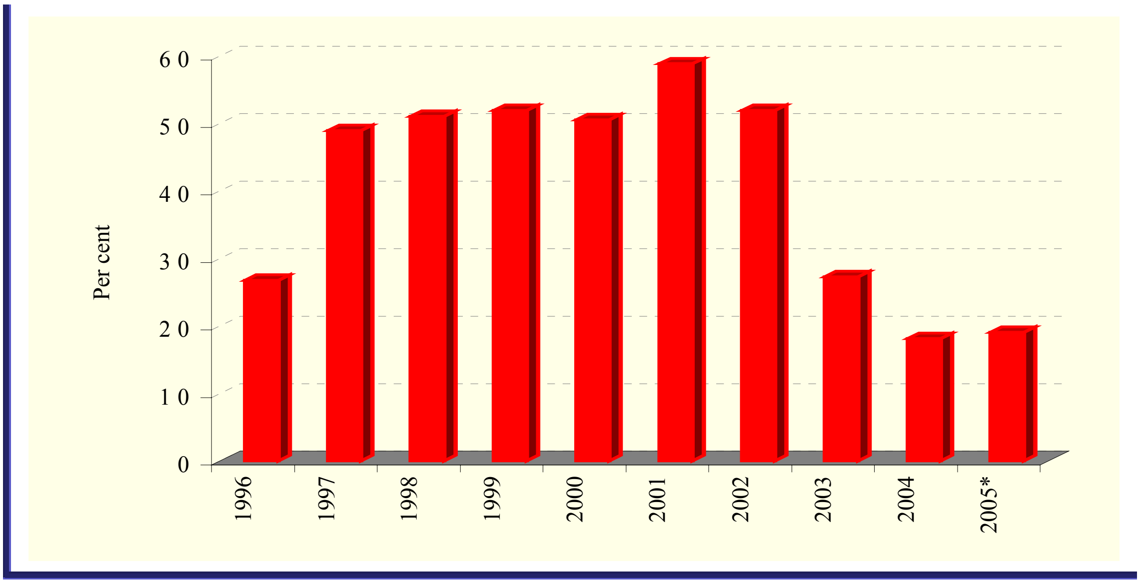
The probability that the guaranteed debts of the organizations in financial distress and the liabilities under the buy-or-pay agreement could be covered by the Treasury from the consolidated budget constitutes a significant portion of explicit financial risks.

Repayment Guarantee

The repayment guarantees extended by the Treasury which were monitored outside the budget until 2003, and budgeted for the probable amount of risk from 2003 onwards were employed for years for such purposes as to keep investment financing costs at minimum and ensure sustainability of economic growth. SEEs used 54.2 per cent and the local governments used 22.3 per cent of the Treasury guaranteed loans at 10.3 billion dollars obtained between 1996 and 2001. Therefore, the share of SEEs and local governments is large in the total guaranteed debt stock.

The first assumption request occurred in 1992, and approximately 13.6 billions were paid in the period from 1992 through the first half of 2005 due to the repayment guarantees extended in favor of the organizations. The largest share in the said repayments first falls on the local governments and then SEEs.

Figure. 3. 4: Undertaken Ratios of Treasury Guaranteed Debt



Source: The Undersecretariat of Treasury

* Figure for 2005 belongs to the first half of the year.

The most significant development realized under the repayment guarantees is the Law on Regulating Public Finance and Debt Management, and an active risk management strategy has been created in respect of monitoring easily the financial transactions carried out under the public financial management and for contingent liabilities, and a risk account has been created to use upon the assumption of guarantees extended.

From 2003 onwards, allotments were set aside from the budget for the probable payments that could be made under the repayment guarantees and possible adverse impact on the Treasury's cash management and borrowing was prevented.

By the Law on Regulating Public Finance and Debt Management and legislation made in this context, a certain increase was achieved in collecting the Treasury claims from 2002 onwards and sharp decreases occurred in assumption rates.

The debt stock under Treasury guarantee went down by 1.5 billion dollars from 2002 to June 2005 to 4.8 billion dollars, the rate of assumption went down from 57.2 per cent to 19 per cent.

A glance at the repayment projection of foreign debts under Treasury guarantee in the mid term reveals that the payment amounts are in a downward trend.

Table. 3. 2: Treasury Guaranteed External Debt Service Projections

(Million Euros)

	Principal	Interest	Total
2005 (III.-IV. Quarter)	889	206	1096
2006	746	173	919
2007	589	143	733
2008	482	117	599
2009-2015+	2040	351	2391

Note: Projections are based on commitments.

Investment Guarantees

In addition to repayment guarantees, investment guarantees extended to 15 electric power plants built under BOT and BO models and one energy SEE with a buy-or-pay agreement constitute significant explicit contingent liability. If the said SEE cannot fulfill its obligations to BOT/BO plants, the Treasury has to assume the liability. Although there has occurred no payment obligation out of the said guarantees, the said financial risks are considered when calculating the likely contingent liabilities.

Additionally, an investment guarantee was given to a municipality for the obligation to pay water price under a BOT project in 1995. A total of 1.2 billion euros was assumed from 1999 through August 2005 under the said investment guarantee.

Treasury Receivables

The treasury claims are comprised of all payments by the Treasury as a result of treasury guarantees for financing facilities procured from any foreign financing source or allowing the use of such facilities as loans and the claims arising from the government domestic bills issued as loans by the Treasury. In this context, looking the distribution of claims stock by source as of the end of June 2005, it is observed that the portion arising from the cash payments of GDIB issued to SDIF has a share of 70.4 per cent of the total, the build-operate-transfer projects have a share of 5.8 per cent, claims arising from the loaning of the foreign debt have a share of 10.7 per cent and the assumptions arising from the foreign borrowing guaranteed by the Treasury have a share of 13 per cent.

On the other hand, 3.7 billion YTL was collected from the said claims in the first half of the year. Sixty percent of this amount is the payments from the organizations. Collections comprised of withholding from the tax revenue shares of the municipalities make up 2.4 per cent, and offsets from the payments of the organizations constitute 37.5 per cent of the total collection.

2005-2008 General Government Gross Debt Stock Projections

Significant improvement is contemplated in the ratio of the general state gross debt stock to GDP as a consequence stable growth environment to be realized by strict fiscal policy and effective public debt management to be applied in the Pre-Accession Economic Program period. While this ratio was 74.8 per cent in 2004, it is projected to recede to 56.7 per cent in 2008.

As in 2004, the gross debt stock data are consistent with the general state definition in the PEP of 2005. In this context, the estimates of the ratio of the general state gross debt stock to the GDP for the period of 2005-2008 are given in Table 3.3.

Table. 3. 3. General Government Gross Debt Stock Projections

(Per cent of the GDP)

	Realization	Estimation			
	2004	2005	2006	2007	2008
Domestic Debt Stock	52.9	50.7	48.1	45.4	42.1
Foreign Debt Stock	21.9	19.3	17.5	16.0	14.6
Total Debt Stock	74.8	70.0	65.6	61.4	56.7
Decrease in Total Debt Stock	---	4.8	4.4	4.2	4.7

3.3. Risks Associated with Public Finance

Strict fiscal policy will be continued in the period of 2006-2008 which aims to ensure sustainability of the debt stock by making a non-interest surplus at a significant ratio of the national income. The risks are given below which might be confronted in the application of revenue, expenditure and borrowing policies to be followed in accord with this goal:

- The existing domestic debt stock is significantly comprised of bills in foreign currency or foreign currency indexed bills and variable interest bills. Therefore, unexpected rises in foreign exchange rates or interest rates pose a risk to the debt stock.
- Developments that could adversely affect premium collection of the social security organizations and failure to discipline health expenditures will lead to increases in transfers to be made from the budget to the social security organizations.
- Treasury guaranteed loans and product purchase and input guarantees extended to build-operate-transfer projects pose a risk to the budget.
- Current account deficit currently at high levels makes a pressure on the foreign exchange rates currently at low levels.
- Significant loss of revenue will materialize if the privatization actions for which tender processes were completed in 2005 are to be cancelled by administrative actions or judicial scrutiny.
- Supplementary measures may be needed if the central government revenues are reduced in order to increase the revenues for local governments.
- Although it is programmed that wages and salaries will be increased in accord with inflation, demands for compensation of erosion in the real wages of the wage earners that occurred in crises and for increasing living standards are important risk factors on the personnel expenditures.

3.4. Sensitivity Analyses

In the context of sensitivity analyses, analyses were conducted using two methods to determine the impact of various risks on the public finance and the sensitivity of the balances projected for the public finance in the period of 2006-2008 to the assumptions. In the first method, an approach was adopted which considered all sectors of the economy and the macro econometric model that was used in the Pre-Accession Economic Program was used for the analyses. In this context, the impacts of any likely slowdown in the growth on the public finance balances were examined. In the second analysis, the sensitivity of the accounting approach employed in previous PEPs and the general government gross debt stock to their own dynamics was assessed. The purpose in using two different methods is to analyze in more detail the sensitivity of projections made for the fiscal policy and public debt stock which are very important in respect of economic policies to the assumptions and risks.

Macroeconometric Approach Analyses

The impact of low growth performance on the public finance was examined under two different scenarios. In the scenarios, it was assumed that the GDP growth would be realized from 2006 onwards at 1 percentage point lower than the baseline scenario. In the first scenario, while the public revenues and public investment and consumption expenditures go down depending on the low growth, it is assumed that the remaining budget borrowing requirement would be financed from the domestic markets. In this context, it is estimated that the share of domestic interest payments in GDP will go up by 0.1 percentage point in 2006 and 2007 with respect to the baseline scenario and 0.2 point in 2008. It is estimated that the ratio of the general government borrowing requirement and the domestic debt stock to GDP will rise up by 0, 0.1, and 0.1 percentage points and 0.7, 1.1 and 1.5 percentage points respectively.

Table. 3. 4: Impacts of Decline in Growth Rate

(Per cent)

	Baseline Scenario			Scenario 1 Difference from Baseline Scenario			Scenario 2 Difference from Baseline Scenario		
	2006	2007	2008	2006	2007	2008	2006	2007	2008
GDP Growth	5.0	5.0	5.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Domestic Interest Payments / GDP	8.7	7.0	6.0	0.1	0.1	0.2	0.1	0.1	0.2
General Government Borrowing Requirement / GDP	-0.2	0.9	0.0	0.0	0.1	0.1	0.1	0.2	0.3
Domestic Debt Stock / GDP	48.1	45.4	42.1	0.7	1.1	1.5	0.7	1.1	1.7

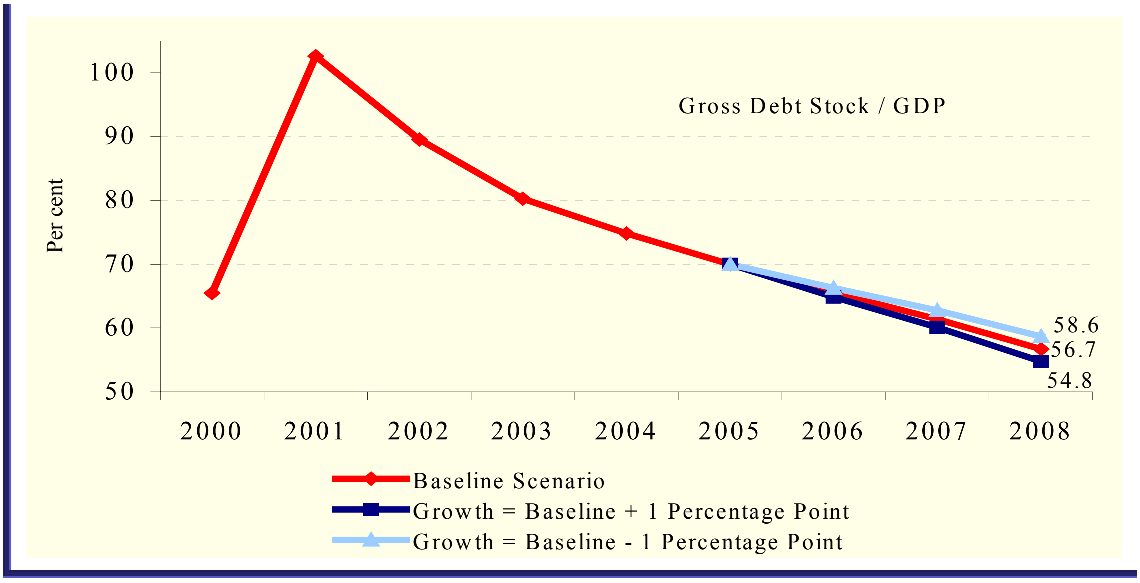
In the second scenario, it is assumed that the public expenditures will keep at nominal levels in the base scenario against any decrease that may occur in the public revenues depending on the low growth. As in the first scenario, it is projected that the borrowing requirement will be financed from the domestic markets. In this context, it is estimated that the share of domestic interest payments in GDP will go up by 0.1 percentage point in 2006 and 2007 with respect to the baseline scenario and 0.2 point in 2008. It is estimated that the ratio of the general government borrowing requirement and the domestic debt stock to GDP will rise up by 0.1, 0.2, and 0.3 percentage point and 0.7, 1.1 and 1.7 percentage point respectively. Outcomes of both scenarios may be seen in Table 3.4.

In both scenarios, the increase in the ratio of the domestic debt stock to GDP is limited in the period of 2006-2008. The reason for this is that as a result of the improvement realized in the public finance, the general government borrowing requirement receded to low levels and the terms of domestic borrowing are longer than earlier periods (see Figure 1.5). Thus, as of September 2005, the average term for Treasury borrowing got to 36.5 months.

Analyses of Accounting Approach

In the context of sensitivity analysis, the impacts of changes in growth, real interest, primary surplus and real exchange rates on the general government gross debt stock were analyzed for the period of 2005-2008 within the framework of accounting approach[4]. The ratio of the general government gross debt stock to GDP was 74.8 per cent as of the year end 2004. As of October 2005, the said ratio is estimated, at the end of 2005, to be at 70 per cent by receding 4.8 percentage points down from the previous year. In the context of sensitivity analyses, the general government gross debt stock which is divided into two as YTL and foreign currency, falls down to 56.7 per cent in 2008 under the assumptions of the baseline scenario.

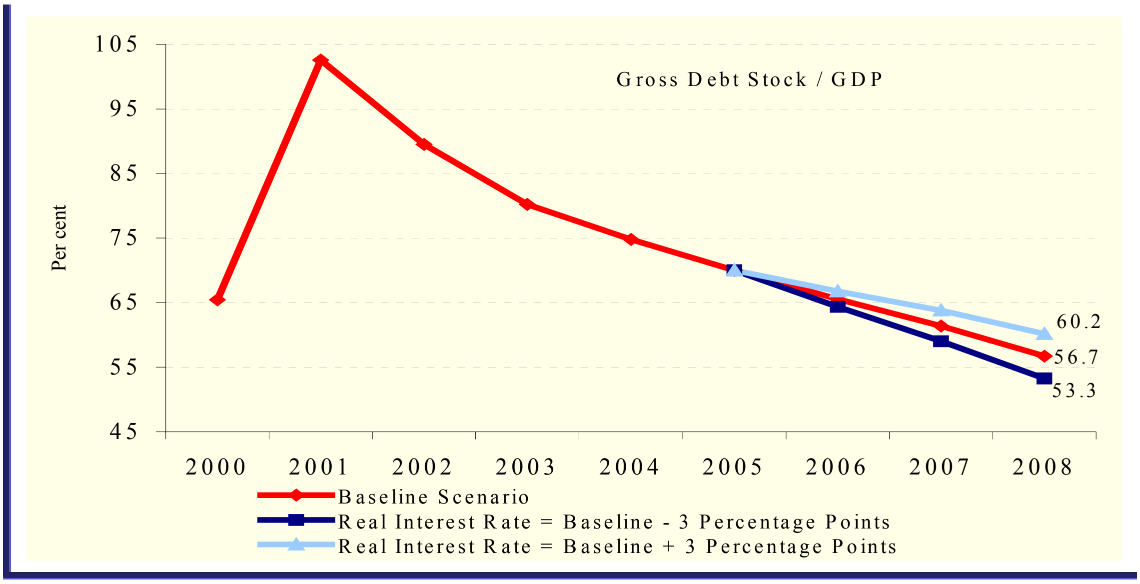
Figure. 3. 5: Analysis of Sensitivity to Growth Rate



First, in order to examine the sensitivity of debt burden to growth, two scenarios were created from 2006 with 1 point less and 1 point more than the baseline scenario with respect to the baseline scenario. According to the outcomes of the said scenarios, under the assumptions of growth being 1 point below or above the baseline scenario, the ratio of the gross debt stock to GDP in 2008 will be 1.9 points above or below the baseline scenario (Figure 3.5).

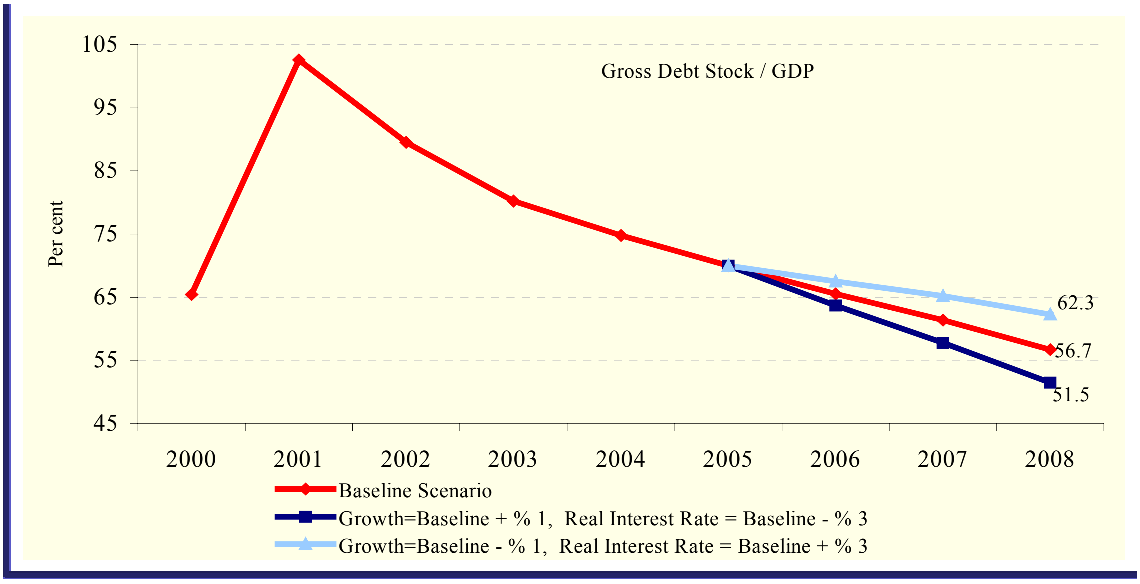
[4] Detailed information on the accounting approach method is provided in the 2003 PEP, Public Finance chapter.

Figure. 3. 6: Analysis of Sensitivity to Real Interest Rate on YTL Denominated Debt



Second, in order to examine how the change in real interest for debt in YTL would affect the debt burden, two scenarios were created with real interest for debt in YTL by year at 3 points below or above the baseline scenario. Accordingly where real interest is 3 points above and below the baseline scenario, the ratio of gross debt stock to GDP in 2008 will be 3.5 points above and 3.4 points below the baseline ratio respectively (Figure 3.6).

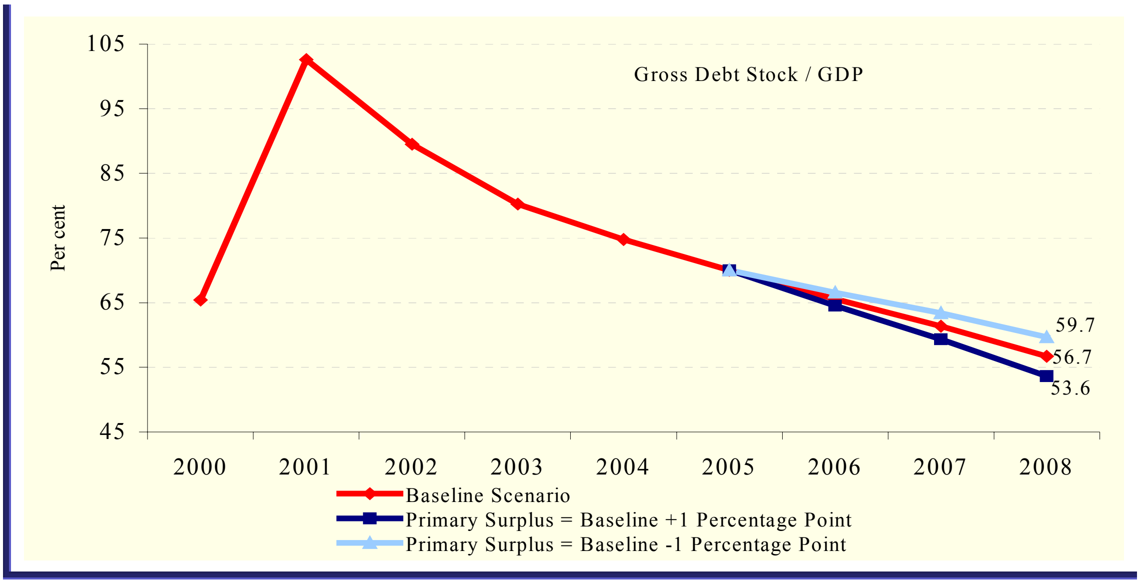
Figure. 3. 7: Analysis of Sensitivity to Growth and Real Interest Rates



Third, in order to examine the impacts of changes that might occur simultaneously in the growth and real interest rates on the debt stock, two scenarios were created, one optimistic and another pessimistic. In the optimistic scenario, it was assumed that the real interest rates for YTL debts will be 3 points below the baseline scenario for every year from 2006, and at the same time, growth will be 1 point above the baseline scenario. Against that, in the pessimistic scenario, it was assumed that the real interest rates for YTL debts will be 3 points above the baseline scenario for every year from

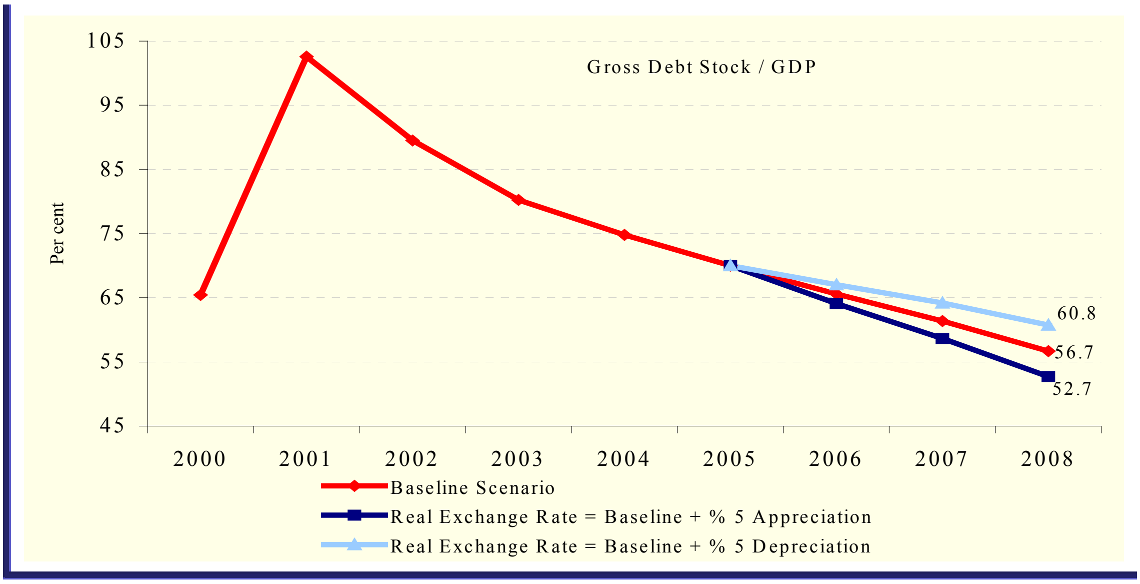
2006, and at the same time, growth will be 1 point below the baseline scenario. Accordingly, while the ratio of the gross debt stock to GDP in 2008 will be 5.2 points below the baseline scenario in the optimistic scenario, this will be 5.6 above the baseline scenario in the pessimistic scenario (Figure 3.7).

Figure. 3. 8: Analysis of Sensitivity to Primary Surplus



In the context of analysis of sensitivity to primary surplus, under the assumptions of primary surplus being 1 point below or above with respect to the baseline scenario for every year from 2006, the ratio of the gross debt stock to GDP in 2008 will be 3 points above and 3.1 points below the baseline scenario (Figure 3.8).

Figure. 3. 9: Analysis of Sensitivity to Real Exchange Rate



Finally, the sensitivity of the debt ratio to the changes in real exchange rate was analyzed. According to the outcome of this analysis, the ratio of the gross debt stock to GDP in 2008 will be 4.1 points above the baseline scenario if the real exchange rate depreciates 5 per cent more every year with respect to the baseline scenario, and 4 points below the baseline scenario where the real exchange rate appreciates 5 per cent more every year with respect to the baseline scenario (Figure 3.9).

In summary, the analyses conducted in the framework of accounting approach indicate that the ratio of the general government gross debt stock to GDP which is estimated to be 70 per cent at the year end 2005, and estimated to be 56.7 per cent in 2008 in the baseline scenario, will be:

- 1.9 points above, if the growth rate is 1 point below the baseline scenario,
- 3.5 points above, if the real interest rate is 3 points above the baseline scenario,
- 5.6 points above, if the growth rate is 1 point below the baseline scenario and at the same time the real interest rate is 3 points above the baseline scenario,
- 3 points above, if the ratio of primary surplus to GDP is 1 point below the baseline scenario, and
- 4.1 points above, if the real exchange rate depreciates 5 per cent more with respect to the baseline scenario.

When these outcomes are compared to the sensitivity analyses outcomes conducted in the PEP 2004, it is observed that the sensitivity of the debt stock has gone down with respect to the past year.

4. STRUCTURAL REFORMS

4. 1. Strengthening Market Economy and Entrepreneurship

4.1.1. Privatization

Privatization, which is one of the basic components of the economic program being implemented, has been rapidly continued. The state completely withdrew from the sectors of fertilizers and mining (electrometallurgy, chromium, aluminum and salt), iron-steel and oil refining, and transferred telecommunications operations to the private sector. On the other hand, efforts for the privatization of the public banks have been initiated and steps were taken to reduce the influence of the public on the financial sector. In this context, the Strategy for Restructuring and Privatization of Public Banks was announced in July 2004 regarding the privatization of the public banks. In line with this strategy, it is planned that Ziraat Bank and Halkbank will be privatized by public offering. As a part of this process, studies are underway to prepare a schedule to gradually remove the privileges and obligations specific to the public banks.

Table. 4. 1: Privatization Transactions, 1985-2005

Covered under the scope of Privatization *	Privatized	Current Situation (October 2005)	
		Under the Scope of Privatization	Under the Program of Privatizations
Public share in 243 companies, 22 incomplete plants, 282 real estate holdings, 6 highways, 2 suspension bridges over Bosphorus, 94 plants, 6 ports, games of chance/transfer of operating rights, vehicle inspection stations/transfer of service rights	Privatization of 159 companies, dissolving of the legal entity in 12 companies, transfer of 6 companies to other public enterprises have been realized.	3 companies, 6 highways, 2 suspension bridges over Bosphorus	23 companies, 90 real estate holdings, 87 plants, 6 ports, games of chance and vehicle inspection station services

* Public shares in 20 companies have been excluded from the scope of privatization subsequently.
Note: In 18 companies, the public shares are still above 50 per cent.

Privatization efforts in Turkey have seriously accelerated in recent years. While in 2004 the total amount was 1.27 billion dollars for the privatization operations for which sale/transfer transactions were completed, the total figure in 2005 reached approximately 25.3 billion dollars (including those undergoing legal proceedings) which includes such large scale privatization as the sale of shares of Turkish Telecom, TÜPRAS, ERDEMİR, Vakıfbank and lease for 15.5 years of operation of Atatürk Airport, and transfer of operating rights for 49 years of Galataport project. The privatization operations actualized in 2005 are given in the table below.

Table. 4. 2: Privatization Revenues and Expenditures, 1985-2004

Revenues			Expenditures
Privatization Proceeds	Dividends and Other	Total	
8.6 billion dollars	5.7 billion dollars	14.3 billion dollars	13.9 billion dollars

In the framework of the Electric Energy Sector Reform and Privatization Strategy Document, Turkish Electricity Distribution Inc. (TEDAŞ) was included in the privatization scope and program on April 2, 2004. Preparations for the privatization of the electricity distribution companies have been completed to a large extent. Electric distribution regions were made into companies, and the works are on the last stage for the tariffs, which will be applicable for 5 years following the privatization. The draft for amending the law that includes the arrangements relating to expropriation and market regulation mechanism after the privatization was submitted to the Prime Ministry. Following the enactment of the draft, it is aimed to initiate the privatization process for the electricity distribution companies by the end of 2005.

Draft specifications for the privatization of games of chance have been completed to a large extent, and the draft bill for the law, which includes the arrangements relating to market regulation mechanism and rules after the privatization, was submitted to the Prime Ministry. Following the enactment of the mentioned draft, privatization process will be initiated.

Table. 4. 3: Privatization Transactions, 2005

Company	Privatization Transaction	Sales Price (Dollars)
Privatization Transactions Completed in 2005		
Turkish Telecom	Block Sales of 55 per cent of Public Shares	6,550,000,000
DHMİ	Leasing of Atatürk Airport for 15.5 Years	2,950,000,000
Vakıfbank	Public Offering of 21.89 per cent of Public Shares	1,094,000,000
TÜPRAŞ	Sales of 14.76 per cent of Public Shares in ISE	453,977,633
Eti Aluminum	Block Sales	305,000,000
PETKİM	Public Offering of 34.5 per cent of Public Shares	273,719,603
Ataköy Otelcilik	Block Sales	62,796,764
Samsun Gübre	Block Sales	41,000,000
Ataköy Turizm	Block Sales	33,697,808
Cyprus Turkish Airlines	Block Sales of 50 per cent of Public Shares	33,000,000
Ataköy Marina	Block Sales	23,755,428
Other	Sales and Transfer of Various Assets and Plants	129,468,973
Total		**11,950,416,209**
Privatization Transactions Undergoing Legal Proceedings in 2005		
TÜPRAŞ	Block Sales of 51 per cent of Public Shares	4,140,000,000
TCDD	Transfer of Operating Rights of Mersin Port	755,000,000
Vehicle Inspection Station	I. Region	313,250,000
Vehicle Inspection Station	II. Region	300,250,000
Emekli Sandığı	İstanbul Hilton Otel	255,500,000
TEKEL	Ankara Headquarter Buildings (Bilkent Twin Towers)	100,000,000
Adapazarı Sugar Plant	Block Sales of 94.09 per cent of Public Shares	45,750,000
TDİ	Transfer of Operating Rights of Galataport Project	4,300,000,000
ERDEMİR	Block Sales of 46.12 per cent of Public Shares	2,770,000,000
Emekli Sandığı	Büyük Efes Otel	121,500,000
TCDD	Transfer of Operating Rights of İskenderun Port	80,000,000
TEKEL	Kaldırım Tuzlası	40,700,000
TEKEL	Kayacık Tuzlası	40,200,000
TEKEL	Yavşan Tuzlası	37,300,000
Emekli Sandığı	Büyük Ankara Otel	36,830,000
Other	Sales and Transfer of Various Assets and Plants	5,768,659
Total		**13,342,048,659**
2005 Total		**25,292,464,858**

In the process of privatization of large ports belonging to the Turkish State Railways (TCDD) in 2005, following the consummation of the tenders for privatization of Mersin and İskenderun Ports, the preparations for the tender of İzmir Port are continuing and it is aimed to make a tender soon. It is planned that the ports of Bandırma, Derince and Samsun will also be tendered by the end of 2005.

In the tender held for the sale of public shares at 56.7 per cent in the Başak Insurance Inc. and 41 per cent in the Başak Pension Inc., 6 bids were received and the tender is currently at the evaluation stage.

Preparatory works for the privatization of the Sugar Factories and Çelik Palas and Tarabya hotels belonging to Emekli Sandığı (Public Pension Fund for Civil Servants) are continuing rapidly. It is aimed to make a tender soon for these enterprises and assets.

The borrowings made by the Privatization Fund prior to 2003 were all paid up in 2004 and 2005. The amount of debts paid in this period is 1.2 billion dollars. Furthermore, the excess cash of the Privatization Fund was transferred to the Treasury. In this context, a cash transfer of 1.35 billion dollars was made to the Treasury in the first six months of 2005. The mentioned transfer and the transfers in the future will be used in the debt repayments by the Treasury and make significant contribution to the reduction of the public debt stock.

4.1.2. Competition Law and Policies

Since November 2004, some amendments were made to the Law No. 4054 on Protection of Competition, which aimed to remedy some practical problems encountered. In this context:

- The obligation to disclose agreements and decisions, which aim to prevent competition directly or indirectly in a market of goods or services or would create such effect, to the Competition Authority, to ensure their validity, was abolished. By this amendment, the resources of the Authority would be used effectively to investigate more important violations rather than the practices, which are of relatively limited impact on the goods and services markets among the violations notified to the Competition Authority by legal requirements.
- The Competition Authority is granted the authority for exemption investigations ex officio. In other words, without requiring any notification, the Competition Authority may grant exemption as a result of this investigation conducted ex officio on this agreements and decisions, which aim to prevent competition or would create such an effect. In addition, the 5-year upper limit is abolished on the individual exemption in order to allow the Competition Authority to grant exemption for longer terms.
- The failure to provide information in cases when information is requested by the decision of the Competition Board or when on-site inspection is being done is placed under penalty sanction.
- In order to quell the concerns that a general principle of law is violated by the fact that the members of the Competition Board are included in both the investigation committee and serve as the decision making body, the provision regarding the inclusion of the members of the Competition Board in the investigation committee was repealed.

- In order to enhance effectiveness in the operation of the Competition Board, the number of members in the Board was reduced to 7 from 11.

Some changes should be made regarding protection of competition for enhancing the effectiveness of practice and also for harmonization with the EU acquis. After such amendments, it will be possible to harmonize the Turkish anti-trust legislation with the EU legislation, which is in the form of regulation and notices.

In the context of secondary legislation, the Communiqué of Group Exemption Relating to Motor Vehicles Distribution and Service Agreements was revised considering the changes in the corresponding EU legislation and the final draft is before the Competition Board. It is expected that the Board will complete its discussions on the draft soon and adopt the draft communiqué.

On the other hand, in order to harmonize with EU legislation in competition law and policies, the draft bill is submitted to the Prime Ministry which provides for the establishment of a unit within the State Planning Organization in order to construct a mechanism for supervising the state aids that disrupts competition and supervise and monitor the state aids.

4.1.3. Improvement of the Investment Environment

Technical committees, which were formed in the context of Reform Program for Improving Investment Environment mentioned in the PEP 2004, continue their work. Developments regarding their work are indicated below.

Regarding the establishment of companies, by the amendments to be made to the Turkish Commercial Code, the liquidation process of unproblematic companies will be shortened and made easier, the requirement for being of the same type company will be repealed in company mergers, and the requirement to have a government commissar in the general assemblies of the companies will be repealed except for special companies.

Regarding employment, the works are underway for the Draft Bill for National Professional Standards Agency prepared by a commission formed by the relevant public agencies and professional organizations in order to establish, spread and sustain the professional standards, examination and certification system in cooperation by the state, employees and employers.

Regarding the sectoral licenses, The Draft Bill for the Law on Establishing Development Agencies is now being debated in the Turkish Grand National Assembly (TGNA), which includes the legislation for the creation of the One Stop Office (Investment Support Offices) System for the sectoral authorizations at the stages of investment and starting operation. This legislation will make the provincial units of the Development Agencies will be the sole authority where applications will be made, followed and coordinated.

In the context of works of the Technical Committee on Investment Location, the following works will be continued: the revision of the Reconstruction Law No. 3194 for shortening the process of reconstruction plan preparation and approval, inventory works for land use, ensuring harmony with the lower and higher scale plans, determining standards for planning industrial areas, accelerating the planning process and free sharing of the data relating to planning by the public agencies, preparing the maps of investment regions, forming the inventories of Organized Industry Zones.

In the context of foreign trade and customs, the works are underway on the Draft Bill Regarding Amendment to the Decree-Law on Organization and Duties of Undersecretariat of Customs. The preparatory works are continuing for the Draft Bill for the Law on Chamber of Customs Advisors and Association of Chambers of Customs Advisors. Thereby, the transactions at the customs will be faster and simplified.

In the context of intellectual and industrial property rights, the works are continuing on the Draft Bill for the Law on Association of Patent and Trademark Attorneys, which aim to regulate the activities of attorneys who are authorized to act on behalf of the applicants before the Turkish Patent Institute and lay down the professional standards, and the Draft Bill for the Law on Copyright Authority which aim to implement the rules of intellectual property rights effectively and operate to conduct all activities in this field, and the revision of the Decree-Law No. 551 in the context of updating the industrial rights legislation.

The Law No. 5331, which regulates the definition of SME, was put into effect on April 16, 2005. Based on this law, the Ministry of Industry and Trade can issue regulation on the definition of SME and this regulation can be put into effect by the Council of Ministers. When the mentioned Regulation is issued, a unique SME definition will be made in harmony with the EU legislation, and this definition will apply to all legislation and programs of the agencies and organizations, which include the terms SME, Medium Scale Enterprise, Small Enterprise or Micro Enterprise. Thereby, the applications made by SMEs for investment and support provided to SMEs will be accelerated and facilitated. Further, in order to enhance communications between SMEs and the organizations providing services to SMEs, an Internet website, which aims to collect the information needed in a site and to provide this information to the enterprises fast and effectively, has been created.

4.2. Financial Sector

4.2.1. Banking Sector

Financial and operational restructuring of the public banks, which is one of the four components of the banking sector restructuring program has been completed. Thus, the Public Banks Joint Board of Directors, responsible for the coordination of the restructuring process of public banks, was abolished in April 2005. Accordingly, the decisions regarding the branches and staff will be made by the authorized bodies of the public banks in line with the developments in the sector and their own strategies.

In the framework of the public banks privatization strategy, it was announced in July 2004 to the public that Ziraat Bank and Halkbank would be privatized by public offering or other methods when convenient market conditions would materialize. The steering committee and project implementation groups formed to monitor and coordinate the formulated strategy submitted their Macro Strategy Report for both banks to the Government in July 2005. These reports were approved by the Government and the efforts were initiated to liquidate the public burden and privileges of both banks.

In the framework of the strategy for removing the problematic banks out of the sector and creating a strong financial sector, İmar Bankası T.A.Ş. was decided to be bankrupt in June 2005 and its liquidation is underway. It was also decided that the shares of Adabank A.Ş., the shareholder rights of which are applied by SDIF except dividends, would be put on sale by taking necessary permission from the Banking Regulation and Supervision Agency (BRSA).

Works are underway to minimize the burden suffered by the public in the resolution process of banks under SDIF. In this context, a total of 3.1 billion dollars was collected in the period between the date of transfer to SDIF and June 2005 from the claims under prosecution by SDIF, claims established under agreed repayment plans, sales of participations and affiliates, property sales and bank sales. In addition, 8.3 billion dollars of revenue is expected from the resolution of assets of the banks transferred to SDIF.

The Banking Law No. 5411 was promulgated in the Official Gazette dated November 1, 2005 issue 25983 which was prepared, in light of the experiences and international practices, to make the regulation and supervision framework more effective, minimize risks, carry out regulation and supervision phases on consolidated basis in line with the consolidation trend emerging in the financial sector, improve corporate governance in the regulation and supervision authority. One of the important novelties introduced by the Law, which was prepared in harmony with the EU directives, was to abolish the Board of Sworn Bank Auditors in charge of on-site audit of banks and establish in its stead a structure which allow for the service of a widely participated and holistic audit group, which includes specialists in law, banking and information technologies in addition to auditors. It is planned that the secondary regulations regarding the Banking Law No. 5411 will be completed within a year.

The Draft Bill for the Banking Cards and Credit Cards Law, which includes provisions that specify the establishment principles of card issuing organizations, was prepared in accordance with the Commission Recommendation of November 1988 regulating the relations between the card holder and the card issuer, and sent to TGNA in November 2005.

The preparatory works are being made by BRSA on the Draft Bill for the Law on Micro Financing Organizations regarding the micro financing organizations which will ensure that low income persons or groups who have no access to financial services will be included in the financial system and increase their income levels. This Draft will contribute to deepening of the financial markets and enhancement of financial diversity. In addition, the enactment of the draft bill regarding the home mortgage which aims to build the legal and institutional infrastructure necessary for development of long term home financing instruments will be another improvement which will add to the depth and diversity of the financial system.

The works regarding the New Capital Adequacy Framework named Basel II are being conducted under the coordination of BRSA and participation by relevant agencies. The results of the quantitative impact study aiming at identifying the impact of the new capital adequacy standard realized by the participation of 23 banks, which represented 95 per cent of the sector, were announced in December 2004. According to the results of the impact analysis, if the new standards were to be applied to the Turkish banking sector’s present portfolio, it was observed that the capital adequacy ratios would significantly go down. As a matter of fact, while the banks participating in the study had an average capital adequacy ratio of 28.8 per cent under the existing legislation, this figure would recede to 16.9 per cent under the standard approaches of Basel II. By implementing the Basel II standards, while the sector’s capital adequacy ratios would still be well above the legal minimum of 8 per cent, any change that may emerge in bank portfolio preferences in the period between the time of the impact analysis and adoption of Basel II may cause changes in the capital adequacy ratios.

BRSA announced the Roadmap to Basel II to the public on May 30, 2005 in order to identify policies and strategies and measures to be applied in transition to Basel II. Works were completed on the matters left to the initiative of the national supervision authority in implementing Basel II. Further, a research report was prepared for SMEs, which might experience the largest part of the problems in adaptation to the new regulations introduced by Basel II. This report provides a detailed analysis on such matters as the place of SMEs in the national economy, financing sources and evaluation of the existing and the new system from the SME's viewpoint. In order to implement the strategies and plans regarding Basel II, BRSA will continue its studies to develop inter-agency interaction and build its institutional capacity.

4.2.2. Capital Market

In 2005, the following improvements were made considering the EU Directives in order to protect the investors in the capital market and create a stable and effective functioning market:

- The works by the Capital Markets Board are in the last stage being conducted for creating a market for SMEs. In this context, the permission was granted in July 2005 to a company (Emerging Enterprises Markets), which would create and develop a transaction platform where trading transactions could be made in this market and which would make the organization required by such platform.
- The Draft for New Capital Markets Law, which will ensure full compliance with the EU Acquis, is being circulated for opinion of relevant parties.
- The Futures and Options Exchange (FOE) was commissioned on February 4, 2005 with its center in Izmir, and futures transactions were started to be traded in FOE based on ISE-30 index, treasury bills with maturities of 91 and 365 days, USD, Euro, cotton and wheat, for which the minimum elements are approved by the Capital Markets Board currently.

The following are the works envisioned for 2005-2008 in order to increase supply and demand in capital markets, ensure confidence and stability in the market, build the infrastructure which will allow implementation of this legislation in harmony with the EU legislation:

- The works for registration of stock shares and pertaining rights of the listed companies are planned to be completed by the beginning of 2006. It is planned that the Government Domestic Bills will be registered in 2006.
- Works realized for restructuring the custody and clearing system will be continued in 2006.
- In the context of harmonization with the EU legislation, the project will be initiated at the end of 2005, which was prepared to benefit from the PHARE program under the Pre-Accession Financial Assistance being provided to Turkey by the EU. Under this project, the twinning program will be used in harmonizing the Turkish capital markets legislation with the EU legislation and technical supports of foreign experts will be used in order to identify the information system infrastructure necessary for the implementation of this legislation.

- By completing the technical and legal infrastructure in the period of 2005-2008, the creation of mortgaged securities and organizations issuing these securities will strengthen the real estate sector. The operation of this system will add depth to the financial sector on one hand and will have positive repercussions on the real economy on the other.
- Important goals of this period include the harmonization of the regulations regarding the capital adequacy of the intermediary institutions with Basel II criteria, which will be adopted by the European Union about mid 2006, and ensuring that the risk assessment of the intermediary institutions will be made more effectively.
- In the period of 2005-2008, it is planned that the existing auditing standards will be harmonized with the International Auditing Standards (IAS). In this line, the draft communiqué prepared in compliance with IAS was submitted to circulation for opinion of the relevant parties in October 2005.
- The draft bill was prepared in order to make amendments to the Capital Markets Law necessary to ensure its compliance with the European Union Acquis and following the enactment of this draft, works will be initiated to make necessary secondary amendments in the relevant legislation. While the works on CMB secondary legislation are being continued within the context of the twinning program under the harmonization of the capital markets legislation with the EU legislation, the matters that require law drafting are handled in the draft bill as well. In the draft, in line with EU regulations, mergers and splits of public joint stock companies were regulated, and the scope of the Investor Protection Fund was expanded to cover all financial instruments and the provisions regarding insider trading and manipulation were harmonized.

4.2.3. Insurance Sector

The works were completed on the Draft Bill for the Law on Regulating and Supervising Insurance Business, which was prepared considering the requirement that the regulations on insurance should be harmonized with the EU acquis and the international standards, and the draft was submitted to the Prime Ministry on June 30, 2005. The draft rearranges the establishment, management, working principles, transfer, mergers and liquidation and audit of insurance and reinsurance companies, considering the international practices and developments.

The basic objective of the draft is to ensure that the insurance sector should be developed in a healthy manner under transparent and objective rules, the financial structures insurance companies should be strengthened, and they should provide best service to the insured customer via competition under similar conditions. On the other hand, the audit activities necessary for the sound operation of the system and timely fulfillment of contract clauses are regulated to protect the insured, the insurer and the third parties entitled to raise claims against the insurance company other than the parties to the insurance contract.

In the draft, considering that the insurance establishment is built on confidence, certain qualifications are required of the founders and these qualifications are rearranged in accordance with the EU directives and present conditions.

In the draft, the security system which partially existed previously were rearranged to cover all mandatory insurances as in the developed countries, it was allowed that the payments would be made upon revocation of the license prior to bankruptcy, and both the securities and the new resources would be collected under the Assurance Account.

In the draft, since there are no specialty courts in insurance field, disputes take long time to be resolved and lead to grievances and considering that many countries have ombudsman practice, an Arbitration Commission is organized under the Turkish Association of Insurance and Reinsurance Companies.

Furthermore, the preparatory works are continuing for the secondary legislation in compliance the EU Directives.

4.3. Labour Market

The presence of a sound and effective labour market in the country is an important factor for ensuring a sustainable growth environment and enhancing the competitiveness of the economy. Failure to increase employment, problems regarding education of the labour force, failure to establish links between education and employment appear as the significant problem areas in creating a competitive economic structure with high job creation capacity.

An important part of the problems arises from the structure and operation of the labour market. Major problem areas are inadequacy of the education level and productivity of the labour force, low employment and low participation rates particularly in women, high unemployment rates particularly for the young population, working age population growth rate being higher than the total population growth rate, and widespread informal employment. Furthermore, the fact that the labour market is not flexible aggravates the existing problems by causing supply and demand imbalances.

The share of agricultural sector in total employment, which was 46.9 per cent in 1990, went down to 34 per cent in 2004. However, the fact that the work force that left the agricultural sector could not be employed adequately in industry and services sectors led to a decrease in employment rates in the mentioned period. In addition to moving away from the in agricultural sector, factors like the reduction in public employment, widespread informal employment and privatization practices aggravate the unemployment problems.

In addition to reasons like inadequacy of the quality of vocational training and the deficiency in in-service training and life long education, inadequacies in the capital accumulation and technological renewal processes result in lower productivity of the labour force compared to the level in EU countries.

The failure to establish an effective relation between employment and education in Turkey lead to an imbalance of labour supply and demand and thus unemployment. Difficulties are experienced in finding intermediate labour force in the areas needed by the economy. However, the highest rate of unemployment is observed among the graduates of vocational schools. The reason for this is that vocational education is not provided in line with the needs of the labour market and the employers fail to find labour at the quality they need. This requires that vocational education should be shaped along the demands of labour market and the National Occupational Qualifications System should be formed.

In Turkey, those who are illiterate and below high school education constituted 69.5 per cent of the labour force, 70.9 per cent of the employment and 58 per cent of the unemployed, in 2004. The fact that the existing labour force has low quality is an important factor that reduces the effectiveness of the labour market by reducing labour productivity and causing supply-demand imbalances in the labour market.

Unemployment rate increases as education level goes up. The reason is that as the education level goes up, labour force participation rate also goes up. As a matter of fact, the unemployment rate among the illiterate was 3.7 per cent in 2004, 9.1 per cent for those below high school education and 14.1 per cent for those with high school or higher education.

Table. 4. 4: Education Level of the Labour Force in 2004

(Per cent)

	Labour Force	Employed	Unemployed	Labour Force Participation Rate	Unemployment Rate
Total	**100.0**	**100.0**	**100.0**	**48.7**	**10.3**
Illiterate	6.3	6.8	2.3	24.4	3.7
Pre-High School	63.2	64.1	55.7	48.2	9.1
High Schools and Equivalents	20.0	18.9	29.1	56.6	15.1
- Vocational - Technical High Schools	---	---	---	67.0	15.8
Higher Education	10.5	10.2	13.0	80.0	12.4

Source: SIS

Informal employment, which causes decline in tax and insurance revenues, inequality of competition conditions among enterprises, bad working conditions for the employees, and deprivation of social security, is one of the major problems of the labour market. It is estimated that about 45 per cent of those employed in 2004 are employed informally. On the other hand, women, handicapped, long term unemployed, and young population continue to experience difficulties in entering the labour market.

Active labour market policies will be implemented to raise the education level particularly of women, harmonize vocational education and labour market policies, increase employability and quality of the labour force in order to reduce unemployment and ensure a stable growth environment focused on job creation. Furthermore, the priority policy areas to solve problems of the labour market include supporting SMEs and entrepreneurship that have high job creation capacity, and ensuring rural development based on revenue and employment generating activities.

In the framework of harmonization with the EU, in order to increase effectiveness of the labour market and along the purpose of harmonization of candidate countries to the European Employment Strategy after becoming full members, studies were initiated to develop a National Employment Strategy in line with the European Employment Strategy. The strategy aims to increase employability, support entrepreneurship, ensure adaptation to changing circumstances, facilitate entry of disadvantaged groups, particularly women and the young population, to the labour market, and their integration to the labour market.

In this context, the Employment Background Study, which was the first step of participation in the European Employment Strategy, was prepared in 2003. The Joint Assessment Paper which is the second step in this process and in which significant problems regarding employment are analyzed by the Commission and country experts and the priorities and policies for employment are determined, is being prepared and is planned to be completed in 2006. In the next phase, a national action plan, which will depict employment policies as a whole and bring permanent solutions to unemployment and employment problems, will be prepared by the Government and social partners. The requirements of employment guidelines prepared every year after membership by the Commission under the European Employment Strategy will be depicted in the national action plan considering the specific conditions.

The institutional and administrative capacity of the General Directorate of Turkish Employment Agency (İŞKUR), which is responsible for the implementation of active labour market programs, was strengthened by restructuring efforts undertaken in 2003. In addition, İŞSKUR permitted 86 private employment offices. İŞKUR provides training courses, vocational training courses and training seminars in industry effectively to youth, women and handicapped particularly. Works are underway to use the Unemployment Insurance Fund revenues for active labour market policies. Furthermore, 241 projects are being carried out under the Active Labour Programs Project implemented in the scope of Turkey-EU Financial Cooperation. Additionally, the Draft Report for Turkey’s Human Resources Development Strategy was prepared under this project.

The Privatization Social Support Project (PSSP) has been extended until the end of 2005. Under PSSP, 18.8 million dollars was used as of the end of August 2005 for job placement services, and 26,819 persons benefited from the project services. In the framework of new job placement services component of PSSP, 8,577 persons, who participated in İŞKUR projects and were successful, were employed. A second PSSP will be prepared to cover 2006-2009, since the privatization practices are going on.

The number of provinces was raised from 36 to 49, which would benefit from the incentives, by enacting the Law No. 5350 that amends Law No. 5084 on Supporting Investments and Employment and Amendments to Some Laws. The support provided by this Law is expected to accelerate SME development at the same time. As of December 2004, 177,514 persons benefited from the incentives under the relevant law.

SMEs, which have a flexible production structure to adapt rapidly to changes in the market conditions, have a significant role in reducing unemployment and creating new jobs. In this context, technical and financial support is provided to SMEs. A Credit Program for Employing Qualified Personnel was prepared by the cooperation of KOSGEB, İŞKUR and Vakıfbank in order to encourage and promote the employment of qualified and registered labour force. Under this program, SMEs will be provided loans with a maturity of 12 months and free of interest. The credit limits will vary by the qualification of the personnel to be employed.

According to the Household Labour Force Survey, while the number of working children at 12-17 age bracket was 1,507,000 in 2001, this figure went down to 948,000 in 2003. In order to take effective action in fighting against child labour, a Scheduled Policy and Program Framework to Eliminate Child Labour was prepared with priority to eliminate worst forms of child labour under the ILO Convention No. 182. By the program, it is aimed to prevent worst forms of child labour in Turkey within 10 years and the activities to prevent child labour in these fields, agencies to perform these activities and their responsibilities were determined.

Table. 4. 5: Trends in Schooling Rates, 1998-2005

(Per cent)

Level of Education	1998-99	2004-05
Pre-School	10.2	15.2
Primary Education	90.6	95.7
Secondary Education (*)	49.0	60.8
Standard High Schools	26.6	38.8
Vocational - Technical High Schools	22.4	22.0
Higher Education	27.4	39.9
Formal	18.1	26.5
Non-Formal	9.3	13.4

* The figures represent the rate of enrolment in formal education.

Important improvements were made in the education level of the population in the last decade. In order to catch up with the era in education and increase the quality of education, the use of information and communication technologies (ICT) and renewal of curricula are targeted. Easy access to education and high quality of education are basic factors for labour quality and productivity. In this framework, reform efforts in the field of education are continuing. In this context, the schooling rates in primary education went up to 95.7 per cent from 90.6 per cent, to 60.8 per cent from 49 per cent in secondary education and to 39.9 from 27.4 per cent in higher education in the last eight years by extending the compulsory education to eight years and improving the physical infrastructure in secondary education and promoting the importance given to non-formal education.

The Primary Education Project being implemented by a credit of 600 million dollars, which was provided by the World Bank in order to support the Primary Education program initiated in 1998, is continuing.

It was decided that the education duration of vocational, technical and general high schools would be gradually extended to 4 years starting from the academic year 2005-2006 from the 9th grades, in order to make the vocational education at secondary school more adaptive to the needs of the labour market. Besides, the education duration of the high schools with preparatory classes would be re-arranged according to 4 years. Furthermore, modular programs based on occupational standards and appropriate certification programs are being developed to shift to modular education on the basis of wide occupational areas in vocational training and allow students to shift horizontally between the programs.

The Draft Bill for the Law on National Professional Qualifications Agency was prepared in cooperation of the Government and social partners, in order to harmonize the labour market and the education system. The Ministry of National Education, representatives of social partners and native and foreign experts formed 64 new education standards through revising the professional standards for 250 occupations prepared by the Professional Standards Board. In line with the framework programs formed based on the education standards developed, modular education-training programs were prepared. Based on the education programs, the student and teacher guidelines for 9th grade were prepared. Furthermore, in order to organize the vocational education system on a modular basis that adapts more flexibly and easily to the market conditions, the Vocational Education and Training System Strengthening Project financed by European Union Mediterranean Program (MEDA) grant is continuing. The works are at the final stage under this project for an analysis of the labour market that meets the local, regional and national labour force needs, equipped with qualifications required by the labour market, based on the supply-demand balance, not solely on the supply.

In the framework EU Education and Youth Programs, 300 students visited our country in 2004 under Erasmus Program, and 1,150 students went to EU countries. The number of academicians visiting our country was 250, and the number of academicians visiting EU countries was 350. Under Leonardo da Vinci Program in the vocational training field, approximately 3,400 students, new graduates or young workers had on-the-job training in European countries, and academicians made study visits. Under the Youth Program, the projects of 205 youth organizations or groups were supported from 2004 onwards. For these projects, 18.3 million euros in 2004 and 30.9 million euros in 2005 were allocated.

The deficiencies in the legislation of work safety and health are at the stage of completion and on this matter, practical measures and inspections will be given weight. The Development of Work Safety and Health Project carried on by the Ministry of Labour and Social Security and financed by EU is continuing.

The Project for Strengthening Social Dialogue for Innovation and Change, which was approved by the European Commission under the 2004 Financial Assistance programming to solve problems of social dialogue mechanisms existing in our country and ensure their more effective operation, was put into practice. Furthermore, a new draft bill, which aimed to solve the problems in the operation of the Economic and Social Council, which is one of the basic social dialogue mechanisms, was prepared by the social partners and proposed to the Government. A law amendment is on the agenda of the Government in this subject.

Some problems are encountered in the practice of the labour legislation, which acquired a flexible structure, by the Labour Law No. 4857. It is necessary to handle such problems, make the labour legislation more flexible and ensure that such flexibility be perceived as secured flexibility.

Table. 4. 6: Matrix of Policy Commitments: Labour Market

(1000 Euros)

	2004	2005	2006	2007	2008
1. Privatization Social Support Project I					
A. Implementation Profile	---	X	X	X	X
B. Net Budgetary Effect	---	-69,382	---	---	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditure	---	-69,382	---	---	---
1. Privatization Social Support Project II					
A. Implementation Profile	---	X	X	X	X
B. Net Budgetary Effect	---	-9,500	-25,779	-27,750	26,971
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditure	---	-9,500	-25,779	-27,750	-26,971
2. Active Labour Market Programs Project					
A. Implementation Profile	---	X	X	X	X
B. Net Budgetary Effect	---	-6,626	---	---	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditure	---	-6,626	---	---	---
3. Occupational Health and Safety Project					
A. Implementation Profile	---	X	X	X	X
B. Net Budgetary Effect	---	-7,324	---	---	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditure	---	-7,324	---	---	---
4. Project for Strengthening Social Dialogue for Innovation and Change					
A. Implementation Profile	---	X	X	X	X
B. Net Budgetary Effect	---	-125	---	---	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditure	---	-125	---	---	---
5. Basic Education Program					
A. Implementation Profile	---	X	X	X	X
B. Net Budgetary Effect	---	-642,050	-820,806	-688,997	-700,000
B.1. Direct Effect on Budgetary Revenues (1)	---	138,211	165,850	200,000	220,000
B.2. Direct Effect on Budgetary Expenditure	---	-780,261	-986,656	-888,997	920,000
Total Net Budgetary Effect					
A. Implementation Profile	---	X	X	X	X
B. Net Budgetary Effect	---	-735,007	-846,585	-716,747	-726,971
B.1. Direct Effect on Budgetary Revenues	---	138,211	165,850	200,000	220,000
B.2. Direct Effect on Budgetary Expenditure	---	-873,218	-1,012,435	-916,747	893,029

(1) It represents the difference between the cost of additional capacity acquired as a result of the tax concession provided as part of the Campaign for 100 per cent Support for Education and the loss arising from the tax concession. Tax losses were included in budgetary expenditure.

(2) The Fundamental Education Project and the projects funded by EIB were included. Expenditure funded by provincial special administrations, MEDA grants and the Social Solidarity Fund were not considered since they are not included in the budget.

4.4. Administrative Reform

The increasing and diversifying demands of people as a result of the rapid and multi-faceted transformation processes being experienced in the world and in Turkey necessitated a radical restructuring particularly in the bureaucratic structures and administrative concept. The public administration reform, which was explained in detail in the Urgent Action Plan that was adopted in the period of the 58th Government and continued in the period of the 59th Government and which was scheduled and clarified in respect of duties, is being placed on the axis of increasing effectiveness and democratisation.

Law on Fundamental Principles and Restructuring of Public Administration

Transformation being experienced in the world and in Turkey in the direction of globalisation and shift to information society brings together the need for restructuring along the axis of effectiveness in public administration, rule of law, respect to human rights and participation. The facts that privatisation and decentralization tendencies are accepted, a competitive strategy based on free market regime is adopted, private sector is further developing and non-governmental organizations are getting stronger make it mandatory to redefine the role of the public in economy. In addition, as a result of increasing centralization, the central institutions and organizations stood away from functions expected from them such as guiding, strategy formation, and supervision. Therefore, it is necessary that the public should withdraw from production in some areas and should strengthen its regulatory and supervisory role, or in more general terms, get a structure, which is small but effective, emphasizing participation, transparent and accountable.

In this general context, the Draft Law on Fundamental Principles and Restructuring of Public Administration, which was prepared as the first phase of the restructuring process in the public sector, to guide the process the to lay down the legal infrastructure, was adopted in the TGNA, however 22 articles of the draft were returned to TGNA for re-discussion on grounds of being contrary to the Constitution, thus the said Law was not legislated.

Civil Service Reform

The Draft Law for Civil Services, which was prepared by the State Personnel Administration in the scope of the State Personnel Regime Reform works that were being carried out in harmony with other studies in the scope of the Public Administration Reform, and aimed to re-regulate the public personnel regime to remedy problems and deficiencies in the public personnel regime, and to ensure effective and efficient performance of public services, was circulated to public institutions and organizations for opinion. Additionally, the works for harmonizing the cadre regime with the restructured public personnel regime are expected to be completed. Works started for this purpose are continuing.

Local Administrations Reform

Local governments failed to provide in good quality and extent the services they were tasked with due to problems in their administrative and financial structures. It is aimed that the local governments will be restructured to become compliant with the principles laid down in the European Charter of Local Self-Government, more effective, participative and transparent. To achieve these objectives, a reform process was started in respect of organization, duties and power, financial resources, personnel and relations with the central government of the local administration.

In the context of the Local Administration Reform, the Law No. 5216 on Greater Municipalities, the Law No. 5302 on Provincial Special Administrations on 4 March 2005, the Law No. 5335 on Local Government Associations on June 11, 2005 and the Law No. 5393 on Municipalities on July 13, 2005 were published in the Official Gazette all of which regulate the organization, duties and powers, personnel and other institutional aspects of local government units.

Local administrations were made the general authoritative institutions in respect of local common services with some exceptions. The conflicts in duties, which may arise with the central institutions due to the principle of generality, will be clarified in favour of local governments with the arrangements to be made in the central institution laws in the coming period.

Some of the administrative wardship practices, which were thought to have adverse impact on works of local administration were removed by the laws, and re-arranged considering the integrity of administration and compliance with laws. Particularly the practice of the approval of the municipal assembly decisions and the budget by the central government was terminated, and the powers of the central government were restricted on such matters as dissolving and putting away from office of the municipal bodies.

With a view to strengthening democratic, participative and transparent structure; regulations were made on the matters of improving the relations with the local people and the municipality, providing active and participative content to citizenry, institutionalising the participation and opinion exchange between the municipal assemblies and the specialty commissions and, and taking the resolutions of the City Council formed by the support of the municipalities to the agenda of the assembly.

Regulations were made to support the local government units to offer effective and efficient services by providing flexibility on such matters as determining their own organizational structures, employing qualified staff and doing business. Local governments were given flexibility on options for doing business by different methods such as turnover by concession, granting license without creating monopoly, leasing and purchasing service at the service supply point for water, waste water, public transportation and solid waste management.

Works are continuing on the laws regulating the revenues of provincial special administrations and municipalities towards strengthening the financial structure of local administration. It is expected that the arrangements regarding the local administration revenues will be legislated by TGNA in 2006.

Draft Law on Regulatory and Supervisory Agencies

The Draft Law on Regulatory and Supervisory Agencies, which was prepared to lay down the common procedures and principles regarding the establishment, organization, duties and powers, supervision, status of members of board and employees of these agencies by eliminating confusions in the present legislation in order to ensure that regulatory and supervisory agencies operate effectively, is being debated in the relevant commissions of TGNA.

Right of Access to Information

As a requirement of democratic and transparent administration, the Law No. 4982 on Right to Access to Information, which was prepared in accordance with the principles of equality, impartiality and transparency to ensure citizen’s access to information produced by the public, was put into effect on October 9, 2003. Furthermore, the Draft Laws on the General Administrative Procedures, State Secrets and Protection of Personal Information related with this subject are being worked on.

Once these laws are legislated, substantial amendments will be done in complementing the right of access to information.

Fight Against Corruption

The Law No. 5065 dated January 14, 2004 on Approval of Ratification of Anti-Corruption Special Law Convention was published in the Official Gazette on January 20, 2004 issue 25352. Further, The Law No. 5191 on Approval of Ratification of the Convention on Laundering, Investigating, Seizing and Confiscating of the Revenues Earned Through Crime was adopted. Also, the Ministry of Justice prepared the Draft Law on Anti-Corruption which lays down procedures and principles regarding the effective fight against corruption and prevention of corruption and increasing the deterrence of penalties imposed on perpetrators of corruption.

Ethical Code of Conduct in the Public

The Ethics Board for Civil Servants was established to lay down the rules of conduct of civil servants and monitor compliance, examine and investigate complaints on this matter, ensure implantation of culture of ethical standards in the public administration. Regulation on Ethical Conduct Principles of Civil Servants and Application Procedures and Principles prepared by the Board and it was put into effect. Furthermore, the fact that mandatory signing of Ethic Pact undertakes all civil servants conduct in certain manners is another development in this field.

Public Financial Management and Control Law

The Public Financial Management and Control Law No. 5018 was adopted by TGNA on December 10, 2003 which was prepared to re-arrange the structure and operation of the public financial management, preparation and implementation of budgets, book recording all financial transactions, reporting and financial control in order to ensure effective acquisition and efficient use of public resources, accountability and financial transparency. In the context of the transitional period envisioned in the Law, necessary preparations are being carried out by the coordination of the Ministry of Finance.

By this Law, a public financial management and control system in compliance with EU norms will be created, effectiveness in budget preparation and implementation will be increased, transparency in financial management will be ensured, the balance between authorisation and responsibility will be re-established in the expenditure process by a sound accountability mechanism, an efficient internal auditing and monitoring system will be established, optimum use of budgetary right will provided by including all revenues and expenses of the public administrations in the budget and by extending the scope of the budget. In this context, many agencies, which were not included in the consolidated budget, were taken under the scope of the budget and the public administrations with general and special budgets and those of the regulatory and supervisory agencies were united under the name of central government budget. Budget information of local administrations and social security institutions are also submitted to TGNA as an annex to the Central Government Budget Law.

By the Law No. 5018:

- Departments of Pre-Expenditure Financial Control and Financial Management were established within the General Directorate of Budget and Financial

Control in Ministry of Finance in order to act as the Central Harmonizing Unit.

- The Internal Auditing Coordination Board was established within the Ministry of Finance to set the internal audit standards and coordinate the works of internal auditors. Furthermore, to provide support services for this Board, Department of Internal Auditing was established within the General Directorate of Budget and Financial Control.

In discussions with the officials of the European Union after the promulgation of the Law, the need emerged for revision of some articles of the Law for compliance with the EU acquis. During the preparation of secondary legislation as required by the Law and opinion and suggestions by the public administrations, it was identified that some amendments were needed to the Law. In this context, the Draft Law was prepared and submitted TGNA. The works of the Assembly on the draft are continuing.

By this amendment bill, some expressions are being corrected, the internal control system is re-defined and made more comprehensive, the financial auditing officer is abolished in order to accelerate the transaction process and increase efficiency in expenditures and the preliminary financial control function is being performed at the financial services unit and the spending units, and in this context the duties, power and responsibilities of the financial services unit is rearranged. Establishment of a well-running structure in the spending units necessary for implementation of the Law and abolishment of the units in the Ministry of Finance performing such duties in the past are envisioned and arrangements regarding the cadres assigned to carry out such functions and their employee rights. Furthermore, in order to avoid problems in the performance of public services, the decree regarding the dissolution of revolving funds, which offer important services to the public and which are predominantly business enterprises, is being repealed and arrangements are made for restructuring these revolving funds until the end of transition period. On the other hand, the charts in the Law No. 5018 are rearranged as a result of the removal of some administrations from the scope of budget because they have been abolished or their names have been changed or they should not be subject to this Law because of their own nature, listing the higher education institutions individually by name because they have legal personality and are subject to a different classification, and ensuring the budgets of some agencies be included in the budget of the related administration or in the budget of the administration which they are attached.

The State Accounting Standards Board and the Internal Audit Coordination Board were established as required by the Law No. 5018, their members were selected and works initiated. Preparatory works are in the last stage for the secondary legislation that should be promulgated pursuant to the Law. The arrangements will be put into effect following the legislation of the Draft Law amending the Law No. 5018. On the other hand, within the framework of the Law No. 5018, the multi-year budgeting system is introduced that will cover three years as of the fiscal year 2006 and the central government budget practice is introduced which is compliant with the international standards and more comprehensive than the consolidated budget system.

The State Accounting Standards Board and the Internal Audit Coordination Board were established as required by the Law No. 5018, their members were selected and works initiated. Preparatory works are in the last stage for the secondary legislation that should be promulgated pursuant to the said Law. The arrangements will be put into effect following the legislation of the Draft Law amending the Law No. 5018.

Box. 4. 1: Medium-Term Program – Medium-Term Fiscal Plan

By the Public Financial Management and Control Law No. 5018, mechanisms were established to strengthen the relation of plan-program-budget. In this context, the budget preparation process and the budget scope were redefined and the multi-year budgeting system was introduced that would cover three years from 2006.

In this context, the Medium-Term Program (MTP) was prepared covering projections of resources and expenditures in the economy in addition to macroeconomic and sectoral objectives, goals and policies for the period of 2006-2008. The first MTP was published as a Decree of the Council of Ministers in May 2005 and it will be renewed every year.

The basic objective of the MTP prepared under the coordination of the Undersecretariat of the State Planning Organization is to raise the living standards of our people in an environment where all segments of our society are considered and the economic and social development of our country is accelerated on the road towards European Union membership.

The MTP offers a consistent set of objectives, policies and priorities and has a perspective of three years, and covers various basic development axes and main sectors in addition to macro policies such as growth, employment.

Basic development axes, monitored under five separate headings are improvement of human resources, strengthening social inclusion, enhancing competitiveness in economy, reducing regional development disparities and spreading good governance in the public sector. The main sectors are education and training, health, environment and urban infrastructure, science and technology, agriculture, manufacturing industry and mining, energy, transportation and communications and tourism.

Medium-Term Fiscal Plan (MTFP) in accord with MTP was prepared under the coordination of the Ministry of Finance and was approved by the Higher Planning Council and published in the Official Gazette on 14 June 2005. OVMP includes the total budget revenue and expenditure estimates, status of target deficit and borrowing and the appropriation proposal ceilings of public administrations for the period of 2006-2008.

The 2006 Annual Program was prepared by SPO and published at the beginning of November 2005 which covered in more detail the basic development axes and main sectors of MTP that covered the period of 2006-2008 and included the activities and projects that would be carried out to achieve the basic objectives and prior goals.

On the other hand, within the framework of the Law No. 5018, the multi-year budgeting system is introduced that will cover three years as of the fiscal year 2006 and the central government budget practice is introduced which is compliant with the international standards and more comprehensive than the consolidated budget system.

Budget Accounting Code System and Fiscal Transparency

Under the works carried out to restructure the public financial management, general and annexed budget agencies have been prepared and applied from fiscal year 2004 in accordance with the Analytical Budget Classification (ABC) which was created based on the Government Finance Statistics (GFS).

It is planned that ABC codes will be introduced in the local administrations, social security institutions, regulatory and supervisory agencies and institutions and agencies with special budgets as of 2006 and in revolving funds and other institutions and agencies (except SEEs) as of 2007.[5] In this context, training programs are carried out relating to ABC.

It is planned to switch to accrual-base government accounting in all the public institutions under the general administration in order to set up an accounting and reporting system in accordance with international standards that would strengthen transparency and accountability in the public financial management, comprehend all

[5] Here the expression "institutions and agencies with special budget" means the administrations which were not included in the budget and taken into the scope with the promulgation of the Law No. .5018 because a significant portion of the administrations with special budgets were administrations with annexed budget and are currently using ABC codes.

financial transactions, assets and liabilities occurring as a result of the activities conducted by the public and to produce sound data.

An accrual-based detailed accounts plan were prepared for all administrations with general and annexed budget included in the central government in line with the framework account plan and the pilot works were completed in 2002 and 2003. The Regulation on Accounting Systems of Agencies with General and Annexed Budget, which was drawn up in accordance with the General Regulation on Government Accounting and included a detailed accounting plan put into force on January 1, 2004. The practice of accrual-based government accounting started in 2004 for the administrations with general and annexed budgets.

It is planned that the Regulation on General Government Accounting which will put into effect on January 1, 2006 will be implemented in local governments and social security institutions and the determination of the principles and procedures regarding the physical count, accounting, and determination of methods to be used for calculation of depreciation and revaluation of the tangible fixed assets be completed until the end of 2006 and the common accounting standards and framework accounts plan will be implemented in all public administrations included within the scope of general government, and thus the results will be easily consolidated and government financial statistics at international standards will be generated, reported and offered to the information of relevant parties in the framework of transparency and accountability approach.

In the context of efforts for secondary legislation to the Law No. 5018, the Regulation on the Structure, Working Principles and Procedures of the Government Accounting Standards Board and was published in the Official Gazette on May 13, 2005 issue 25814.

The Budget Management and Information System (BMIS) was designed and was started to be used as of January 2004 in order to benefit from the information technologies in the budget preparation and implementation process. BMIS ensures all phases from the preparation to the implementation and to extracting the implementation results will be carried out rapidly and reliably and contributes to transparency of these processes. With BMIS it is possible in electronic medium to obtain and combine the budget proposals of spending agencies during the budget preparation process, to make appropriation transactions rapidly according to the analytic budget code system during the budget implementation process and to monitor the transactions relating to the appropriations. The BMIS allows communication among the relevant institutions that have function in budget preparation process in electronic medium and operate mutually.

4.5. Agriculture and Rural Development

4.5.1. Agriculture

The basic objective in agricultural policies is to ensure balanced and adequate nutrition to the increasing population and create an agricultural structure which is economic, socially and economically sustainable, well-organized and highly competitive by taking food security principle in account.

In this direction, in the pre-accession process to the EU, while emphasis is given to raising and ensuring stability in the income level of producers, ensuring production increase using policy tools not disrupting the market operation and preserving and effectively using soil and water resources both in terms of quality and quantity; it is aimed by accelerating rural development to alleviate the pressure of employment and rural migration into the urban caused by the transformation in the structure of agriculture. In this context, implementation of measures towards improving human resources, diversifying rural economy and enhancing rural infrastructure is important.

Due to increasing budgetary costs, the existing ineffective support policies were changed and the Direct Income Support (DIS) was introduced in 2000 instead of price and input subsidy in agricultural supports. The Agricultural Reform Implementation Project (ARIP) was implemented in the same year in order to create the technical infrastructure for this policy change, it was aimed under the project to establish the farmer registration system and related land registration-cadastral system, to ensure a change over from crops, which are in excess supply, to alternative crops, to restructure agricultural sales cooperatives and unions and to pay severance benefits during this process. The project is financed by a total loan of 600 million dollars from the World Bank, with 200 million dollars being the program loan.

Since not much progress has been made in the aforesaid components, the scope and implementation period of ARIP were revised in 2005. In this context, the project was extended to 2007 and in order to accelerate works, administrative measures were taken for the implementation of each component by the responsible institutions. Resources set aside for alternative product works, which were not successful, were shifted to existing and new practice areas such as establishing the farmer registration system and accelerating supportive cadastral works, land massing, agricultural investment support, preserving agricultural land for environmental purposes and licensed storage.

However, in order to meet needs other than income stability which is attempted to be ensured by the DIS program in the sector, a strategy document was prepared and made in to a Decree of the Higher Planning Council at the end of 2004 to facilitate decision making of related parties of the agricultural sector and to improve the sector in the framework of economic development goals and strategies in the period of 2006-2010. Thus, the agricultural supports are being restructured and the DIS payments are addressed with the policy tools regarding production under this scope. The policy framework laid down in the Strategy Document will have an institutional and legal infrastructure with the Agriculture Framework Law, which is currently being debated in TGNA. By this Law, it is aimed that the DIS practice will be carried on with more focusing on objectives, agricultural land for environmental purposes will be protected in areas exposed to erosion and adverse environmental effects considering the interaction of agriculture and environment and support tools that do not disrupt market mechanisms will be introduced for agricultural production under market conditions. In this context, the Agricultural Framework Draft Law includes principles to institutionalise the DIS practice on one hand, and will become an agricultural support framework law that includes other tools on the other. Studies are continuing on cost and revenue impact of the system to be introduced in the following period.

The DIS payments being implemented for the last four years instead of price subsidies have the largest share in the support budget (62 per cent of all budget transfers reserved for agriculture in 2005). The DIS payments are made to farmers registered in the Farmer Registration System. In this context, while 2.1 million farmers received DIS payment in 2001, the number rose to 2.8 million in 2004 by a 33 per cent increase. In 2005, the DIS payments to be made to farmers doing plant production was diversified, and it was aimed to make additional DIS payment to farmers who had their soil analyzed or engaged in organic agricultural activities in addition to the DIS payment per land (basic DIS payment).

The harmonization studies on food security and control, organic agriculture, Integrated Administration and Control System (IACS) / Land Parcel Identification System (LPIS) and efforts for the preparation of the Rural Development Plan to ensure harmony with the Common Agricultural Policy and to meet the commitments in agriculture in the National Program are being supported programming within the framework of Turkey-EU Financial Cooperation in 2004. Furthermore, projects regarding the support for establishment of border check points, control of rabies, establishment of reference laboratories, creation of institutional structure related to rural development payments have been included in the 2005 programming.

Land and Farmer Registration Systems

The Project for Preparation to Implement EU Common Agricultural Policy, which also includes IACS and LPIS, included in the Turkey-EU Financial Cooperation 2004 Programming and was started in 2005. In this direction, within the Ministry of Agriculture and Rural Affairs, studies will be emphasized to provide support on creating basic elements of IACS at EU norms and create an operational integrated administration and control system in the medium-term.

Efforts are underway to create the Farm Accounting Data Network that will be supported in the framework of Turkey-EU Financial Cooperation.

Measures are being taken for establishing the Farmer Registration System, a prerequisite for effective implementation of DIS. Works are being conducted in the scope of ARIP in order to strengthen the land registration and cadastral infrastructure because the system is based on the land information and make the checks whether the payment are being made to land actually being cultivated and to the right persons. In addition, the tender was completed to establish the farmer registration system, and it is expected that the hardware infrastructure will be completed in 2006 and the software infrastructure in 2007.

Plant Production

It is observed that the potential of plant production, which significantly depends on climate conditions, is not fully realized and yield is low which has a share of 65 per cent approximately in the total agricultural production. Therefore, it is important that high quality seeds and new varieties should be used extensively to increase yield and quality in the plant production, all types of reproduction materials relating to superior quality plant varieties should be procured timely and at standards and quality products should be obtained.

A Draft Law on Seeds was prepared and which is in the agenda of the TGNA which was designed to amend the Law No. 308 on Registration, Control and Certification of Seeds adopted in 1963 considering the international seeding systems and advancing technologies in the framework of alignment with the EU legislation. This Draft is expected to become law until the end of 2005. By the said Law, it is aimed that the legal ground for the determination of the seed production areas will be created, the country's genetic resources will be recorded, seed industrialists, producers, growers, users and distributors and producers of seedlings and young trees and growers of decoration plants will be organized as sub-associations, and also the higher organization, Union of Turkish Seed Growers will be established.

The Law No. 5042 on Protection of Growers' Rights Related to New Plant Varieties was promulgated on January 15, 2004 in order to encourage development of plant varieties and protect new varieties and the rights of growers. The Regulation on Protecting Growers' Rights in New Plant Varieties and the Regulation on Farmer Exception Practice Principles relating to this Law were promulgated in the Official Gazette on August 12, 2004, and the Regulation on Utilization of Employees in Public Institutions and Organizations to Growers' Rights was promulgated in the Official Gazette on April 30, 2005.

Organic agriculture maintains its importance as an interesting production form because of low pollution in our country's soils and climatic conditions. In parallel with the developments in the world, the number of product varieties reached 174 in 2004 while it was only 8 in 1985. A total of 6,789 hectares of production land existed in 1996, but this figure reached 209,573 hectares in 2004. The Organic Agriculture Law No. 5262 on this matter was promulgated in the Official Gazette on December 3, 2004. The Regulation on Principles and Practices Regarding Organic Agriculture prepared based on this Law was promulgated in the Official Gazette on June 10, 2005.

The Project of Spreading and Controlling Organic Agriculture has been carried out since 1997 in order to develop training, dissemination and building institutional capacity in the field of organic agriculture. In the framework of EU Financial Cooperation, the Project for Developing Organic Agriculture and Harmonizing Turkish Legislation with the EU Legislation was started in 2005 as a sub-component of the this project in order to develop legislation alignment and information infrastructure.

The Agriculture Insurance Law No. 5363 was promulgated in the Official Gazette on June 21, 2005 in order to compensate the damages that farmers may suffer due to risks exposed in the agricultural production. The Law regulates the pool to be formed for operating the insurance system and risks that will be insured by this pool, revenues and expenses of the pool, premium and damage excess support, insurance contracts, provision of reinsurance, insurance companies' duties, authorizations and responsibilities, and principles and procedures for contributions and participations.

Phytosanitary Issues

As part of the Project to Ensure Alignment of Turkish Legislation in the Field of Plant Health with the EU Acquis, which was launched in 2003 and partly funded by the EU, efforts have been initiated to establish four agricultural quarantine laboratories. The project has total budget of 5.3 million euros of which 1.1 million euros will be contributed by Turkey. Major renovations of the quarantine laboratories were completed in 2004 as a result of a procurement process initiated in the last quarter of 2003 and the Project will be completed in the end of 2005.

Livestock Sector

Efforts effectively carry on in improving animal species, increasing production of concentrated feed and fodder crops of high quality, eradicating animal diseases and pests, organizing animal breeders, and improving publication services in order to make the livestock sector competitive.

The Decree No. 2000/467 on Supports on Livestock, which expired in 2005 was renewed and the Supports on Livestock Decree No. 2005/8503 of the Council of Ministers was put into effect for 2005-2010. The said Decree has many support components such that fodder plant production should be increased, breeding of suds should be promoted, artificial insemination should be spread, and a region free of animal diseases should be created and it is planned that a total resource of approximately 300 million euros will be set aside for 2006.

According to the Communiqué on Implementation for Supporting Veterinary Doctors Employed in Slaughterhouses and Plants for Encouraging Healthy Production promulgated in the Official Gazette on May 25, 2005 based on the Decree No. 2005/8503 of the Council of Ministers on Supports on Livestock promulgated in the Official Gazette dated February 24, 2005, it was aimed to employ 300 veterinary doctors in the private sector read meat plants and slaughterhouses and poultry plants and slaughterhouses for this purpose.

In addition, works on the alignment of national legislation on livestock with the related EU regulations are underway. In this context, almost all of the cattle were included in the animal identification system. Works are operated by including the newborns to the system starting from 2005 and removing those died or slaughtered out of the system. Works were commenced to identify sheep and goat population.

In order to harmonize with the EU acquis in the field of animal health, the Project for Creating Animal Health Information System and Border Check Points was implemented in 2003 with a total budget of 17 million euros with 13.3 million euros EU contribution and 3.7 million euros Turkey contribution. In this context, it was planned to build a veterinary border checkpoint selected as pilot compliance with EU norms. For this purpose, the construction of the Border Check Point at Istanbul Sabiha Gökçen Airport was started and planned to be completed in September 2005. The project is expected to finish in 2005. Further, a project will be implemented by EU grant to build at EU norms a total of 6 border check points at İzmir, Mersin (port border check point), Hatay (Cilvegözü), Habur, Gürbülak, Sarp (land border check points).

In the field of animal health, Emergency Plans were formed for avian influenza, small ruminant plague, and foot-and-mouth diseases. Control and Eradication Plans were also prepared for foot-and-mouth disease, sheep-goat pox, tuberculosis and brucellosis. Further, 20 analyses being used by 9 different laboratories in the Central Veterinary and Control Research Institutes were accredited by the Turkish Accreditation Agency (TÜRKAK). The preparatory works for legislation in compliance with the EU legislation regarding the meat and meat product plants are underway and expected to finalize by the end of 2005.

Fisheries

The Project for Institutional Strengthening and Development of Fishery Sector was prepared to be implemented in the period of 2004-2006 in order to increase the sustainable contribution of the fishery sector to national economy and harmonize it with the EU Common Fishery Policy. For the project with a total cost of 6.6 million euros, Turkey will finance 434,000 euros. Under this project, it is planned to provide institutional strengthening, create legal and structural policies, ensure protection, control and resource management and make necessary regulations on the common market organizations, and fishery vessels registration and information system.

It is planned within this project that by a Twinning Contract, the fishery management system of our country would be harmonized with the management system of member countries and occupational training would be received and because the contract was concluded in the end of 2004 no expenditure was yet made under the project. The Technical Assistance Contract to be carried out simultaneously with this project aims to complete the twinning activities and will go into effect on 30 November 2005. Further, the Construction Contract for Administrative Buildings and the Water Products Information System and Technologies Procurement Contract were signed. Under these contracts, the vessel monitoring system and the fishery information system will be established, materials and equipment, software and hardware will be purchased for establishing the link between such systems and 30 prefabricated ports, and the personnel will be employed to work on these systems at the ports. Additionally, the Personnel Training and Administration Buildings Equipment Procurement Contract is at the stage of signing.

Foodstuffs

The Law No. 5179 on Amending the Decree with Force of Law on Production, Consumption and Control of Foodstuffs was promulgated in the Official Gazette on 5 June 2004. This law aims to ensure that the Ministry of Agriculture and Rural Affairs as the sole authority will Greater Municipalities Law No. 5216 and the Municipalities Law No. 5393 promulgated in 2004 and 2005 respectively, local governments were given authority in the implementation of the food legislation by delegating the permission actions of the enterprises producing foodstuffs and the registration actions to food registry. In order to ensure effectiveness in control and monitoring food safety, it is important to establish a structure, which can monitor and intervene from a single centre. On the other hand, due to the critique of the Law No. 5179 by the European Commission, the Law is being reviewed for full compliance purposes and it is planned to be submitted to TGNA by the end of 2005.

In the field of foodstuffs, a large part of the EU legislation including some regulations included in the Turkish-EU Council Resolution No. 2/97 was harmonized by a total of 82 Communiqués under the Regulation on Turkish Food Codex and Regulation on Food Radiation. It was scheduled for the future that additional 16 EU directives would be complied with in the framework of legislative alignment included among the short and mid-term priorities in the National Program. Regarding this matter, the Regulation on National Commission of Food Codex was prepared as required by the Law No. 5179 on Amending the Decree-Law Regarding Production, Consumption and Inspection of Food and promulgated in the Official Gazette on September 13, 2004 issue 25582 and afterwards the National Commission of Food Codex was established and commenced work.

Under the Project for Improving Food Control Services which is included in the Public Investment Program and will be completed by the end of 2005, equipment and instrument requirements of 15 laboratories were provided from the grant received from the MEDA-I fund. Under the project, 767 items of 121 types of equipment at 9 million euros obtained as grant from EU was delivered in November 2004 to 15 laboratories (Ankara, İstanbul, İzmir, Bursa, Samsun, Mersin, Gaziantep, Van, Trabzon, Erzurum, Tekirdağ, Kocaeli, Antalya, Adana and Konya). Instrument and analysis training were provided to 45 laboratory staff. Currently the Provincial Control Laboratories of Ankara, İzmir, İstanbul, Mersin and Bursa Food Control and Centre Research Institute have been accredited by the Turkish Accreditation Agency. Provincial Control Laboratories of Antalya, Trabzon, Samsun, Giresun and Ordu applied for accreditation by TÜRKAK. Works for expanding the scope of accredited laboratories are continuing.

Within the studies for harmonization with the EU Council Regulation No. 339/93/EEC regarding security controls of products imported from third countries, a project was realized within the Matra technical support program of the Dutch

Government. In this context, İstanbul Provincial Agriculture Branch and four customs points in Istanbul were chosen as pilot regions, and coffee, cacao, lysitin, carnitin, glutamine and aspartame food stuffs were included as pilot products and the project was completed in May 2005.

A new project will be started in 2006 within the Matra program to be implemented in Ankara Provincial Control Laboratory. This project aims to detect unwanted substances in the food such as dioxin, acrylamide etc., determine limits for such substances, find out origins, training for inspectors, and build capacity in crisis management.

The Project for Restructuring and Strengthening Food Security and Control System in Turkey supported by EU and covering the period of 2005-2007 aims to ensure food security in Turkey, increase effectiveness in food control system, and structurally strengthen the existing central and field organization of the Ministry of Agriculture and Rural Affairs and its duties and responsibilities, and improve cooperation with the private sector. The total cost of the project is 10.97 million euros, with 2.04 million euros being financed by Turkey.

The Project for Establishing the National Food Reference Laboratory as a sub-component of this project has a total cost of 6.65 million euros. For this amount, 5.1 million euros will be granted by EU, the remaining 1.55 million euros will be covered by Turkey via the Public Investment Program. The construction for the National Food Reference Laboratory in Ankara will start in 2006, and the instrumentation-equipment and device needs will be completed in 2007.

The Food Security and Control twinning component of the Project will be implemented from January 2006 due to some technical difficulties. In the context of strengthening food control, the Procurement of Control Equipment and Establishment of Information System for Food Security Control System is at the stage of tender.

4.5.2. Rural Development

In the context of integration with EU and Development Plans, the rural development goals of Turkey is to ensure physical and social development of rural areas and increase the competitiveness in rural areas, increase the income level of the rural population and economic and social development, to widen training and participatory organization and to protect environment.

By the Council Regulations No.1290/2005 and 1698/2005 which came into force this year, the funds regarding the common market regulations were separated from each other and the European Agricultural Fund for Rural Development (EAFRD) was created. On the other hand, a strategic approach was adopted for attaining EU Lisbon and Göteborg goals. In this context, regulations were undertaken in order to ensure the consistency of rural development policies especially cohesion and environmental policies with the EU’s other policies and to use the relevant funds in a complementary and synergy-creating manner.

While agricultural activities have an important place in rural development, non-agricultural activities are emphasized in rural development policies, as the rural areas are underdeveloped in economic and social respects. Maximum attention will be given to cooperation between agencies since rural development is multi-dimensional and covers various sectors.

The activities for development of rural areas will be realized in order to contribute to the goals of Development Plan on the following principles: to ensure the harmony of rural development policies and sectoral and spatial policies, to perceive the rural development and agricultural development as a whole, to accord with the agricultural and rural policies of the EU, to consider the differing characteristics, needs and potential of the rural areas in the country, to ensure coordination and cooperation among the relevant organizations responsible for the implementations of all rural development projects, to include local administrations, the non-governmental organizations and beneficiaries in the decision making and the implementation processes.

The preparatory works for the Rural Development Strategy are at the final stage in order to comply with the EU's Common Agriculture Policy and also the rural development policies which are getting more important in terms of cohesion and environmental policies and build a policy framework for rural development works in Turkey. In the context of this strategy document, the preparatory works for the Rural Development Plan, which will be prepared, continue. The corresponding works will be underpinned also by a technical support project in the context of Turkey-EU Financial Cooperation. The implementation program will be designed to ensure close cooperation and division of work between agencies and to include not only compliance with EU in terms of scope but also all rural development activities

Capacity building works are continuing regarding the management of EU rural development funds to be used by Turkey in the period of 2007-2013. In this context, technical support will be provided by a twinning project in order to strengthen the institutional capacity under Turkey-EU Financial Cooperation. The project prepared to provide support to establishment of the Rural Development Payment and Implementation Organization is expected to be implemented after signing the memorandum of understanding.

Various rural development projects, mostly funded by foreign loans and grants, have been carried out in Turkey and some of them are currently being implemented. The corresponding projects includes basin management and small scale agricultural development projects and covers such activities as development of agriculture and livestock, irrigation, rehabilitation of watery areas, construction of village roads, construction of forest roads, creation of drinking water ponds, providing drinking water, increasing agricultural and livestock production and forestation. However, the Village-Based Participative Investment Program was put into practice in 16 pilot provinces in the context of TRUP via financing investments and expenditures at certain rates in compliance with the criteria specified by the civil society organizations, private sector and public sector. In the forthcoming period, the creation and implementation of projects, based on beneficiary participation and responsibility and providing financing directly to the beneficiaries, will be continued.

On the other hand, Anatolian Watersheds Rehabilitation Project, which comprises various activities in the rural parts of 6 provinces located in central Turkey and 28 micro-basins where poverty is widespread, came into force. This project includes soil protection, rehabilitation of forestry land and agricultural land and activities for rehabilitation of natural resources such as pasture improvement, as well as revenue increasing activities such as improvement of livestock and greenhouses, small scale irrigation infrastructure and product diversification. The project aims to contribute to building capacity in compliance with EU standards and similar activities. Rehabilitation activities and revenue increasing activities were implemented in 5 micro-basins whose plans were completed, and it is foreseen that implementations will be continued in 10 micro-basins in 2006. On the other hand, in accordance with the policies of realizing agricultural potential in rural areas, supporting entrepreneurship and accelerating socio-economic development, technical and financial support have been provided to 310 cooperatives engaged in greenhouses and livestock in the rural areas in 2005.

Electrification, communications and stabilized-road service infrastructures have been almost completed in the rural areas. However, these infrastructures need to be modernized and works are continuing in this respect. Efforts are under way to extend and improve water supply networks, sewerage, and waste water treatment facilities in rural areas. In 2005, the General Directorate of Rural Services was abolished and the rural services related to settlement were transferred to the Ministry of Public Works and Settlement, and other services to provincial special administrations, except in Istanbul and Kocaeli and in these cities such services were transferred to greater municipalities.

Table. 4. 7: Matrix of Policy Commitments: Agriculture

(1000 Euros)

	2004	2005	2006	2007	2008
1. Agricultural Reform Implementation Project (1)					
A. Implementation Profile	---	---	---	X	---
B. Net Effect on Budget	-48,713	-42,026	-30,000	-31,980	---
B.1. Direct Effect on Budgetary Revenues	0	0	0	0	---
B.2. Direct Effect on Budgetary Spending	48,713	42,026	30,000	31,980	---
2. Plant Health – Project To Eradicate Plant Diseases and Pests (2)					
A. Implementation Profile	---	---	---	---	---
B. Net Effect on Budget	-1,013	-910	-1,600	-1,800	-1,850
B.1. Direct Effect on Budgetary Revenues	0	0	0	0	0
B.2. Direct Effect on Budgetary Spending	1,013	910	1,600	1,800	1,850
3. Animal Health – Project To Eradicate Plant Diseases and Pests (1)					
A. Implementation Profile	---	---	---	---	---
B. Net Effect on Budget	-7,819	-8,233	-7,011	-7,881	-13,770
B.1. Direct Effect on Budgetary Revenues	0	0	4,969	4,969	0
B.2. Direct Effect on Budgetary Spending	7,819	8,233	11,980	12,850	13,770
4. Pursuant to the Decree 2000/467 and 2005/8503 on Supporting Livestock Sector					
A. Implementation Profile	---	---	---	---	---
B. Net Effect on Budget	-91,500	-104,000	-230,000	-270,000	-270,000
B.1. Direct Effect on Budgetary Revenues	0	0	0	0	0
B.2. Direct Effect on Budgetary Spending	91,500	104,000	230,000	270,000	270,000
5. Spread and Control of Organic Agriculture Project (3)					
A. Implementation Profile	---	---	---	X	---
B. Net Effect on Budget	---	---	375	710	---
B.1. Direct Effect on Budgetary Revenues	---	---	463	710	---
B.2. Direct Effect on Budgetary Spending	---	---	88	0	---
6. Fisheries Sector- Legal and Institutional Alignment to the EU Acquis Project					
A. Implementation Profile	X	---	X	---	---
B. Net Effect on Budget	1,064	1,083	3,588	---	---
B.1. Direct Effect on Budgetary Revenues	1,064	1,293	3,812	---	---
B.2. Direct Effect on Budgetary Spending	0	210	224	---	---
7. Restructuring and Strengthening of Food Safety and Control Management in Turkey					
A. Implementation Profile	---	X	---	X	---
B. Net Effect on Budget	---	250	3,964	2,680	---
B.1. Direct Effect on Budgetary Revenues	---	250	4,950	3,734	---
B.2. Direct Effect on Budgetary Spending	---	0	986	1,054	---
8. Direct Income Support (4)					
A. Implementation Profile	---	---	---	---	---
B. Net Effect on Budget	-1,403,832	-1,391,404	-1,153,326	---	---
B.1. Direct Effect on Budgetary Revenues	0	0	0	---	---
B.2. Direct Effect on Budgetary Spending	1,403,832	1,391,404	1,153,326	---	---
Total Net Effect on Budget					
A. Implementation Profile	---	---	---	---	---
B. Net Effect on Budget	-1,551,813	-1,545,240	-1,414,010	-308,271	-285,620
B.1. Direct Effect on Budgetary Revenues	1,064	1,543	14,194	9,413	0
B.2. Direct Effect on Budgetary Spending	1,552,877	1,546,783	1,428,204	317,684	285,620

Note: In EU-funded projects, impact on budgetary revenues result from EU contributions with grant and investment component in the related projects.
(1) It includes all spending under the Agricultural Reform Implementation Project including investment and transfers.
(2) No amount was spent by the EU and Turkey under the projects as the bidding projects related to the EU project have yet to be completed. Figures recorded as budgetary spending represent spending related to the national project, which is being implemented under the National Investment Program and also comprises the EU Projects.
(3) The amount belongs to sub-component of Improvement of Organic Agriculture and Cohesion of Turkish Acquis to EU Project which has been initiated by EU contribution in 2005 and implemented since 1997 by financing from national budget.
(4) They represent spending from the budget in the current year and excludes payments related to the respective year. The amount is the projected value for 2006.

4.6. Other Reform Areas

4.6.1. Regional Development

The basic objectives in regional development policies are to distribute economic development and social welfare in a balanced manner in the country in the framework of a development approach based on local dynamics, to keep the inter-regional migration tendencies in the region, to ensure balanced distribution of population in space, to ensure a healthy structure of urbanization and to reduce the socio-economic developments differences in rural and urban areas by increasing the welfare in the rural areas.

At central level, the twinning project called Improving the Institutional and Administrative Capacity of SPO General Directorate of Regional Development and Structural Adjustment was initiated on June 1, 2005. The purpose of this project is to improve, implement, manage and coordinate the regional development policies, develop integrated mechanisms, which will allow the implementation of EU funded projects and to strengthen the institutional capacity. In this respect, in order to realize the targeted institutional structure, the necessary project is comprised of six interrelated sub-components, which include organizational structure, coordination, institutional capacity and human resources, communications and management.

At regional level, negotiations of the Draft Law on the Establishment, Coordination, and Duties of Regional Development Agencies are at the stage of completion in the TGNA in order to accelerate regional development in compliance with the principles and policies laid down in the Development Plan and Annual Programs, to ensure proper and efficient use of funds, to implement EU programs, to increase cooperation among the private sector, non-governmental organizations and the public sector and to ensure coordination between provinces in this regard. It is foreseen that 9 agencies will be established in 2006, two in 2007 and three in 2008 in priority in the regions where regional development programs supported by EU grants. Furthermore, it is planned to arrange various training programs for developing capacities of personnel to work in the Development Agencies to be established and as well as to improve technical infrastructure of the Project Coordination and Implementation Units, which coordinate the EU supported regional programs in the regions.

Projects were collected by the method of call for proposal within the context of Cultural Heritage Development Program under the Southeastern Anatolia Project Regional Development Program being carried out under the coordination of the Prime Ministry Southeastern Anatolia Project Administration, and 32 projects with a total of 12 million euros were found successful.

In the context of the Turkey-Bulgaria Cross-Border Cooperation Program, implementation of Joint Small Projects Fund Program, which will cost 500,000 euros and supported in the framework of Financial Assistance Programming for 2003 was started in the third quarter of 2004. In this context, project proposals collected by the method of call for proposal were evaluated and 9 selected projects were decided to be supported. In the context of the program, the Joint Small Projects Fund Program with a budget of 500,000 euros and Edirne Ekmekçizade Kervansaray Restoration Project were included in Financial Assistance Programming for 2004. Due to problems in programming, implementation of the projects defined in 2005 could not be initiated. These projects were left to 2006 programming.

In order to determine the framework of bilateral cooperation in the context of the Interreg III/A Greece-Turkey Program, preparatory works continue. It is planned to initiate the program implementation in 2006. In this context, it is foreseen to make call for proposals for 1,452 thousands euros in 2006 including the budgets allocated in 2004 and 2005 but not utilized and it is planned that 80 per cent of the payments will be made in 2006 and 20 per cent of them in 2007 and resource planning of the national budget is being undertaken in this context. The remaining amount under the program will be proposed in the form of defined projects for later programming periods and the resource to be set aside is not yet determined.

In the context of 12 NUTS-II Regions with priority as defined in the Preliminary National Development Plan (PNDP), calls for proposals were made in April and May 2005 in the Eastern Anatolia Development Program and TR82 (Cankırı, Kastamonu and Sinop provinces), TR83 (Amasya, Çorum, Samsun and Tokat provinces) and TRA1 (Bayburt, Erzincan and Erzurum provinces) NUTS-II Regions Development Program being carried under the coordination of SPO, and the evaluation process is continuing for the project proposals collected at the Central Finance and Contracts Unit. However, as the evaluation process has not been completed at the current stage, payments, in the context of TR82, TR83 and TRA1 NUTS-II Regions Development Program, are transferred to the year of 2006. In the Eastern Anatolia Development Program, the Tatvan Wastewater Plant Rehabilitation Project was converted into a construction project and this increased the cost.

The implementation of TRA2 (Ağrı, Ardahan, Iğdır and Kars provinces), TR72 (Kayseri, Sivas and Yozgat provinces), TR52 (Karaman and Konya provinces), TRB1 (Bingöl, Elazığ, Malatya and Tunceli provinces) NUTS-II Regions Development Program under the Financial Assistance Program for 2004 is foreseen to start in the last quarter of 2005. In the program, it is planned that 80 per cent of the payments will be made in 2006 and 20 per cent of them in 2007 and resource planning of the national budget is being undertaken in this context.

In addition, a regional development program was proposed to the 2005 Financial Assistance Programming to be implemented in TR90 (Artvin, Giresun, Gümüşhane, Ordu, Rize, Trabzon) NUTS II Region, which is one of the priority NUTS II regions included in the PNDP. The implementation of the TR90 NUTS II Region Development Program (Eastern Black Sea Development Program) will start in 2006. The budget of the program is total 24 million euros, with 18 million euros from EU and 6 million euros Turkey’s contribution. In the program, it is planned that 80 per cent of the payments will be made in 2006 and 20 per cent of them in 2007 and resource planning of the national budget is being undertaken in this context.

A project was also proposed to the 2005 Financial Assistance Programming in a view to provide technical support to the programming and administration phases of the Regional Development Programs and to support the establishment and operation of Development Agencies. Preparation of the regional development strategies and operations programs in a participative approach and supporting the prioritization of infrastructure investment project ideas; supporting enhancement of the capacities for implementing, monitoring and evaluating the EU supported regional development programs in the center and region, as well as providing technical consultancy, material and equipment for the establishment and operation of Development Agencies, are foreseen with the project. The budget of the program is 19.5 million euros, with 18.5

million euros from EU and 1 million euros Turkey's contribution. The implementation of the program will be started within 2006.

Moreover, the works of the Yeşilırmak Basin Development Project, which has been an example of regional development plans financed from the public budget, are planned to be completed in the forthcoming period.

It is thought that the contribution of regional programs to economy will be limited particularly in the pre-accession period considering the implementation period of Regional Development Programs prepared and started to be implemented, amount of funds allocated to the programs and the capacity of regional and central agencies to draw up and implement projects. It is, however, expected that project development and implementation capacity at regional and central level will be enhanced through efficient use of pre-accession funds and positive effects on income and employment will be observed in these regions during this period although they will be limited in scale.

Table. 4. 8: Matrix of Policy Commitments: Regional Development

(1000 Euros)

	2004	2005	2006	2007	2008
1. Eastern Anatolia Development Program (1)					
A. Implementation Profile	---	---	X	X	---
B. Net Effect on Budget	---	---	-314	-1,256	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	---	-314	-1,256	---
2. Regional Development in TR82, TR83 and TRA1 NUTS II Regions Program					
A. Implementation Profile	---	X	X	---	---
B. Net Effect on Budget	---	---	-12,330	---	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	---	-12,330	---	---
3. Turkey-Bulgaria Cross-Border Cooperation Program					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	-85	-600	-2,803	-418
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	-85	-600	-2,803	-418
4. Interreg III/A Greece-Turkey Program					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	---	-1,162	-290	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	---	-1,162	-290	---
5. Regional Development in TR72, TR52, TRB1 and TRA2 NUTS II Regions Program					
A. Implementation Profile	---	X	X	X	---
B. Net Effect on Budget	---	---	-16,540	-4,130	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	---	-16,540	-4,130	---
6. Regional Development in TR90 NUTS II Regions Program (2)					
A. Implementation Profile	---	---	X	X	X
B. Net Effect on Budget	---	---	---	-4,800	-1,200
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	---	---	-4,800	-1,200
7. EU Regional Programs (3)					

A. Implementation Profile	---	---	X	X	X
B. Net Effect on Budget	---	---	-1,476	-2,209	-2,102
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	---	-1,476	-2,209	-2,102
8. Regional Development Project (4)					
A. Implementation Profile	---	---	X	X	X
B. Net Effect on Budget	---	---	-414	-623	-579
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	---	-414	-623	-579
9. Allocations for Local Administrations					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	-2,530	-4,250	-4,607	-4,610
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	-2,530	-4,250	-4,607	-4,610
10. Development Agencies					
A. Implementation Profile	---	---	X	X	X
B. Net Effect on Budget	---	---	-76,741	-78,143	-79,146
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	---	-76,741	-78,143	-79,146
Total Net Effect on Budget					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	-2,615	-113,827	-98,861	-88,055
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Expenditures	---	-2,615	-113,827	-98,861	-88,055

Note: Spending related to the programs being implemented take place in the following year due to the approval procedure under Decentralized Implementation System.

(1) The EU granted project of Tatvan Wastewater Plant Rehabilitation Project led to additional 25 per cent co-financing from the national budget. The allocations under this project that has a total cost of 6.3 million euros, of which 1.57 million euros comes from the national budget as a Turkish contribution is planned to be 20 per cent in 2006 and 80 per cent in 2007 and resource planning regarding national budget is realized accordingly.
(2) This program will be proposed under the Financial Assistance Program for 2005.
(3) For the regional development projects under this project, in case of necessary circumstances, transfers will be made to the budgets of local administrations and their enterprises directly or via Ministry of Internal Affairs' budget.
(4)Yeşilırmak Project prepared by strategic planning approach.

4.6.2. Health, Social Security and Improvement of Income Distribution

Works related to social security reform have continued in 2005. The reform drafts prepared by the Ministry of Labor and Social Security include the arrangements that institutions operating in the social security system will be combined as one single organization, unity of norms and standards will be provided in the system to ensure financial sustainability of the system and a universal health insurance will be introduced to include the entire population. The Draft Law for the Social Security and Universal Health Insurance, which regulates the long and short term insurance branches and universal health insurance in the social security system, is on the agenda of the TGNA. Works are continuing on the draft laws, which regulate the institutional structure of the system and social aids system. It is aimed that the corresponding drafts will be enacted in 2006 and come into effect in 2007.

Various steps were taken in 2004 and 2005 to introduce the universal health insurance. In this context, significant easiness is provided to meet the outpatient treatment of poor citizens in health institutions. By the Law No. 5283 promulgated on January 19, 2005, health units of Social Security Institutions and some public agencies and all of their duties, rights and obligations along with movable and immovable property and vehicles were transferred to the Ministry of Health.

Various regulations were undertaken to provide improvements in the field of social aid and services in 2005. The Law No. 5378 on Handicapped and Amending Some Decrees which was put into effect in July 2005 aims to prevent handicapping, solve the problems relating to health, education, rehabilitation, employment, care and social security of the handicapped and ensure their social inclusion and coordinate such services. The Child Protection Law published in the Official Gazette on July 15, 2005 aims to regulate the procedures and principles related to protecting children who need protection or driven to crime, assuring their rights and well being. According to the Law, the Social Services and Child Protection Agency will implement the measures of counseling, care and accommodation for the children driven to crime.

In the first part of the Health Transformation Project initiated as support to the Health Transformation Project, pilot implementations, necessary training and establishment of the health information system were focused. The Health Transformation Project includes five components and their sub-components as follows:

1. Restructuring the Ministry of Health for effective administration;
   - 1.1. Restructuring the Ministry of Health,
   - 1.2. Establishing the national drug and medical devices agency,
   - 1.3. Quality assurance and accreditation of health facilities,
   - 1.4. Building the monitoring and evaluation capacity.
2. Establishing universal health insurance and strengthening institutional capacities of social security organizations;
   - 2.1. Developing the actuarial capacity,
3. Reorganizing the provision of health services;
   - 3.1. Starting the family medicine practice for the first step health services,
   - 3.2. Autonomy of state hospitals,
   - 3.3. Establishing the effective referral system,
   - 3.4. Strengthening the public health.
4. Strengthening human resources capacity;
   - 4.1. Health and social security labor policy and planning,
   - 4.2. Strengthening public health school.
5. Establishing health and social security infrastructure;
   - 5.1. Creating health information system,
   - 5.2. Creating social security information system.

Among these, the components of establishing universal health insurance and strengthening institutional capacities of social security organizations, establishing health and social security infrastructure are the basic common components of the social security reform and health reform.

By implementing five components in the health transformation project and restructuring the system, it is aimed to build an effective, easily accessible and high quality health system. For this purpose, the Law on Pilot Implementation of Family Medicine was passed by the TGNA on November 24, 2004 under the introduction of family medicine for basic health services among the works being carried in the framework of reorganizing the provision of health services. In this context, the works in Düzce selected as the pilot province and other necessary legal regulations for implementation have been completed. This pilot implementation was started at the end of September 2005.

Legislative efforts are continuing for establishing the National Institution of Medicine and National Institution of Medical Devices. While the National Institution of Medicine will perform duties of regulating and supporting such as the adoption of basic policies related to medicine, drug licensing and R&D activities development, the National Institution of Medical Devices will ensure the standardization and supervision of medical devices and consumables. Thereby, effectiveness will increase in rational management of drugs and materials.

Works were initiated to establish the health and social security infrastructure and the project related to electronic patient registration system, which will be the basis of the pilot project of family medicine, was prepared. Moreover, necessary funds were reserved in the 2006 budget for creating the health and social security information systems as soon as possible.

In the context of strengthening public health, special importance is accorded to preventive health services so as to prevent individuals being sick and increase their quality of life and prevent potential costs, and in this respect, the hemoglobinopathy control program, national new-born survey program, measles elimination program, the project for supporting encouragement of breast-feeding and prevention of iron deficiency anemia are being implemented. Furthermore, a strategic plan and an action plan for reproductive health were prepared.

Box. 4. 2: Social Inclusion in Turkey

Turkey joined the Community Program for Fighting Social Exclusion pursuant to the Framework Agreement dated 26 February 2002 and the articles 2-4 of the Memorandum of Understanding dated 3 February 2003. Turkey as a candidate country will prepare the first Social Inclusion Document (JIM) in this process. JIM will analyze the current situation of Turkey in the context of social inclusion and is therefore very important for determining relevant policy priorities.

Some social segments are exposed to social exclusion in Turkey in terms of benefiting health and education services and cultural facilities, taking part in production activities and participating in decision-making processes. They are also the segments most exposed to the risk of poverty. Those socially excluded are particularly those working at temporary and insecure jobs particularly in the agriculture sector, uneducated, women, children, elderly and the handicapped.

It is determined as an objective in the Medium Term Program (2006-2008) and the 2006 Annual Program that those individuals and groups exposed to or under the risk of poverty and social exclusion will be included actively in the economic and social life and by increasing their quality of life, social solidarity and integration will be achieved. In this context, it is essential to create a social protection network which includes the entire population and integrates the disadvantaged groups, to increase the accessibility of public services, to integrate migrants with the society and that all segments of society assume responsibility in such issues.

Table: The Poorest Segments in Terms of Food and Non-Food Expenditures According to Various Criteria

(Per cent)

Criteria	The Poorest Segment	Poverty Rate (2002)	Poverty Rate (2003)
Settlement Place	Rural	35.0	37.0
Gender	Women	27.2	28.3
Education	Illiterate	41.1	42.4
Household Characteristic	Patriarchal or Big Family	34.3	32.7
Economic Activity	Agriculture	36.4	39.9
Employment Status	Causal Worker	45.0	43.1
Reason for Not looking for a job	Handicapped	36.0	---
Social Insurance	No Health Insurance	43.6	---
General Poverty Rate (Food and Non-Food Poverty)		27.0	28.1

Source: SIS

In addition to positive developments in per capita national income, both the developments in social services and aids and what is foreseen, in the framework of social security reform, are important in terms of income distribution and fight against poverty. As the poor segment is usually not covered by the social security system, they are supported by the social services and aid system. The difference between the share of national income taken by the poorest segment of the population and that of the richest segment has been getting smaller since 1994. In addition, in case the food expenditure cost is accepted as the line of poverty in Turkey, 1.35 per cent of the population was below this line in 2002, it declined to 1.29 per cent of the population in 2003. In case of the situation that the cost of food and non-food expenditures are accepted as the poverty line, 26.96 per cent of the population was below this line in 2002, and it was realized as 28.12 per cent in 2003. Despite the improvements in the income distribution and poverty that requires not only economic stability but also policies on sectoral basis, Turkey is still far from the European Union average.

Table. 4. 9: Matrix of Policy Commitments: Health Care-Social Security

(1000 Euros)

	2004	2005	2006	2007	2008
1. Neonatal Screening Program (Phenylketonoury, Hypothyroid)					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	-420	-1,200	-620	-190
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Spending	---	-420	-1,200	-620	-190
2. Ministry of Health / EU Healthy Reproduction Program					
A. Implementation Profile	---	X	X	---	---
B. Net Effect on Budget	---	-1,000	-1,500	---	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Spending	---	-1,000	-1,500	---	---
3. Life Free of Cancer Project (1)					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	---	-890	---	---
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Spending	---	---	-890	---	---
4. Application of Good Laboratory					
A. Implementation Profile	---	X	X	X	---
B. Net Effect on Budget	---	---	-325	-200	-200
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Spending	---	---	-325	-200	-200
5. Eradication of Epidemics (2)					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	---	-1,000	-3,000	-2,500
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Spending	---	---	-1,000	-3,000	-2,500
6. Health Transformation Project in Health Care (3)					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	-900	-11,150	-15,500	-11,250
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Spending	---	-900	-11,150	-15,500	-11,250

7. Other (Medication, Biocidal project, etc.)					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	-220	-1,800	-1,500	-1,000
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Spending	---	-220	-1,800	-1,500	-1,000
Total Net Effect on Budget					
A. Implementation Profile	---	X	X	X	X
B. Net Effect on Budget	---	-2,640	-17,865	79,180	84,860
B.1. Direct Effect on Budgetary Revenues	---	---	---	---	---
B.2. Direct Effect on Budgetary Spending	---	-2,640	-17,865	79,180	84,860

(1) It is the continuation of Cancer Screening and Research Centers Project.
(2) Establishment of Surveillance System Project is included.
(3) Establishment of institutional and database infrastructure of universal health insurance and social security is included.

4.6.3. Information and Communication Technologies

The vision transforming into information society of Turkey which aims to use the information now being accepted as the most valuable input in all fields of economic and social life is to become a country that is a focal point in science and technology production, utilizes information and technology as an effective tool, produce more value by its information based decision making processes, successful in global competition and with high welfare level.

In the framework of the e-Transformation Turkey Project which aims to implement this transformation vision, the Short-Term Action Plan (STAP), which covered 2003-2004, included priority actions for the creation of effectively working and safe information systems to provide effectively online services by the public administrations. Further, it was taken into account that actions included in STAP would be in harmony with the actions relating to restructuring public administration in the Urgent Action Plan, ensuring effectiveness in public services and services to citizens.

The e-Transformation Turkey Project 2005 Action Plan was adopted by the Decision No. 2005/05 dated 24 March 2005 of the High Planning Council and works were commenced on the plan which as prepared by the participation of relevant public and civil society organizations as a transitional plan during the Information Society Strategy preparatory works following the completion of STAP upon the instructions by the e-Transformation Turkey Executive Board.

While STAP includes mostly the actions for establishing legal and technical infrastructure in the framework of transforming Turkey into information society, the 2005 Action Plan mostly includes actions for implementation. 34 (47 per cent) of STAP actions were completed and 19 (26 per cent) were transferred to the 2005 Action Plan directly or after revision. Other continuing actions are being monitored.

A total of 50 actions are included in the 2005 Action Plan under the headings of information society strategy, technical infrastructure and information security, training and human resources, legal infrastructure, e-government, e-health, and e-commerce. There are 28 public institutions and agencies responsible for these actions.

The tender process was completed which was initiated by SPO to procure consulting services for the preparation of the Information Society Strategy which would formulate the basic goals that should be achieved in transforming Turkey into information society and policies, necessary methods and tools and resources that should be employed to achieve such goals. The Information Society Strategy Document will be finalized at the end of 2005. The strategy will cover the topics of information and communication technologies, social transformation, work environment and entrepreneurship, effective public administration and also the institutional structuring and governance model and the communications strategy will be prepared. The Strategy Document will also include a prioritized action plan on e-government.

The first three phases of the protocol signed between the Ministry of National Education and Turkish Telecom Inc. in the context of educating human resources needed by the information society, and as of July 2005, 20,350 schools under Ministry of National Education were connected to Internet over Asymmetric Digital Subscriber Line (ADSL). Preparatory works are continuing for the supplementary protocol as the fourth phase of the said protocol to connect 22,534 more schools to ADSL Internet connection. By the completion of this phase, the total of 42,534 schools all over Turkey will have ADSL Internet access and services.

A pilot implementation project was commenced by Ministry of National Education which provided communications between the school administration, students and parents for 25 schools in the framework of Education Portal to serve the citizens. Works are underway to include 120 more schools in this facility by the end of 2005.

The most important component of the e-Transformation Turkey project is the e-government. In this context, Turkish Telecom Inc. was assigned by the Decree of the Council of Ministers No. 2005/8409 the duty and responsibility to create the technical infrastructure for the e-Government Portal focusing on the needs of citizens and businesses where all users would access integrated public services from single point. The tender for the said service was finalized and the e-Government Portal will be commissioned in 2006 which would include 19 pilot services. The equipment and software management created in the framework of e-Government Portal will be later turned over to the Undersecretariat of State Planning Organization free of charge.

The Identification Data Sharing System (IDSS) was commissioned by the IDSS Implementation Regulation promulgated in the Official Gazette dated 10 July 2005 issue 25871 which project was an important component of e-Government services and would allow the public administration to share identity information of Central Census Management System (MERNIS) that provides access to citizen identity information by a single and a unique number as of October 2005, 23 public administrations started to utilize this service.

The Regulation on Procedures and Principles regarding Implementation of Electronic Signature Law and the Communiqué regarding Processes and Technical Criteria relating to Electronic Signature which was prepared by the Telecommunications Authority for the implementation of the Electronic Signature Law which is one of the cornerstones of the legal infrastructure of the information society were put into effect. In this context, three electronic certificate providers were authorized with one being a public institution.

In order to provide electronic certificate needs of the public from one single center to avoid waste of public resources and duplicate investments and prevent disruptive effects of public sector on competition in the market by crowding-out the private sector investments, the Scientific and Technological Research Council of Turkey, National Research Institute of Electronics and Cryptology (TÜBITAK-UEKAE) by the Directive of the Prime Ministry No. 2004/21 was tasked as the Public Certification Center (KamuSM) to meet institutional certification needs of the public institutions and organizations, and the KamuSM commenced operations on July 1, 2005.

The Turkish Penal Code No. 5237 includes legislations on cyber crimes, and such legislations went into effect on June 1, 2005. In addition, the Draft Bill for the Law on Protection of Personal Data was returned to the Ministry of Justice for consulting the opinion of relevant public institutions and organizations, and the evaluation process is continuing.

The Inter-Agency Electronic Data Exchange Program (IDA) of EU which was completed at the end of 2004 and to which Turkey is a party was made in to Interoperable Delivery of pan-European Services to Public Administrations, Businesses and Citizens (IDABC) as of January 1, 2005 by the European Commission. The memorandum of understanding regarding Turkey's participation in the IDABC program is in the approval process.

Turkey was included in the e-Government country review of OECD which aimed to assess the level of preparation for e-Government, and the works in this scope are planned to finalize by April 2006.

Works are continuing for liberalization and compliance with the EU acquis in the telecommunications sector which aim to have low-cost and widespread telecommunications services in quality for Turkey's transformation into information society. In this context, 55 per cent of the shares of Turkish Telecom were sold in block.

The Draft Bill for the Electronic Communications Law, which aims to eliminate the disorganized structure of legislation in the field of telecommunications and make legislation as needed by the sector in line with new developments, was submitted to TGNA.

After the full liberalization, authorizations were issued for long distance telephone services starting from May 2004, and as of September 2005, 41 operators were authorized. Further, the Assignment Contract for Performing Satellite Services was signed between the Telecommunications Authority and the Turksat Satellite Communications and Operation Inc., and the Assignment Contract for Performing Maritime Communications and Navigation Safety Communications Services was signed with the General Directorate of Coastal Safety and Salvage Administration. In addition, the numbers of operators authorized by service types are given below:

1. National Telecommunications Services: 1
2. Global System for Mobile Communications (GSM) Mobile Phone Services: 3
3. Satellite Platform Services: 1
4. Satellite Telecommunications Services: 22
5. Global Mobile Personal Communications by Satellite (GMPCS) Mobile Phone Services: 5
6. Internet Service Providers: 71
7. Data Communications Services over Land Lines: 18
8. Joint Use Radio Services: 43

In the context of compliance with the EU legislation, developments regarding secondary regulations in the field of telecommunications are given in Table 4.10.

The Consumer Guide prepared by the Telecommunications Authority was issued in August 2005 for allowing the consumers to access information on services being provided in the telecommunications sector and laying down the procedures of complaint in case of confronting a problem.

In the context of the 2002 Turkey-EU Financial Cooperation Programming, the Project for Institutional Structuring in the Telecommunications Authority at an amount of 2.3 million euros which aimed to strengthen the institutional capacity of the Telecommunications Authority was implemented on 10 January 2005 following the completion of the tender relating to the service procurement portion of the project and signing the relevant contract on 30 November 2004. Under this one-year project, activities will be conducted to develop legal and regulatory framework and strengthen the institutional capacity of the Authority.

Table. 4. 10: Legislation within the Framework of Adaptation to the EU Acquis

Date	No	Title	Remarks
23/09/2004	Official Gazette No. 25592	Communiqué on Procedures and Principles Regarding Implementation of Number Fees	Communiqué covers procedures and principles regarding number fees to be charged at primary allocation by number type
22/12/2004	Official Gazette No. 25678	Regulation on Consumer Rights in Telecommunications Sector	Regulation lays down procedures and principles for protecting rights and interests of consumers receiving telecommunications services
06/01/2005	Official Gazette No. 25692	Regulation on procedures and principles regarding Implementation of Electronic Signature Law	Regulation lays down procedures and principles regarding legal and technical aspects of electronic signature and implementation
06/01/2005	Official Gazette No. 25692	Communiqué regarding Processes and Technical Criteria relating to Electronic Signature	Communiqué lays down in detail processes and technical criteria regarding electronic signature
05/02/2005	Official Gazette No. 25718	Regulation on Amending the Regulation regarding Telecommunications Service and Infrastructure	Regulation Annex for Cable Platform Services
17/02/2005	Official Gazette No. 25730	Regulation on Amending the Regulation of Authorization for Telecommunications Service and Infrastructure	Regulation Annex for Broadband Fixed Wireless Access Services
03/03/2005	Official Gazette No. 25744	Regulation on Service Quality in Telecommunications Sector	Regulation covers procedures and principles regarding the provision of services and/or operation of infrastructure at national and international service quality standards by telecommunications operators
03/03/2005	Official Gazette No. 25744	Regulation on Amending the Regulation of Authorization for Telecommunications Service and Infrastructure	Regulation amendment for Long Distance Phone Services
11/05/2005	Official Gazette No. 25812	Regulation on Amending the Regulation of Authorization for Telecommunications Service and Infrastructure	Amendment to Provisional Article 1 of the Regulation of Authorization dated 26 August 2004
25/06/2005	Official Gazette No. 25856	Law on Provision of Universal Service and Amending Some Laws	Law lays down procedures and principles to provide universal service which is of public service nature but financially

	25856	Laws	difficult for operators to meet, and perform obligation of universal service in electronic communications sector
29/06/2005	Official Gazette No. 25860	Regulation on Amending the Regulation of Access and Interconnection	Amendments were made to Article 18 Separation of Accounts and Article 19 Reporting and Auditing
07/09/2005	Official Gazette No. 25929	Regulation on Amending the Regulation of Authorization for Telecommunications Service and Infrastructure	Regulation Annex for Infrastructure Operation Service
---	---	Regulations of Right of Passage	Works are underway to comply with Perfect Competition Directive No. 96/19/EC

Works are continuing for the project titled Strengthening Physical Infrastructure for Market Monitoring in Telecommunications Sector with 4.8 million euros support under the 2003 Turkey-EU Financial Cooperation Programming and now it is in the tender phase. Under this project, the amount of 714,000 euros that is the contribution share was transferred to the main account of the National Fund 2003 National Contribution Share for the strengthening of the existing laboratory in which the Telecommunications Authority will conduct its market monitoring activities in order to implement the Regulation on Market Monitoring and Supervision. In addition, the project is in the tender phase for strengthening the existing laboratory infrastructure in which the certified organization candidates will perform their compliance assessment activities under the Regulation on Certified Organizations. Works have been completed for the prerequisites that should be met by the Telecommunications Authority for the support at an amount of 6.4 million euros.

Table. 4. 11: Matrix of Policy Commitments: Information and Communication Technologies

(1000 Euros)

	2004	2005	2006	2007	2008
1. Project of Enhancement of Physical Infrastructure of Telecommunication Authority					
A. Implementation Profile	---	X	X	---	---
B. Net Budget Effect	---	-714	-476	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	-714	-476	---	---
2. Project of Enhancement of Institutional Capacity of Telecommunication Authority					
A. Implementation Profile	---	---	---	---	---
B. Net Budget Effect	---	---	---	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	---	---	---	---
Total Net Budget Effect					
A. Implementation Profile	---	X	X	---	---
B. Net Budget Effect	---	-714	-476	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	-714	-476	---	---

4.6.4. Transportation

The Transportation Main Plan was completed which would develop strategies that would ensure balance between various types of transportation in order to create the transportation infrastructure suiting the needs of country's economy and social life.

Moreover, the tender was completed for the Transport Infrastructure Needs Analysis (TINA) which would determine main transport arteries in order to integrate Turkey into EU transportation networks and this work is contemplated to be finalized in one year. This study aims to determine the arteries, connections and transfer points of the Trans-European transportation network's Turkish extensions and integrate Turkey into the Trans-European transportation networks in the future years.

On the other hand, the Mersin Container Port Project was proposed under the heading of infrastructure to the EU Pre-Accession Financial Cooperation Programming and it is currently under evaluation.

In the transportation sector, the restructuring of the Turkish State Railways (TCDD) is one of the basic reform areas. TCDD prepared a Restructuring Action Plan which covers the period of 2003-2008 in the field of railroad transportation. In line with this action plan and under the EU Legislation in order to create the legal and institutional framework of the railway sector, the Project for Restructuring and Strengthening the Railways Sector was prepared. For this project, 4.75 million euros financing was obtained with 4.25 million euros from EU resources as grant and 0.5 million euros from national resources. This project is comprised of the components named the Railways Sector Organizations (Twinning Project), Information Technology System for Financial Management Information System, New TCDD Organization and Financial Relations with Government.

Under the sub-project of Railways Sector Organization, a general railway draft bill which regulates the railways sector, a separate draft bill for TCDD and drafts of secondary legislation will be prepared on Operating License, Safety Certificate, Infrastructure Access and Billing and Passenger Rights. This project, being carried out together with the German Railways, is to be completed by August 2006.

In the context of the sub-project of New TCDD Organization and Financial Relations with Government, it is expected that the financial management information system will be set up to measure and monitor the financial performance of TCDD on the basis of business units, knowledge and skills of TCDD managers will be developed in accord with the business environment, obligations of the public sector will be defined and the contracts with the government will be made accordingly.

On the other hand, as a result of negotiations with the World Bank, it was agreed to support the TCDD restructuring project by a two-phase Applicable Program Loan (APL). This project, which will be implemented between 2005 and 2010, is comprised of the components of supporting the signalization projects to increase line capacity at selected TCDD lines and restructuring the labour force.

A portion of 184.7 million dollars of the 221 million dollars to be provided under APL1 will be given by the World Bank. Depending on the developments under APL1, negotiations for APL2 will start. It is expected that 230 million dollars will be provided under APL2. Of this amount, 115 million dollars will be financed from the World Bank.

In maritime transportation, in addition to the conventions of maritime safety to which we are a party including mainly the flag and port state controls, the amendments and protocols that would be later developed will be approved and legislative and technical changes will be made to comply with the EU acquis. The Project for Strengthening Maritime Transportation Safety was completed for enhancing maritime safety under the 2002 Financial Cooperation Programme.

The Regulation on Opening, Operating Vehicle Inspection Stations and Vehicle Inspection in full compliance with the EU Directive No. 96/96 regarding technical inspections of land vehicles was promulgated by the Ministry of Transport in 2004. In the context of this regulation, vehicle inspections will be made in the inspection stations operated by natural or legal persons whom will be granted Operation Certificate (Authorization Certificate) by the Ministry of Transport which will supervise these stations.

The Highways Sector Support Project which includes regulations necessary in the process of harmonization with EU, personnel training and strengthening traffic inspections was taken into the 2004 Turkey-EU Financial Cooperation Programming. In the context of this project, the current condition of the highways transportation sector was examined and a Draft Gap Analysis Study and an Action Plan were prepared. In this framework, EU funds will be utilized in personnel training, supply of machinery and equipment and transition to automation. EU accepted the project fiche at 5.5 million euros prepared under this project. For the part under the twinning component of the project, the Netherlands-Germany joint proposal was selected. Preparations for contract with Netherlands-Germany started and the process are continuing.

The Training Needs Assessment Study which is a prerequisite for the service procurement component which makes up the second leg of the Highways Sector Support Project was realized and the Assessment Report of Transportation Sector Training Needs and Training Facilities Quality.

Table. 4. 12: Matrix of Policy Commitments: Transportation

(1000 Euros)

	2004	2005	2006	2007	2008
1. Reconstruction of TCDD and Turkish Railway Sector					
A. Implementation Profile	---	---	X	---	---
B. Net Budget Effect	---	---	-477	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	---	-477	---	---
2. Project on Support to Road Sector					
A. Implementation Profile	---	---	X	---	---
B. Net Budget Effect	---	---	-1,500	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	---	-1,500	---	---
Total Net Budget Effect					
A. Implementation Profile	---	---	X	---	---
B. Net Budget Effect	---	---	-1,977	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	---	-1,977	---	---

4.6.5. Energy

Turkey attaches great importance to making energy market reforms and fully harmonizing its national energy legislation with the EU legislation. In this direction, significant reforms were made in Turkey in recent years and considerable progress was made for opening the sector to competition.

The Energy Market Regulatory Authority (EMRA) which was established in the framework of the Electricity Market Law that went into effect in March 2001 continues the secondary legislation works for the healthy operation of the sector.

In the framework of the Strategy Document which was adopted and announced in March 2004 by the Higher Planning Council, some amendments were made to the Electricity Market Law by the Law No. 5398 legislated in July 2005 in order to liberalize the electricity sector, privatize distribution assets and continue the reforms in the sector in a healthy manner. Accordingly:

- Electricity distribution assets will be privatized by the method of transfer of operating rights,
- EMRA will approve and supervise the operation, investment planning and implementation regarding the privatized distribution facilities and assets,
- Organized Industry Zones (OIZs) will be defined in a separate category from the electricity distribution network, and OIZs will be allowed to produce, trade and distribute electricity in a vertical structure,
- Private sector electricity distribution companies will be able to produce electricity without any restriction.

In 2005, 21 electricity distribution regions formed under the Strategy Document were made into companies and their licenses were granted. Besides, these companies were turned over to the Privatization Administration and their privatization is at the final stage. It is expected that the privatization tender process will start at the end of 2005 and distribution privatization will be completed by the end of 2006.

Following the determination of hydroelectric plants that would remain within the public, the works for making the production portfolio groups were underway and now are about to complete. In this framework, it is envisioned that privatization of generation plants may commence in 2006.

The works were completed for price equalizing mechanism necessary for the operation of the market, and preparation of the balancing and settlement mechanism for the transition period. The Transition Period Contracts study is about to be completed.

Significant progress was made for the restructuring of the electricity sector as a result of works conducted under the Strategy Document. The completion of the reform will be possible by completing the privatization of production portfolio groups that will start in 2006, and creating a structure in which many market actors compete both in the production and distribution. According to the Strategy Document, the reform is to be completed to a large extent in 2008.

In the framework of the Natural Gas Market Law that went into effect in May 2001, various regulations were put into effect in the natural gas sector in the last four years on licensing, facilities, transmission, distribution and customer services, certification, internal installation, tariffs and inspection. EMRA holds natural gas distribution tenders in order to create the market structure envisioned in the Law. To date, natural gas distribution networks were installed in a total of 68 settlements with 45 only in industry and 23 in both industry and dwellings. In this context, EMRA granted distribution license to 28 companies, and it is planned to supply natural gas to 80 new settlements by 2009.

All the natural gas import agreements are held by the Petroleum Pipeline Corporation (BOTAŞ). BOTAŞ will not sign a new purchase contract until its share in the import falls below 20 per cent of the national consumption. EMRA granted natural gas import license to 35 companies to date. BOTAŞ announced a tender in November 2004 to transfer the import agreements to the private sector. It is under obligation to transfer existing purchase and sale agreements to independent supply companies by 2009. In this context, the tender for Transferring the Natural Gas Purchase and Sale Agreements (Import Agreements) was promulgated in the Official Gazette dated September 22, 2005.

Important progress was made in the liberalization of petroleum market that is another component of the energy sector. Following the effect of the Petroleum Market Law, significant progress was made in the secondary legislation works made for liberalizing the market activities relating to crude oil, fuel and other petroleum products (Table 4.13). The new market structure defined in the Petroleum Market Law commenced operations as of January 2005. In this framework, EMRA continues licensing actions.

The Liquefied Petroleum Gas (LPG) Law No. 5307 was promulgated in the Official Gazette dated 13 March 2005 which was prepared to realize the regulation, direction, monitoring and supervision activities necessary to sustain the market activities in a transparent, egalitarian and consistent manner regarding the provision of liquefied petroleum gases supplied from domestic and foreign resources in the context of a safe and economic competition environment. In the framework of the Law, the secondary legislation preparation was started and the License Regulation for Liquefied Petroleum Gas Market went into effect on 16 September 2005.

The Law No. 5346 regarding Use of Renewable Energy Sources for Electricity Production was promulgated in the Official Gazette dated 18 May 2005 which was prepared in parallel with the EU practices in order to increase the contribution of renewable sources to energy supply. The basic objective of the Law is to increase use of renewable energy without forcing the circumstances of free market mechanism in the perspective of the EU Directive which aims to increase the use of electricity produced from renewable energy sources.

The works are continuing on the Energy Efficiency Law, and it is contemplated that the draft for the said Law will be submitted to TGNA in 2005. Manifold benefits are expected from this Law that energy should be rationally used, national saving potential will be provided to the economy of the country, environmental pollution arising from energy use should be reduced and new jobs will be created.

Efforts are continuing to create energy markets in the Southeast Europe integrated with gas and electricity and create a market structure that will attract investment to the region in natural gas networks, electricity generation and transmission lines. Turkey actively participates in such works that aim to create a regional energy market. In this context, works are continuing for the adoption of a legally binding Regional Market Agreement.

Table. 4. 13: Legislation Realized in 2005 in Energy Market

Date	No	Name	Description
		Electricity	
10/11/2004	Official Gazette No. 25639	Regulation on Electricity Transmission System Supply Reliability and Quality	Lays down procedures and principles regarding supply reliability and quality conditions to be applied for planning, operating the transmission system reliably and at low cost and supplying quality, adequate and low cost electricity to consumers.
21/12/2004	Official Gazette No. 25677	Regulation on Electricity Market Balancing and Settlement	Lays down procedures and principles regarding realization of real time balancing and settlement of active electric energy supply and demand.
06/01/2005	Official Gazette No. 25692	Regulation on Electricity Market Customer Services	Lays down standards, procedures and principles to be applied to customers who already connected or wish to connect to the distribution network and those parties which provide such customers with services under connection agreement, retail sales contract or bilateral agreement.
18/05/2005	Official Gazette No. 25819	Law on Use of Renewable Energy Sources for Electricity Production	Lays down procedures and principles regarding the increase the use of electricity produced from renewable energy sources.
21/07/2005	Official Gazette No. 25882	Law on Regulating Privatization Practices and Making Amendments to Some Laws and Decree-Laws	Legislated to remedy some problems encountered in reforms to be done under the Strategy Document and privatization practices.
23/07/2005	Official Gazette No. 25884	Regulation on Electricity Market Licensing	Final form of the regulation on procedures and principles regarding licenses to be issued to legal persons engaged in electricity market activities issued in 2002.
24/08/2005	Official Gazette No. 25916	Regulation on Electricity Market Distribution	Lays down procedures and principles regarding operation and planning of the distribution system reliably and at low cost.
24/08/2005	Official Gazette No. 25916	Regulation on Electricity Market Free Consumers	Lays down procedures and principles regarding practices for natural and legal persons acquiring free consumer title in electricity market.
07/09/2005	Official Gazette No. 25929	Regulation on Electricity Market Import and Export	Lays down procedures and principles regarding electric energy import and/or export activities and principles relating to capacity allocation and use for trans-border trade on interconnection lines.
04/10/2005	Official Gazette No. 25956	Regulation on Procedures and Principles regarding Issuance of Renewable Energy Source Certificate	Lays down procedures and principles regarding issuance of Renewable Energy Source Certificate to legal persons that hold production license for production facilities based on renewable energy sources.
		Natural Gas	
12/05/2005	Official Gazette No. 25813	Regulation on Natural Gas Market Certification	Lays down procedures and principles regarding issuance of certificates to natural or legal persons engaged in construction and service activities of internal installation and service lines.

24/09/2005	Official Gazette No. 25946	Regulation on Natural Gas Market Distribution and Customer Services	Lays down procedures and principles regarding selection of company to be issued urban distribution license and natural gas distribution activities and customer services provided by companies holding distribution licenses.
		Petroleum	
06/01/2005	Official Gazette No. 25692	Regulation on Procedures and Principles to be Followed in Supervision, Preliminary Investigation and Investigation Conducted in Petroleum Market	Lays down procedures and principles regarding monitoring, supervision and sanctioning the market activities relating to provision of petroleum and mineral oil directly or after refining to consumers reliably and economically in competitive environment.
21/04/2005	Official Gazette No. 25793	Procedures and Principles regarding Service Procurement from Public Institutions and Organizations and Private Auditing Organizations for Audits to be Conducted in Petroleum Market	Issued to regulate service procurement from public institutions and organizations and private inspection organizations for audits to be conducted in the petroleum market.
24/06/2005	Official Gazette No. 25855	Regulation on Technical Criteria Applicable in Petroleum Market	Lays down procedures and principles regarding compliance with marketed petroleum and mineral oil with technical regulations and standards.
14/09/2005	Official Gazette No. 25936	Regulation on Petroleum Market Licensing	Lays down procedures and principles regarding licenses to be issued to natural and legal persons, notifications to EMRA and record schemes.
12/10/2005	Official Gazette No. 25964	Regulation on Procedures and Principles regarding National Marker Practice in Petroleum Market	Lays down procedures and principles regarding the affixing of national marker to fuel marketed domestically.
		Liquefied Petroleum Gases (LPG)	
13/03/2005	Official Gazette No. 25754	Law on Amending Liquefied Petroleum Gases (LPGS) Market Law and Electricity Market Law	Legislated to realize the regulation, direction, monitoring and supervision activities necessary to sustain the market activities in a transparent, egalitarian and consistent manner regarding the provision of LPG in the context of a safe and economic competition environment.
16/09/2005	Official Gazette No. 25938	Regulation on Liquefied Petroleum Gases (LPGS) Market Licensing	Lays down procedures and principles regarding licenses to be issued to natural and legal persons, notifications to EMRA and record schemes in order to make market activities relating to provision of LPG to users.

Five separate projects are being carried out with EU in the context of reforms in the energy sector:

1. The twinning project with the theme of Increasing Energy Efficiency in Turkey was started on 13 July 2005 which aimed to strengthen the administrative capacity of the Electrical Power Resources Survey and Development Administration-National

Energy Savings Center (EIEI/UETM) attached to the Ministry of Energy and Natural Resources tasked with carrying out energy savings programs and contributing to development of relevant policies in order to improve energy efficiency in Turkey. The general purpose of the project is to implement the energy efficiency programs in order to develop energy efficiency performance of our country in compliance with the EU acquis and EU experiences. The total cost of the project is 1.25 million euros and it is wholly financed under the financial cooperation programs.

2. The project with a budget of 1.8 million euros for Providing BOTAS with Legal and Know-how Support in Natural Gas Transmission and Transit was implemented on 1 September 2005 in order for BOTAS to perform its obligations to transmit and transit natural gas in parallel with EU standards and practices. The project is financed wholly by EU grant.

3. TEIAS carries out the project for Feasibility Study for Turkey's Integration to Union for the Coordination of Transmission of Electricity (UCTE) Electricity System for determining under what technical conditions the national electricity network will be connected to the UCTE system in a fully synchronized manner, in the framework of the purpose of fully integrating the national electricity market with the EU electricity market. The project budget is 1.5 million euros, in which 12,500 euros is national contribution.

4. The twinning project named Strengthening the Institutional Structure of EMRA which was included in the PEP 2003 and planned to start in October 2003 was started in July 2004 with the partner Italian Energy Regulatory Authority after completing the necessary actions. The project budget is 974,000 euros. In that figure, 84,000 euros was reserved for purchase of goods. There is a domestic contribution of 21,000 euros in the aforesaid part. A series of activities were realized under the project in order to strengthen the organizational structure and personnel capacity of EMRA, and all activities planned under the project were completed as of the end of September 2005.

5. The Regulatory Board Information System Project being carried out by EMRA aims to set up a regulatory information system in order for EMRA to regulate and supervise effectively the energy markets. Under the project it is contemplated that information technology infrastructure will be established and requests of relevant units for the regulatory information system will be identified, the EMRA portal will be established, the work flow system will be created, document processing system will be established, special processing applications will be developed, support services will be provided, and training activities realized. The project has a total budget of 1,085,000 euros. EMRA will cover 35,000 euros as the domestic contribution to 150,000 euros set aside for purchase of goods. The tender for the project was announced, and the Preliminary Evaluation Committee formed to evaluate the applications completed its works. It is planned that the tender will be concluded as of November 2005 and the contract will be signed and the project implemented.

Table. 4. 14: Matrix of Policy Commitments: Energy

(1000 Euros)

	2004	2005	2006	2007	2008
1. Project for Feasibility Study for Turkey's Integration to UCTE Electricity System					
A. Implementation Profile	---	X	X	X	---
B. Net Budget Effect	---	---	-12.5	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	---	-12.5	---	---
2. Project on Strengthening the Institutional Structure of EMRA					
A. Implementation Profile	---	X	---	---	---
B. Net Budget Effect	---	-21	---	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	-21	---	---	---
3. The Regulatory Board Information System Project					
A. Implementation Profile	---	X	X	X	---
B. Net Budget Effect	---	-35	---	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	-35	---	---	---
Total Net Budget Effect					
A. Implementation Profile	X	X	X	X	---
B. Net Budget Effect	---	-56	-12.5	---	---
B.1. Direct Effect on Budget Revenues	---	---	---	---	---
B.2. Direct Effect on Budget Expenditure	---	-56	-12.5	---	---

ANNEX TABLES

Table.1: Growth and Related Indicators

Percentages unless otherwise indicated	ESA	2004	2005	2006	2007	2008
1. GDP Growth at Constant Prices (14+15+16)	B 1 g	8.9	5.0	5.0	5.0	5.0
2. GDP at Current Prices (Billion YTL)	B 1 g	431	487	542	594	646
3. Change in GDP Deflator		9.9	7.7	6.0	4.5	3.5
4. CPI Change (Annual Average)		8.6	7.7	5.8	4.4	4.0
5. Employment Growth*		3.0	2.0	2.5	2.5	2.5
6. Labour Productivity Growth**		5.7	2.9	2.4	2.4	2.4
7. Investment Expenditures (Per cent of the GDP)		25.8	26.7	27.2	27.8	28.4
Sources of Growth: Percentage Changes at Constant Prices						
8. Private Consumption Expenditures	P3	10.1	5.2	4.1	4.6	4.6
9. Government Consumption Expenditures	P3	0.5	1.0	5.2	0.8	0.5
10. Gross Fixed Capital Formation	P51	32.4	14.6	8.7	7.4	7.7
11. Changes in Inventories and Net Acquisition of Valuables (Per cent of the GDP)***	P52+P53	1.2	-0.5	0.0	0.4	0.2
12. Exports of Goods and Services	P6	12.5	6.8	8.6	10.3	9.8
13. Imports of Goods and Services	P7	24.7	8.6	7.9	9.5	9.0
Contributions to GDP Growth						
14. Final Domestic Demand		12.6	6.5	5.2	4.7	4.9
15. Changes in Inventories and Net Acquisition of Valuables	P52+P53	1.2	-0.5	0.0	0.4	0.2
16. External Balance of Goods and Services	P11	-4.9	-1.0	-0.2	-0.1	-0.1
Growth of Gross Value Added						
17. Agriculture		2.0	1.0	1.5	2.2	2.0
18. Industry		9.4	5.0	5.1	5.3	5.3
19. Construction		4.6	21.2	20.9	8.2	7.1
20. Services		10.2	5.8	5.7	5.3	5.4

* Occupied population, domestic concept, persons, national account definition.
** Growth of GDP at constant prices per person employed.
*** Contribution to growth.

Table.2: Labour Markets Developments

	2004	2005	2006	2007	2008
1.Population (Thousand Persons, Mid-year)	71,152	72,065	72,974	73,875	74,766
2.Population Growth Rate (Per cent)	1.31	1.28	1.26	1.23	1.21
3.Working Age Population (Thousand Persons)*	49,906	50,813	51,738	52,647	53,561
4.Labour-Force Participation Rate (Per cent)*	48.7	48.5	48.8	49.1	49.4
5.Employment Level (Thousand Persons)*	21,791	22,225	22,781	23,350	23,934
6. Employment Growth Rate (Per Cent)	3.0	2.0	2.5	2.5	2.5
7. Public Sector Employment (General Government, Thousand Persons)	2,503	---	---	---	---
8. Public Sector Employment Growth Rate (Per cent)	15.8	---	---	---	---
9.Unemployment Rate (ILO Definition, Per cent)	10.3	9.8	9.8	9.7	9.6
10. Labor Cost Growth Rate (Per cent)					
Public	3.1	---	---	---	---
Private	4.5	---	---	---	---
11.Average Real Wage Growth Rate (Per cent)					
Public	1.7	---	---	---	---
Private	3.5	---	---	---	---

* +15 years-old

Table.3: Balance of Payments

Billion Dollars, Unless Otherwise Indicated	**2004**	**2005**	**2006**	**2007**	**2008**
1. Current Account (Per cent of the GDP)	-5.2	-5.9	-5.8	-5.5	-5.3
2. Total Exports of Goods	67.0	76.0	82.7	90.6	99.3
3. Total Imports of Goods	-90.9	-108.1	-117.0	-127.2	-138.1
4. Balance on Goods	-23.9	-32.0	-34.3	-36.6	-38.7
5. Services: Credit	24.0	28.2	30.5	34.1	37.6
6. Services: Debit	-11.2	-13.1	-13.8	-15.6	-17.0
7. Balance on Services	12.8	15.1	16.8	18.5	20.6
8. Net Interest Payments From Abroad	-3.6	-4.1	-4.6	-4.8	-5.0
9. Other Net Factor Income From Abroad	-2.0	-1.6	-1.4	-1.3	-1.5
10. Current Transfers	1.1	1.3	1.5	1.4	1.4
11. *of which* from EU (Billion Euro)	---	---	0.3	0.5	0.5
12. Current Account Balance	-15.6	-21.3	-22.0	-22.7	-23.2
13. Foreign Direct Investment	1.9	4.2	4.2	4.3	4.4
14. Change in Official Reserves	-0.8	-11.1	-1.7	-1.9	-2.5
15. Foreign Debt (Total)	161.8	166.0	177.6	188.2	199.5
16. *of which*: Public	73.8	70.3	68.0	66.3	65.5
17. *of which*: Foreign Currency Denominated	---	---	---	---	---
18. Exchange rate vis-à-vis EURO (end-year)	1.8268	1.7347	---	---	---
19. Exchange rate vis-à-vis EURO (annual average)	1.7677	1.7666	---	---	---
20. Net Foreign Saving (Per cent of the GDP) (1)	5.8	6.8	6.7	6.5	6.3
21. Domestic Private Saving (Per cent of the GDP) (1)	22.5	18.6	18.4	19.7	19.4
22. Domestic Private Investment (Per cent of the GDP) (1)	14.1	15.3	16.0	16.7	17.4
23. Domestic Public Saving (Per cent of the GDP) (1)	-2.5	1.4	2.1	1.6	2.9
24. Domestic Public Investment (Per cent of the GDP) (1)	3.7	4.5	4.5	4.2	4.2

(1) 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.

Table.4: General Government Budgetary Developments

Per cent of the GDP	ESA	2004	2005	2006	2007	2008
Net Lending by Sub-Sectors *						
1. General Government	S13	5.2	1.3	-0.2	0.9	0.0
2. Consolidated Budget	S1311	3.1	-1.5	-1.6	-0.9	-1.9
3. Funds	S1311	-0.1	-0.3	-1.3	-0.4	-0.5
4. Local Government	S1313	0.0	0.4	0.4	0.4	0.4
5. Social Security Fund	S1314	3.8	4.0	3.5	2.4	2.6
6. Revolving Funds	S1311	-0.5	-0.3	-0.3	-0.4	-0.4
7. Unemployment Fund		-1.0	-1.0	-0.9	-0.8	-0.8
8. Universal Health Insurance		0.0	0.0	0.0	0.6	0.6
General Government (S13)						
9.Total Receipts	ESA	41.7	43.3	44.1	42.7	41.9
10.Total Expenditures	ESA	46.9	44.7	43.9	43.6	41.9
11. Budget Balance*	B9	5.2	1.3	-0.2	0.9	0.0
12.Interest Payments	D41	13.4	9.8	8.7	7.0	6.0
13.Primary Balance*		-8.2	-8.4	-8.9	-6.1	-6.0
Components of Revenues						
14. Taxes	D2+D5	23.6	24.9	24.8	24.0	23.5
15. Social Funds	D61	7.8	7.8	8.2	9.7	9.5
16. Other		10.4	10.7	11.1	9.0	8.9
17. Total Receipts	ESA	41.7	43.3	44.1	42.7	41.9
Components of Expenditures						
18. Total Consumption	P3+D1	18.2	18.0	17.8	18.6	18.1
19. Social Security Transfers		7.8	8.4	8.4	8.1	8.1
20. Interest Payments	D41	13.4	9.8	8.7	7.0	6.0
21. Subsidies (1)	D3	0.9	1.0	0.9	1.0	0.9
22. Gross Fixed Capital Formation	P51	3.1	3.8	3.7	3.7	3.7
23. Other		3.4	3.8	4.2	5.3	5.1
24. Total Expenditure	ESA	46.9	44.7	43.9	43.6	41.9

(1) Includes agricultural support, duty losses of SEEs and Support and Price Stability Fund.
* (+) refers to deficit, (-) refers to surplus.

Table.5: General Government Debt Developments

	ESA	2004	2005	2006	2007	2008
Per cent of the GDP						
1. Gross Debt Level		74.8	70.0	65.6	61.4	56.7
2. *Of which*: Repayments Due		30.8	30.3	23.9	20.5	15.2
3. Change in Gross Debt		-5.4	-4.8	-4.4	-4.2	-4.7
Contributions to Change in Gross Debt						
4. Primary Balance (Per cent) (*)	B9	-8.2	-8.4	-8.9	-6.1	-6.0
5. Interest Payments (Per cent) (*)	D41	13.4	9.8	8.7	7.0	6.0
6. Nominal GDP Growth (Per cent)	B1g	-24.5	-17.4	-16.1	-14.6	-14.3
7. Other Factors Influencing The Debt Ratio		13.9	11.2	11.9	9.5	9.6
8. Other Factors Influencing The Debt Ratio: Exchange Rate Change etc.		14.3	11.5	12.5	10.0	10.1
9. Other Factors Influencing The Debt Ratio: Privatization Receipts		-0.4	-0.3	-0.5	-0.5	-0.5

(*) There is no estimated data in the framework of ESA-95 critera.

Table.6: Divergence From Previous Update

	2004	2005	2006	2007	2008
1. GDP Growth (Per cent)					
Previous Update	9.6	4.8	5.1	5.1	---
Latest Update	8.9	5.0	5.0	5.0	5.0
Difference	-0.7	0.2	-0.1	-0.1	---
2. Current Account Balance (Million Euros)					
Previous Update	-11,647	-8,946	-8,678	-8,462	---
Latest Update	-12,590	-16,368	-17,483	-18,027	-18,421
Difference	-943	-7,422	-8,805	-9,565	---
3. Total Foreign Debt Level (Million Euros)					
Previous Update	123,875	128,904	133,407	139,482	---
Latest Update	130,484	132,800	140,952	149,365	158,333
Difference	6,609	3,896	7,545	9,983	---
4. Actual General Government Balance (Per cent of the GDP)					
Previous Update	-6.3	-4.4	-2.1	-0.5	---
Latest Update	-5.2	-1.3	0.2	-0.9	0.0
Difference	1.1	3.1	2.3	-0.4	---
5. Actual General Government Primary Balance (Per cent of the GDP)					
Previous Update	7.8	7.5	7.2	7.0	---
Latest Update	8.2	8.4	8.9	6.1	6.0
Difference	0.4	0.9	1.7	-0.8	---
6. General Government Gross Debt Level (Per cent of the GDP)					
Previous Update*	78.4	75.3	72.2	68.3	---
Latest Update	74.8	70.0	65.6	61.4	56.7
Difference	-3.6	-5.3	-6.6	-6.9	---

*Not applicable

Table.7: Assumptions on the External Economic Environment Underlying the PEP 2005 Framework

	2004	2005	2006	2007	2008
Interest Rates (Per cent)					
Domestic Interest Rate (Treasury Bill Rate, Simple)	24.7	16.4	---	---	---
Short term Domestic Interest Rate (Treasury Bill Rate, Simple)	---	---	---	---	---
Long term Domestic Interest Rate (Treasury Bill Rate, Simple)	---	---	---	---	---
Euro Area: Short term (3-months Money Market)	2.1	2.2	2.7	---	---
Euro Area: Long term (10-years Govt. Bonds)	4.0	3.8	4.3	---	---
USA: Short term (3-months Money Market)	1.6	3.7	4.1	---	---
USA: Long term (10-years Govt. Bonds)	4.3	4.6	5.2	---	---
Exchange Rates				---	---
Exchange Rate vis-à-vis € (YTL / €)	1.7677	1.7666	---	---	---
Change in Annual Average (“-“ depreciation)	4.9	0.1	---	---	---
Parity (USD/ €)	1.24	1.25	1.26	1.26	1.26
Percentage Change in Real Exchange Rate (“+“ depreciation)	-6.8	-10.0	0.4	-0.2	-0.6
Real GDP Growth					
World (excluding EU)	5.7	4.8	4.6	---	---
USA	4.4	3.6	3.0	---	---
Japan	2.7	1.1	1.7	---	---
EU-25	2.4	2.0	2.3	2.5	2.5
World Trade (In Real Terms)					
EU Export Market (Extra-EU-25)	12.1	9.1	7.7	---	---
EU Imports (Excluding intra-EU-25)	7.6	7.0	6.8	---	---
World Import (Excluding EU-25)	12.8	9.1	7.7	---	---
International Prices					
World Import Prices (Percentage Change)	9.3	6.5	1.5	---	---
Non-Oil Commodity Prices	14.4	1.3	-1.1	---	---
Oil Prices (USD per Barrel)	34.6	51.2	58.3	56.6	54.7

Table.8: Cyclical Developments *

	2004	2005	2006	2007	2008
1. Real GDP Growth	8.9	5.0	5.0	5.0	5.0
2. Actual Balance	3.1	-1.5	-1.6	-0.9	-1.9
3. Net Interest Payments	12.3	8.5	8.2	6.6	5.6
4. Potential GDP Growth	5.7	6.5	6.1	5.6	5.6
5. Output Gap (percentage difference from the potential)	2.7	1.3	0.3	-0.3	-0.8
6. Cyclical Budget Component	0.8	0.3	0.1	-0.1	-0.2
7. Cyclically Adjusted Balance	7.8	3.4	2.6	2.6	1.5
8. Cyclically Adjusted Primary Balance	-5.3	-6.2	-6.1	-4.5	-4.5

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

Table.9: Structural Reform Agenda and Developments

Measures Taken in the Last Year's PEP	Realization Status (Y/N)	Date[6]	Comments
Privatization			
Block sale of 55 per cent of shares of Turkish Telecom	Y	2005	Realized on November 14, 2005.
Commencing by March 31, 2005 the tender process for privatizing electricity distribution companies and/or regions	N	---	Preparations are complete to a large extent; the tender process will have started by the end of 2005.
Public offering of a portion of THY shares	Y	2004	191 million dollars of proceeds obtained from the sale of 20 per cent of shares.
Public offering of a portion of PETKİM shares	Y	2005	274 million dollars of proceeds obtained from the sale of 34.5 per cent of shares.
Privatization of TEKEL Cigarette Industry Enterprises and Trade Inc.	N	---	Sale not realized due to submission of no proposals in the tender. A new sales strategy being worked on.
Privatization of public banks	N	---	In line with the Public Banks Restructuring and Privatization Strategy, Ziraat Bank and Halkbank to be privatized by public offering.
Competition Law and Policies			
Amendments to Law No.4054 on Protection of Competition	Y	2005	Amendments made in 2005 to Law No.4054 on Protection of Competition. Amendments aim to use the financial and human resources of the Competition Authority more effectively.
Amending LawNo.4054 on Protection of Competition in order to increase effectiveness and also comply with the legislation in effect in EU in the form of Regulation and Notice	N	---	Draft text prepared by the Competition Authority being circulated for opinion of relevant institutions.
Works on harmonizing the Communiqué No.1998/3 on Group Exemption regarding Motor Vehicles Distribution and Service Agreements with the Commission Regulation no.1400/2002 regarding Motor Vehicle Sector Vertical Agreements and Compliant Action Categories	N	---	Draft communiqué on the agenda of Competition Authority.
Works on establishing a functionally independent unit for monitoring and supervising government aids within SPO	N	---	Draft Bill submitted to Prime Ministry.

[6] The date or foreseen date of realization.

Improvement of the Investment Environment			
Law on the Establishment of Regional Development Agencies	N	2005	The Draft Bill for the Law on Establishing Development Agencies is now being debated in the general assembly of TGNA, which includes the legislation for the creation of the One Stop Office (Investment Support Offices) system for the sectoral authorizations at the stages of investment and starting operation regarding the sectoral licenses.
SME Definition Law	Y	2005	By Law No.5331, the Ministry of Industry and Trade is authorized to issue regulation on the definition of SME, which apply to all legislation and programs of the agencies, and organizations, which include the terms SME, Medium Scale Enterprise, Small Enterprise or Micro Enterprise. When the regulation is issued, an SME definition compliant with EU will be made.
Investment Promotion Activities	Y	2005	Activities for fixing Turkey’s image as investment environment, increasing foreign investments and expanding existing investments are continued by strengthening the institutional capacity of the General Directorate of Foreign Capital, Undersecretariat of Treasury.
Financial Sector			
Privatization of public banks	N	---	Works are continuing along the Strategy Report, which aim to privatize Ziraat Bank and Halkbank by public offering or other methods when convenient market conditions would materialize. Furthermore, 21.89 per cent of shares of Vakıfbank were offered to public.
Legislation regarding the Banking Cards and Credit Cards Law which includes provisions that specify the establishment principles of card issuing organizations	N	2005	Draft Bill submitted to the relevant ministry in April 2005.
Making amendments to Banking Law, in light of international experiences and practices, to make the regulation and supervision framework more effective, minimize risks, carry out regulation and supervision phases on consolidated basis in line with the consolidation trend emerging in the financial sector, improve corporate governance in the regulation and supervision authority	Y	2005	Banking Law No.5411 was promulgated in the Official Gazette dated November 1, 2005 issue 25983.
Disclosure of quantitative impact study regarding New Capital Adequacy Framework (Basel II) and determining associated roadmap and announcing to public	Y	2005	Results were announced in December 2004 of the quantitative impact analysis realized by the participation of 23 banks, which represented 95 per cent of the sector in order to identify impact of the new capital adequacy standard. In May 2005 the Roadmap to Basel II was announced to the public in order to identify policies and strategies and measures to be applied in transition to Basel II.

Completing in 2005 the establishment works for a company to lay down the organization and infrastructure of an organized market where capital market instruments issued by SMEs will be traded and commencement of operations in the market	N	2005	The works by the Capital Markets Board are in the last stage being conducted for creating a market for SMEs and the permission was granted on July 14, 2005 to a company (Emerging Enterprises Markets) which would create and develop a transaction platform where trading transactions could be made in this market and which would make the organization required by such platform It is expected that establishment works will be completed in the last quarter of 2005.
Works on the registration of participation certifications of investment funds at Central Registry Institutions	N	2005	Works on registration of at least on participation certificate of fund for all investment fund founders were realized on August 1, 2005, and it is planned to register all investment fund participation certificates as of December 2005.
Completing works on the registration of stock certificates and associated rights of listed companies by the beginning of 2005	N	2005	Works are continuing because more time than envisioned in the project plan is required to establish and operate the needed systems.
Continuing works on restructuring custody and clearing system	N	2006	Registration works took significant time in the work plan of Takasbank and held priority. With commencement of smooth operation of dematerialized system in 2006, works on this matter will be accelerated.
Commencement of operations and development of Futures and Options Exchange in İzmir where futures transactions will be traded based on goods and financial instruments in order to develop risk transfer mechanisms and establish reference price formation for future	Y	2005	The Futures and Options Exchange (FOE) was commissioned on February 4, 2005 with its center in Izmir, and futures transactions are being traded in FOE based on IMKB-30 index, treasury bills with maturities of 91 and 365 days, USD, Euro, cotton and wheat where the minimum elements were approved by the Capital Markets Board at present.
Initiating the project to benefit from the Pre-Accession Financial Fund for Candidate Countries in Central and Eastern Europe (PHARE) program under the Pre-Accession Financial Assistance being provided to Turkey by the European Union	Y	2005 – 2007	Draft for the contract for EU Twinning Project on Support of Harmonization of Capital Markets Board to EU Capital Markets to be signed between the Capital Markets Board and the German Ministry of Finance, and following the signature of the contract, works are to start in November 2005.
Legal and technical works for creating home mortgage financing system	Y	2005-2006	Draft bill prepared and submitted to Prime Ministry. Secondary regulations are planned to be completed by November 2005 on creating home mortgage financing system.
Works on extending compliance with International Financial Reporting Standards (IFRS) will continue in the future period	Y	2004-2005	- IFRS-compliant Communiqué Series XI No.25 promulgated in Official Gazette in November 2003, effective from January 1, 2005, requires mandatory IFRS application to partnerships, intermediary institutions, portfolio management companies and other enterprises under consolidation whose financial instruments are traded in exchange. - By an amendment on December 21, 2004 to Communiqué Series XI No.25, IFRS practices of enterprises will be deemed performance of preparation and disclosure obligations depicted in the communiqué provided that financial

			statement form requirements be observed, and thus contribution is made to widespread adoption of the regulation. - Making existing auditing standards compliant with International Auditing Standards will help spread compliance with IFRS.
Establishing specialty courts for capital markets	N	---	No progress made due to the need for coordinated work with other institutions.
Registration of GDBI along with stock certificates and investment funds at the Central Registry Institution and custody and monitor on customer basis	N	2006	Ministry assignment was made in May 2005 needed for registration of GDBI, and project is expected to be implemented in 2006.
Legislation of the draft bill for Law on the Regulation and Supervision of the Insurance Transactions	N	2005	Preparatory works on draft bill were completed and submitted to Prime Ministry on June 2005.
Labor Market			
Active Labor Market Programs Project	Y	2005	245 projects are underway under the project. Project will be completed at the end of 2005.
Administrative Reform			
Law on Public Financial Management and Control	Y	2005-2007	Law No. 5018 on Public Financial Management and Control was legislated in TGNA on 10 December 2003, promulgated on 24 December 2003 in Official Gazette. The said Law provides for a 3-year transition period covering 2005-2007. From 2008 onwards, Law No. 5018 will be fully implemented in public administrations under general administration.
Spreading analytical budget classification to the public institutions and agencies outside the scope of consolidated budget	Y	2005-2007	Under the works carried out to restructure the public financial management, for budgets of the administrations with general and annexed budget have been prepared and applied in 2004 in accordance with the Analytical Budget Classification which was created based on the Government Finance Statistics. ABC codes will be introduced from 2006 in the local governments, social security agencies, regulatory and supervisory agencies and institutions and agencies with special budgets, and organizations with revolving funds and other institutions and agencies (except SEEs) as of 2007.
Law on Fundamental Principles and Restructuring of Public Administration	N	---	The Draft Law No. 5227 on Fundamental Principles and Restructuring of Public Administration was adopted in TGNA and submitted to the President, however 22 articles of the draft was returned to the TGNA for re-discussion .

Civil Service Reform	N	---	The Draft Law on Civil Services was circulated to public institutions and organizations for opinion, which was prepared by the State Personnel Administration in the scope of the State Personnel Regime Reform works.
Local Administrations Reform	Y	2005	Under the local governments reform, the Greater Municipalities Law No. 5216 was promulgated on 10 July 2004, the Municipalities Law No. 5393, and the Provincial Special Administration Law No. 5197 on 10 July 2004.
Anti-Corruption Law	N	2006	Works are continuing on Draft Law for Anti-Corruption prepared by the Ministry of Justice.
Ethical Code of Conduct in the Public	Y	2004	The Law No. 5176 on Establishing Public Servants and Amending Some Laws was legislated in May 2004. Furthermore the Board prepared and put into effect the Regulation on Ethical Conduct Principles of Public Servants and Application Procedures and Principles.
Agriculture			
Organic Agriculture Law	Y	2004	The Organic Agriculture Law No. 5262 on the matter was promulgated in the Official Gazette dated 3 December 2004 issue 25659. The Regulation regarding Organic Agriculture Principles and Practices prepared based on this Law was promulgated in the Official Gazette on 10 June 2005 issue 25841.
Agriculture Framework Law	N	2006	The policy framework laid down in the Agriculture Strategy Document (2006-2010) will have an institutional and legal framework with the Agriculture Framework Law. By the Law which is currently being debated in TGNA, it is aimed that the DIS practice will be carried on with more focus on objectives, agricultural land for environmental purposes should be protected in areas exposed to erosion and adverse environmental effects considering the interaction of agriculture and environment and support tools that would not disrupt market mechanisms should be introduced for agricultural production under market conditions.
Agriculture Insurance Law	Y	2005	Agriculture Insurance Law No. 5363 was promulgated in June 2005 in order to compensate the damages that farmers may suffer due to risks exposed in the agricultural production.
Draft Law on Seeds	N	2005	The Draft Law on Seeds was prepared and waiting at the agenda of the General Assembly of the TGNA which was designed to amend the Law No. 308 on Registration, Control and Certification of Seeds adopted in 1963 considering the international seed growing system and advancing technologies in the framework of alignment with the EU legislation. It is expected to be legislated by the end of 2005.

Issuing regulations relating to the Law Protection of Growers' Rights Related to New Plant Varieties	Y	2004	The Law No. 5042 on Law Protection of Growers' Rights Related to New Plant Varieties was promulgated in the Official Gazette dated 15 January 2004 issue 25347 in order to encourage development of plant varieties and protect new varieties and the rights of growers and to fulfill international obligations. Three regulations were issued for the implementation of the Law. These are the Regulation on Law Protection of Growers' Rights Related to New Plant Varieties and the Regulation on Farmer Exception Practice Principles promulgated on 12 August 2004, and the Regulation on Entitlement of Employees in Public Institutions and Organizations to Grower's Rights promulgated on 30 April 2005.
Privatization of TEKEL	Y	2004	TEKEL was restructured in the form of strategic business units of cigarette, alcoholic beverages, cigarette marketing, alcoholic beverages marketing, leaf tobacco and salt, and the privatization of Alcoholic Drinks Industry Inc. was completed in February 2004.
	N	---	Cigarette and leaf tobacco units are expected to be privatized in the future period.
Privatization of sugar factories	Y	2005	Public shares in Adapazarı and Kütahya Sugar Factories, subsidiaries of Turkish Sugar Factories Inc. were privatized in the last year.
	N	---	Other sugar factories are expected to be privatized in the forthcoming period.
Preparing Rural Development Strategy	Y	2005	First draft of the strategy document was shared with European Commission, and consulted for opinion. Document was reviewed and technical works are about to finish. It is expected that after high level approvals, the strategy document will come into effect by the end of 2005.
Preparing Rural Development Plan	N	2006	Works were started regarding the Rural Development Plan, and the auction preparations are continuing for the technical assistance component of Project No. TR 0402.08 subject to the 2004 financial cooperation programming.
Strengthening the Institutional Capacity	N	2005-2006	The twinning contract is at the stage of signing relating to the twinning component of the Project No. TR 0402.08 subject to the 2004 financial cooperation programming and implementation is planned to start until the end of 2005.
Regional Development			
Draft Law on Organization, Coordination and Duties of Development Agencies	N	2005	Draft is on the agenda of the TGNA. All articles except the last seven have been affirmed.

Twinning Project for improving institutional and administrative capacity of SPO General Directorate of Regional Development and Structural Adjustment	Y	2005	Implementation of the Project started on June 1, 2005 and will last 18 months.
Eastern Anatolia Development Program	N	2005	Call for proposal was undertaken in April for the project and evaluation of the project proposal continues.
Southeastern Anatolia Project Regional Development Program / Cultural Heritage Development Program	Y	2005	Projects were collected by the method of call for proposal and 32 selected projects will be supported
TR82, TR83 and TRA1 NUTS-II Regions Development Program	N	2006	With technical assistance team starting duties as of April 2005, call for proposals was announced in May 2005. Evaluation process for project proposals continues.
Turkey-Bulgaria Cross-Border Cooperation Program/ Joint Small Projects Fund Program	Y	2005	Project proposals collected by the method of call for proposal were evaluated and 9 selected projects were decided to be supported.
Turkey-Bulgaria Cross-Border Cooperation Program / Edirne Ekmekcizade Kervansaray Restoration Project	N	2005	Construction auction was announced for the restoration project and bids were evaluated. It is foreseen that implementation will start as of December 2005.
Health, Social Security and Improvement of Income Distribution			
Starting Family Medicine Pilot Implementation	Y	2005	Family Medicine Pilot Implementation started in September 2005.
Creating health information system	N	2006	Works are continuing for creating standard information system.
Combining social security institutions as one single organization, separating the long term and short term insurance programs and establishing universal health insurance	Y	2005	Health units of SSI and some other public administrations were transferred to the Ministry of Health.
	N	2005-2006	Draft Law for Social Insurance and Universal Health Insurance was submitted to the TGNA and is on the agenda of Plan and Budget Commission.
	N	2005-2006	Works are at the final stage on the Draft Laws for the Social Security Agency and Social Aids and Premium-free Payments.
Information and Communication Technologies			
e-Transformation Turkey Project 2005 Action Plan	Y	2005	Implemented by the Decision No. 2005/5 of the High Planning Council.
Information Society Strategy Document	Y	2005	To be completed at the end of 2005.
Law on Protection of Personal Information	N	2005	Evaluation process is continuing on the draft bill.

Communiqué on Procedures and Principles regarding Separated Access to Local Network	Y	2004	Went into effect on July 1, 2005.
Communiqué on Procedures and Principles regarding Implementation of Number Fees	Y	2004	Went into effect on September 23, 2004.
Regulation on Consumer Rights in Telecommunications Sector	Y	2004	Went into effect on December 22, 2004.
Regulation on Amending the Regulation of Authorization for Telecommunications Service and Infrastructure	Y	2005	Regulation for Cable Platform Services went into effect on February 5, 2005.
Regulation on Amending the Regulation of Authorization for Telecommunication Service and Infrastructure	Y	2005	Regulation on Broadband Fixed Wireless Access Service went into effect on February 17, 2005.
Regulation on Service Quality in Telecommunications Sector	Y	2005	Regulation regarding the national and international service quality of services by telecommunications operators providing telecommunications services and/or operating telecommunications infrastructure went into effect on March 3, 2005.
Regulation on Amending the Regulation of Authorization for Telecommunications Service and Infrastructure	Y	2005	Regulation on Long Distance Phone Services went into effect on March 3, 2005.
Regulation on Amending the Regulation of Authorization for Telecommunications Service and Infrastructure	Y	2005	Amendment to Provisional Article 1 of the Regulation of Authorization went into effect on May 11, 2005 to be effective from August 26, 2004.
Regulation on Amending the Regulation of Access and Interconnection	Y	2005	Amendments were made to Article 18 of Separation of Accounts and Article 19 of Reporting and Auditing.
Regulation on Amending the Regulation of Authorization for Telecommunications Service and Infrastructure	Y	2005	Regulation for Infrastructure Operation Service went into effect on September 7, 2005.
Legislation on Right of Way	N	---	Works are underway to comply with Perfect Competition Directive No. 96/19/EC.
Transportation			
Restructuring the Turkish Republic State Railways	N	2003-2006	A twinning project was started in 2003 to harmonize Turkish railway legislation with EU directives under Turkey-EU Financial Cooperation Program. The tender process for the project was completed and the German Railways was selected as the contractor. Project is expected to be completed in 2006.
Energy			
Works for privatizing electricity sector	N	2004 - 2008	Electricity distribution system was reformed as 21 regions so as to start distribution privatizations, which are prioritized under the Strategy Document and these companies were turned over to the Privatization Administration and their privatization is going on. It is expected that the privatization tender process will start at the end of 2005 and distribution

			privatizations will be completed by the end of 2006. According to the Strategy Document, distribution privatization will start in 2005 and be completed in 2006. It is envisioned that other privatizations will be completed by 2008.
Regulatory Board Information System Project	N	2004-2005	It is planned that tender is expected to be completed as of November 2005, contract will be signed, and implementation will start.
Project for Strengthening Institutional Capacity of EMRA	Y	2005	All activities under the project were finalized as of the end of September 2005.
Project for Feasibility Study for Turkey's Integration to UCTE Electricity System	N	2005-2006	TEIAS carries out the project for Feasibility Study for Turkey's Integration to UCTE Electricity System for determining under what technical conditions the national electricity network will be connected to the UCTE system in a fully synchronized manner in the framework of the purpose of fully integrating the national electricity market with the EU electricity market.
Project for Providing BOTAŞ with Legal and Know-How Support in Natural Gas Transmission and Transit	N	2005-2006	The project was implemented on 1 September 2005 in order for BOTAŞ to perform its obligations to transmit and transit natural gas in parallel with EU standards and practices.
Project for Increasing Energy Efficiency in Turkey	N	2005-2006	The project aiming to implement the energy efficiency programs in order to develop energy efficiency performance of our country in compliance with the EU acquis and EU experiences is wholly financed under the financial cooperation programs.