04

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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/43

10:00 a.m., March 4, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	C. Taylor
J. de Groote	H. G. Schneider
B. de Maulde	
	J. Delgadillo, Temporary
R. D. Erb	C. Dallara
	M. A. Janjua, Temporary
	Jaafar A.
	T. Yamashita
	M. Casey
	C. Robalino
G. Laske	
	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
	T. de Vries
A. R. G. Prowse	K. G. Morrell
G. Salehkhou	
F. Sangare	E. I. M. Mtei
M. Senior	J. L. Feito
J. Tvedt	Wang E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

T. S. Kivanç, Advisor to Executive Director, IBRD. African Department: R. O. Carstens. Asian Department: B. Banerjee. European Department: L. A. Whittome, Counsellor and Director; L. Alexander, L. Hansen, P. C. Hole, G. F. Kopits, G. Tyler. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; N. Kirmani. IMF Institute: M. Misurlioglu, Participant. Legal Department: Ph. Lachman. Research Department: R. Saracoglu. Advisors to Executive Directors: S. R. Abiad, A. A. Agah, J. R. N. Almeida, L. Ionescu, M. A. Janjua, P. Kohnert, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, H. Arias, L. Barbone, R. Bernardo, M. Camara, T. A. Connors, R. J. J. Costa, M. K. Diallo, G. Ercel, C. Flamant, I. Fridriksson, A. Halevi, M. Hull, P. Leeahtam, W. Moerke, V. K. S. Nair, Y. Okubo, J. K. Orleans-Lindsay, J. G. Pedersen, G. W. K. Pickering, E. Portas, T. Ramtoolah, J. Reddy, D. I. S. Shaw, H. Suzuki, J. C. Williams, A. Yasseri.

1. TURKEY - REVIEW OF STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper reviewing the stand-by arrangement for Turkey (EBS/83/17, 1/21/83; and Cor. 1, 2/24/83).

Mr. de Groote made the following statement:

My Turkish authorities are grateful to the staff for the clear and precise assessment of the current situation of the Turkish economy, with which they broadly concur.

Continuous implementation by the Turkish Government of its economic program, supported by the three-year stand-by arrangement, has brought Turkey success on the economic front. In the more than two-and-a-half years the stand-by has been in effect, all program objectives have been achieved or even exceeded: the annual rate of increase in the wholesale price index has dropped from over 107 per cent in 1980 to 25 per cent in 1982, and a remarkable improvement has been achieved in the balance of payments situation. The authorities have improved resource allocation by introducing a flexible exchange rate policy and positive real interest rates, and also by reducing government intervention in the economy in favor of greater reliance on market forces. They have brought budgetary expenditures under control and reformed the tax system. The strict application of these policies, together with wage restraint imposed on wage settlements in both public and private sectors, made it possible to hold real domestic expenditures to an increase of only 1 per cent in 1982, while GNP grew by 4.4 per cent in real terms during the same period through a further substantial improvement in the balance of payments.

Exports have nearly doubled in volume during the period of the program, growing from 4.9 per cent of GNP in 1980 to about 9.5 per cent in 1982, and a simultaneous increase in invisible receipts, mainly from workers' remittances and contractors' earnings, reduced the current account deficit from 6 per cent of GNP in 1980 to about 2 per cent in 1982. The capital account also showed positive results, even though financial assistance from the banks and the special OECD assistance were less substantial than had been anticipated: gains in political and economic stability led 80 new firms to invest in Turkey in the course of the last year. These improvements greatly aided the punctual servicing of Turkey's foreign debt: debt service payments in 1982 amounted to $2.2 billion.

In keeping with the desired change from an inward-looking to an outward-looking policy orientation, 1982 saw the continuation of the policy of liberalizing imports and the easing of certain exchange restrictions. The authorities intend to continue opening up Turkish industry to international competition despite a generalized trend toward protectionism.

Achievement of the program targets in the monetary field proved to be difficult in 1982. Monetary aggregates exerted strong upward pressure, partly because of the rapid and dramatic improvement in the balance of payments position but also because of unforeseen developments in a nonbanking financial institution. The control of the money supply had to be temporarily subordinated to the shoring up of confidence in the entire banking sector. As soon as circumstances permitted, the Government took steps to restrain the rate of monetary expansion by reducing the growth of net domestic assets of the Central Bank. In addition, new measures were taken to strengthen the financial structure of the banking system and reinforce public confidence in the financial sector. The complicated system governing liquidity and cash reserves was simplified. Other new principles embodied in recently proposed amendments to the banking laws include introducing deposit insurance, increasing the capitalization of banks, rationalizing the branch network system, and establishing more efficient supervision of the banking system. The real interest rate on deposits was lowered by 5-10 percentage points in order to reduce the cost of borrowing. A simultaneous reduction in the withholding tax maintained the real net interest earnings of depositors at nearly the same level as before.

The Government will continue to use monetary policy to bring down inflationary pressures. Monetary targets have thus been established consistent with a projected inflation rate of 20 per cent and a real growth rate of 4.8 per cent for 1983. In view of the fundamental structural reforms in the financial sector, however, it is extremely difficult to predict the evolution of the monetary aggregates, and continued vigilance will therefore be maintained by the authorities. To reduce the pressures on the banking system, the Government has taken measures aimed at making it easier for firms to raise funds in the capital markets by allowing them to increase their capital base by revaluing assets that had been eroded by the past high inflation.

As to the consolidated budget, it has been difficult to estimate total revenues for 1982 due to the impact of the tax reform, the decline in the inflation rate, and the fact that the 1982 budget was only in effect for the last ten months of the year. The authorities have accordingly watched actual revenue trends closely and made immediate adjustments of expenditures as required, succeeding thereby in holding the deficit to 1.7 per cent of GNP.

The Government is convinced that the tax system should be further reviewed with an eye to generating additional revenues; such reviews, which would incorporate comments made by the Executive Directors in the course of successive Board discussions, would provide the basis for amending current regulations and improving the efficiency of tax collection. These measures are expected to decrease the budget deficit still further, to 1.3 per cent of GNP in 1983.

The new strategy adopted in 1982 for state economic enterprises (SEEs), permitting them to respond more freely to market forces, has yielded positive results, as explained in detail in the staff paper. The Government is at present actively discussing various new proposals for further improving the conduct of the SEEs, which should strengthen their gradual and irreversible transition to market-oriented operation.

The increased utilization of industrial capacity that followed the resolution of the balance of payments bottlenecks, the good weather that swelled agricultural output, and the positive contribution of the foreign balance, all did not suffice to keep Turkey's unemployment rate from rising further during 1982. Little relief may be expected in the short term, since economic growth must for now continue to depend mainly on the expansion of the export sector, whose contribution to GDP is still rather limited. The authorities are nonetheless hopeful that with the continued opening up of the economy they can succeed in the medium term in optimizing the relationships among growth, employment, and the balance of payments.

In 1983, the Government intends to continue implementing present policies and will reject any policy action that would run counter to the objectives set forth at the inception of the present program. Specifically, fiscal and monetary policies will continue to be characterized by restraint, interest rates will be maintained at positive real levels, and exchange rate policy will be flexible. Since the economy is now basically on track, more emphasis will be laid on its structural improvement. When the present program expires in June of this year, the Turkish authorities may well request a new stand-by program at the end of the present one that would further support their continued adjustment efforts. The financing of the balance of payments will reflect the improved performance of the Turkish economy: more emphasis will be placed on borrowing from the international financial markets, particularly by seeking medium-term syndicated loans. Together with the anticipated borrowing from the Fund, these borrowings should suffice to meet Turkey's foreseeable balance of payments needs. Turkey's increased creditworthiness in the international markets will provide it with the resources necessary to continue the reorientation of the Turkish economy to a more outward-looking stance.

In conclusion, I may say that my Turkish authorities are aware that adjustment is a continuous process requiring unceasing effort to arrest and eliminate imbalances. They believe that Turkey is on the right track to balanced and sustainable growth.

They have asked me to express their thanks for the understanding and confidence that the Fund has shown by its unwavering support of the Turkish adjustment program.

Mr. Suraisry considered that the three-year stand-by arrangement with Turkey had thus far been successful: the authorities had made significant progress in correcting imbalances within the economy; inflation had been reduced; the public sector borrowing requirement had been cut in half as a percentage of GNP; the current account deficit had been reduced from 6.25 per cent of GNP in 1980 to 2 per cent in 1982; and arrears had been eliminated. That success had at the same time justified the Fund's efforts to play a catalytic role in encouraging the international financial community to provide Turkey with debt relief and increased foreign assistance. The Turkish case was a good example of successful cooperation between the authorities of the member, the Fund, and official and private creditors; he hoped that the financial packages recently agreed for other countries would be equally successful.

He could support the program for 1983, which aimed at a further significant reduction of both the current account deficit and the public sector borrowing requirement, Mr. Suraisry continued. The authorities' intention to meet those objectives through continued monetary and fiscal restraint and a flexible management of the exchange rate was welcome, and the quantitative performance criteria set out in Table 12 of EBS/83/17 seemed appropriate.

On the fiscal side, Mr. Suraisry commented, a reduction in the Central Government's cash deficit to 1.3 per cent of GNP in 1983 would require considerable restraint, with no real increase in expenditures or in transfers to the state economic enterprises. It would also demand an increase in revenues through improvements in tax administration and collection procedures. It was thus encouraging to note that the authorities had stated their readiness to cut budget appropriations further if revenues did not improve as expected.

The program for 1983 seemed well designed to build on the progress made in recent years toward strengthening the financial position of the state economic enterprises, Mr. Suraisry said. Investment in those enterprises was projected not to increase in real terms, and profits were expected to rise. Nonetheless, like the staff, he was disappointed at the slow pace of structural reform in the state enterprises, which had led to a delay in the release of World Bank funds under a structural adjustment loan. He urged the authorities to take effective and speedy action to correct the situation.

The authorities had found it difficult in the past to exercise effective control over monetary expansion, Mr. Suraisry observed. The problem in recent years could be traced in part to a consistently better than expected balance of payments outcome, which would have made it necessary to reduce the credit ceilings in order to meet the monetary targets;

it had also been due to an insufficiently firm application of available policy tools. He was thus pleased to see that the 1983 program contained adequate safeguards to prevent slippages in the control of monetary expansion.

Noting that the final purchase under the stand-by arrangement was scheduled for April, Mr. Suraisry wondered about the operational significance of the end-May performance criteria. It was clear that the authorities would need to continue their adjustment efforts beyond the current stand-by arrangement, particularly in view of the bunching of debt service payments arrears in 1985. In that regard, he would welcome comment from the staff or Mr. de Groote on the likelihood of a further arrangement between Turkey and the Fund at the conclusion of the present program.

Mr. Laske stated that, while full success had not yet been achieved, Turkey had certainly made good progress under the stand-by arrangement on both the domestic and external fronts. The current account position had improved significantly, primarily because of a strong expansion in exports--especially manufactures--to newly developed markets. The rate of inflation had been reduced, although not by an impressive margin, with further reductions envisaged for 1983. The rate of real growth had by and large been maintained at the previous year's level, an impressive achievement given the unfavorable environment of the world economy. Finally, nearly all performance criteria had been observed.

While the authorities deserved commendation for pursuing policies that had produced such positive results, they would need to pay particular attention to the remaining areas of weakness, Mr. Laske continued. Public finances had improved in recent years; however, the domestic and the overall public sector borrowing requirements had risen in relation to GNP by roughly 1 percentage point more than originally envisaged. While the deviation from the target was not particularly large, it could represent the beginning of a serious deterioration if further efforts were not made to contain the growth of the borrowing requirements. He was thus pleased that the authorities had indicated a willingness to redress the situation.

There was a close relationship between fiscal developments and the performance of the state economic enterprises, Mr. Laske observed. The ratio of profits of the state enterprises to GNP had improved during 1982, but progress in more basic adjustments had been lacking to such an extent that the World Bank had felt compelled to delay disbursements under its structural adjustment loan for the time being. Since the state economic enterprises played such a prominent role in the Turkish economy and in the fiscal performance of the Government, prompt action by the authorities to improve the operations of those enterprises would be essential.

Monetary developments in Turkey had also been worrying, Mr. Laske commented. In 1982, expansion in two important aggregates had been substantially faster than programmed because of the better than expected balance of payments performance and the emergency aid provided by the Central Bank to the banking system in the wake of the Kastelli crisis.

For 1983, it would be important for the authorities to make certain that monetary expansion was consistent with the objective of further reducing the rate of inflation. A continued restrictive stance was all the more important because of the price pressures that would likely result from the unplanned creation of liquidity in 1982. He welcomed the structural changes already taken or planned in the financial system; in particular, the implementation of a deposit insurance scheme should improve savings. An increased flow of remittances from Turkish workers abroad would also be helpful.

With respect to exchange rate policy, Mr. Laske considered that the gratifying expansion of exports in 1982 had, to a great extent, been due to the flexible exchange rate policy pursued by the authorities. Given the continuing discrepancy between price performance in Turkey and her main competitors, it would be important for the authorities to maintain a flexible exchange rate policy in order to secure Turkey's international competitiveness. On a related matter, he had some doubts about whether the recent success in opening new markets for Turkish exports could be continued, especially in view of the balance of payments prospects for the oil producing countries, which had become important markets for those exports. The Turkish authorities should thus strive for a diversification in exports, both geographically and in terms of product type. Such diversification would require close attention to the international competitiveness of goods to be exported, which was why a sensible and flexible exchange rate policy was so important.

The effort of the Turkish authorities to reduce import restrictions was commendable, Mr. Laske said, although more could be done. Domestic producers had become somewhat inefficient because of the wall of protection that had surrounded the Turkish economy in recent years, and it could only benefit the entire economy if greater competition were forced upon those producers. All means available should be employed to make the operations of the Turkish productive process more competitive, more efficient, and more profitable; further liberalization was one step toward that end.

Mr. Taylor stated that he was in broad agreement with the staff appraisal. The authorities had had great success in improving the trade and current account balances, and annual increases of more than 40 per cent in the volume of exports in the previous two years had represented a remarkable feat. However, he shared the staff's view that Middle Eastern markets could not be expected to provide as much scope for export growth in the future as they had in the past. The 1983 balance of payments forecast was a cautious one, and caution was warranted in view of the current uncertainty about oil prices; while falling oil prices might be beneficial to the Turkish economy initially, they could soon adversely affect Turkey's export markets.

With regard to fiscal policy, the staff's cautious projections for revenue in 1983 were understandable, especially since assumptions about revenue collection in 1982 had proved to be optimistic, Mr. Taylor continued.

Hence, he welcomed the authorities' commitment to balance any revenue shortfalls with matching cuts on the appropriations side. He was somewhat disappointed that the originally planned reduction in budgetary arrears would not be carried out, a development that might weaken the thrust of other criteria in the program.

The pace of reform of the state economic enterprises had slowed somewhat, Mr. Taylor noted. A government committee was reviewing all state economic enterprises and would be reporting its findings to the Prime Minister in May; and it was possible that the review itself had contributed to the slowdown of reform. He noted that the authorities remained committed to ensuring that shortfalls in the self-financing of state enterprises would not be offset by greater access to central bank financing or by higher than planned budget transfers; however, further and more basic adjustments would be needed in future.

On the monetary side, the authorities should be commended for the measures taken to contain the banking crisis in the summer of 1982 and to bring the monetary aggregates back on track in the fourth quarter of the year, Mr. Taylor said. Their commitment to the 1983 program targets was also commendable. The structural changes made in the banking system had perhaps been somewhat overdue, but their adoption and rapid implementation was welcome. He was pleased that the authorities intended to consult with the Fund if monetary developments in 1983 differed significantly from the expectations in the program.

Turning to the external sector of the economy, Mr. Taylor remarked that one disappointment in the balance of payments picture for 1982 had been the failure to encourage larger private capital inflows, despite the elimination of external arrears. It would be prudent of the authorities not to rely on a major improvement in the flow of funds from international capital markets in the foreseeable future. Also, the process of shifting from official to market sources of finance might not proceed as rapidly as had once been hoped. It would therefore be important to maintain the trend of export growth, even if at a slower pace.

As noted by the staff, the pursuit of a flexible exchange rate policy had been a crucial factor in the export recovery, Mr. Taylor said, and it would be vital that the rate continued to be adjusted, at a minimum to maintain competitiveness. Indeed, since some further improvement in the current account was called for, he wondered whether a case might not be made for somewhat stronger action on the exchange rate side, perhaps as part of a strategy that combined a further adjustment in the rate with a move toward import liberalization and an opening up of the economy to competitive influences from modern industries outside.

Good progress had been made in dismantling exchange restrictions, Mr. Taylor observed, and he welcomed the elimination of Turkey's one remaining multiple currency practice and the termination of two bilateral payments agreements with nonmembers. The intention to terminate the remaining bilateral payments agreement was also welcome. Still, further action was required on the trade side, and he shared the staff's view that it would be desirable to continue with the liberalization of the trade and payments system.

On a presentational matter, Mr. Taylor indicated that he had found Table 6 of the staff paper--which showed external debt service projections through 1988--to be particularly helpful in focusing on Turkey's external financing requirements. A table projecting total indebtedness would also have been useful, particularly in the context of a request for further use of Fund resources.

With respect to the scope for a follow-on program with Turkey, Mr. Taylor remarked that, where access to capital markets was limited, it might be appropriate as a matter of general policy for the Fund to consider another stand-by arrangement, provided of course that there continued to be a balance of payments need and that corrective policies were being followed. Even a three-year stand-by arrangement could in certain circumstances be compatible with the Fund's financing role. The circumstances in which a follow-on arrangement might be considered by the Fund after an extended arrangement might be more exceptional, because an extended arrangement, at least in principle, should leave the member with a sustainable balance of payments. In the particular case of Turkey, the use of Fund resources was already quite high, and a follow-on program might push the economy fairly close to the limits of Fund access. Hence, if a follow-on request were to be seriously considered, it would have to be put forward in the context of strong and successful adjustment in the third year of the current stand-by arrangement. Moreover, any follow-on program should promise the achievement of a sustainable payments balance at its conclusion. On a related point, there were signs that Turkey's credit standing was improving; for example, the export credit agency in the United Kingdom--along with most other official insurers--had resumed short-term coverage for the Turkish economy and had even provided some limited medium-term coverage on an exceptional basis.

In sum, Mr. Taylor said, the signs for further progress under the current program seemed quite good. Output growth was likely to be maintained or strengthened, which should help to increase employment and dampen the various destabilizing factors that might otherwise upset a return to a civilian government. Lower oil prices would ease pressures on the import bill, and the revival of domestic demand could appropriately take up some of the slack created by the slower pace of export recovery. Nevertheless, it would be essential to maintain the export effort.

Mr. Erb considered that Turkey had adjusted significantly under its stabilization program with the Fund. It was important, however, for Turkey to consolidate the gains that it had made while continuing to implement reforms in the state economic enterprises and in the relatively complex and restrictive trade regime. He was happy to note from Mr. de Groote's statement that the "Turkish authorities are aware that adjustment is a continuous process requiring unceasing effort to arrest and eliminate imbalances."

Monetary expansion had been far more rapid in 1982 than had been projected, Mr. Erb observed. While the demand for money might have strengthened, monetary expansion at the rates experienced in 1982 was inconsistent with a further reduction in the inflation rate. The program for 1983 called for a sharp reduction in monetary expansion; however, M-2 was still projected to grow by 35 per cent, albeit with some decline in velocity. He would not be surprised if price developments in Turkey shortly began to reflect the rapid monetary growth experienced in 1982, when M-2 had increased by 62 per cent. Hence, he recommended that the authorities stand ready to tighten monetary policy further if the inflation rate should rise, or fail to fall, in 1983.

In the area of interest rate reform, Mr. Erb noted that nine major banks would be encouraged jointly to establish interest rates in Turkey. The procedure would seem to foster oligopolistic pricing and might lead to a situation in which interest rates turned out to be higher than if they had been set in a competitive market. He would welcome comment from the staff or Mr. de Groote on that matter.

While there had been much progress in reforming the state economic enterprises, still more needed to be done to make many of them more efficient, Mr. Erb remarked. He was concerned that planned reforms had been so slow that the World Bank had delayed the release of the second tranche of the third structural adjustment loan. Reform of the state enterprises was an important element in the medium-term adjustment effort; hence, he urged the authorities to reach agreement with the World Bank as soon as possible on issues related to state enterprises.

On the external side, Turkey had made excellent progress in adjusting its balance of payments, and the success of the authorities could be attributed in part to a flexible exchange rate policy and supportive monetary and fiscal policies, Mr. Erb commented. He urged the authorities to continue to pursue a flexible exchange rate policy with further adjustments, if necessary, in order to maintain competitiveness. He agreed with the staff that the Middle Eastern markets in the near term might not offer the same export growth potential for Turkey that they had in the recent past, and competitiveness would thus be important. It should also allow the authorities to continue to work toward simplifying the trade and payments system, which the staff had described as relatively complex. Efforts to liberalize import restrictions should be intensified because further import liberalization could, inter alia, contribute to a more efficient allocation of resources, which would be an important element in the restructuring of the state enterprise system. Finally, he hoped that any follow-on arrangement with the Fund would include provisions for further progress in reforming the state enterprises and the trade and payments system while the authorities continued to make improvements in monetary and fiscal policies. The structural problems that needed to be addressed could probably be dealt with in the context of a one-year stand-by arrangement, since significant structural adjustment had already been taking place under the current three-year arrangement with the Fund.

Mr. de Maulde observed that Turkey was nearing the end of an adjustment program begun nearly three years previously, with the final purchase from the Fund to be made at the end of April 1983. It was thus important to take stock of the progress achieved thus far and to come to some view about the outlook for the Turkish economy beyond the expiration date of the present program. It was clear, on the one hand, that performance criteria had been observed and that improvements in public finance, the balance of payments, and the inflation rate were continuing. That outcome, together with the achievement of a sustained rate of growth over the period, demonstrated that the economy remained on the path drawn for it at the beginning of the program. Other less favorable signs indicated, however, that the process of adjustment and the structural improvement of the economy associated with it had slowed. Uncertainties about recovery in the world economy could not be ignored.

The remarkable successes achieved in the fight against inflation in the past might not be repeated in the future, Mr. de Maulde considered. As measured by the various consumer price indices, inflation had increased at a rate of 31 per cent in 1981 and had declined very little in 1982; indeed, the rate had been 29 per cent for the 12 months ended November 1982. The projections for 1983 suggested an inflation rate of only 20 per cent, which implied a significant improvement. However, those projections were based only on continuation of current fiscal and monetary policy, and it was thus difficult to avoid the impression that they might be optimistic. On the fiscal side, a slight improvement was expected in the central government deficit, but it was clear that the improvement could be brought about only by reducing the share of expenditures relative to GDP as a means of offsetting the stagnation in revenues. Since it was likely that revenues for the current fiscal year had been overestimated, expenditures could fall further in terms of GDP and investment outlays might decline in real terms. Any fall in expenditure and investment would indicate that the structural improvement of the fiscal system--a key element of the program--was not taking place as expected, and the difficulties experienced by Turkey in the past could re-emerge.

He had similar concerns about the operation and financial structure of the state economic enterprises, Mr. de Maulde continued. It was disquieting to note, for example, that the World Bank, which was assuming a key role in promoting structural adjustment of the state enterprises in Turkey, appeared to have reservations about the evolution of the process and had, for the time being, withheld the second tranche of the structural adjustment loan. One of the intriguing aspects of the evolution of the state economic enterprises had to do with the use of manpower. The current limits placed on hiring should have led to a decline in employment equivalent to approximately half the rate of normal vacancies, with exceptions made for hiring in new plants. However, the figures showed little change in the increase in total employment for 1982 and 1983. Since investment by the state enterprises was expected to decline in relation to GNP in 1983, following a sizable decline in 1982, the new investments that did take place would have to be in uncommonly labor-intensive projects for the projections to be consistent. He would appreciate staff comment on the matter.

He had not found in the staff report a clear assessment of what the financial program had achieved in the real economy, Mr. de Maulde said. Such an assessment would have helped Directors in understanding the nature of the improvements described in terms of the financial variables, particularly in the area of exports and, to a lesser extent, of imports. Common sense would suggest that the achievement of such strong export growth by an economy so traditionally oriented toward import substitution must have required significant modifications in the production of various goods and services. A brief description of what had happened in the real economy would also have helped Directors to evaluate the potential of the newly expanded export sector and might have provided some insight into the kind of export-led growth that could be expected for Turkey over the medium term. In that regard, Mr. de Groote had rightly noted the importance of the future contribution of the export sector to the problem of unemployment. If it was to make a real contribution, however, much would depend upon the capacity of the export sector to increase its present market shares, both geographically and in terms of an expansion of products in response to shifts in external demand. Finally, he could fully support the efforts of the Turkish authorities to continue the process of adjustment in the economy, and he therefore had no difficulty in endorsing the staff appraisal and proposed decision.

Mr. de Vries stated that he also could support the proposed decision. Both the staff and Mr. de Groote had given a clear picture of where the Turkish economy stood as it neared the end of an important three-year program with the Fund. Much success had been achieved by the authorities, although there remained a number of areas in which further adjustment efforts would be required.

Over the period of the stand-by arrangement with Turkey, exports had doubled in volume, the current account deficit had been reduced drastically as a percentage of GNP, and the flexible exchange rate policy of the authorities had played a crucially supportive role, Mr. de Vries continued. He welcomed the intention of the authorities to continue pursuing a flexible exchange rate policy. On a related matter, he recalled that the Fund had approved a multiple currency practice in Turkey until end-December; yet, on December 19, 1982, the regulation providing for such a practice had been replaced by another. He was unclear whether the new regulation constituted a multiple currency practice.

Turkey's budgetary position was generally on track, Mr. de Vries remarked, but it had been maintained in a way that showed some weakness. Tax collections had been lower than expected, but the situation had been counterbalanced by a smaller than expected level of arrears. The real weakness in the economy, however, continued to be the state economic enterprises. The continued reliance on regulations rather than on market forces was vividly illustrated by the rules on hiring under which one person was to be hired for every two vacancies that existed. More generally, progress in structural adjustment in the public enterprises had been slow, and the World Bank had thus found it necessary to withhold the second tranche of its structural adjustment loan.

Monetary policy in Turkey had suffered some difficulties because of the increase in liquidity that had taken place in connection with the Kastelli affair, Mr. de Vries noted. The problems had since been resolved, however, and monetary policy was once again on track. Like the staff, he welcomed the elimination of reserve requirements, a move which appeared to have eased some of the problems associated with very high and very low interest rates.

The possibility of a follow-on stand-by arrangement with the Fund was, in his view, to be welcomed, Mr. de Vries said. However, Turkey was at present not far from the overall 600 per cent limit on access to Fund resources. While it was not so close to the limit as to preclude a new stand-by arrangement at the conclusion of the present one, the financial constraints should be borne in mind. In any event, he agreed with Mr. Erb that any follow-on arrangement should pay close attention to the state economic enterprises and the exchange rate system in Turkey.

Mr. Casey observed that the Turkish authorities had made important adjustments under the stand-by program and had managed to combine good growth with strong moves toward internal and external stability, although the improvements needed to be consolidated over the medium term. Confidence in Turkey by the international community was being regenerated, with 80 firms having newly invested in Turkey in 1982. There were also indications that official export credit agencies were beginning to reconsider the Turkish market favorably; it was to be hoped that commercial creditors would not be far behind. The elimination of external arrears had no doubt played a major role in helping to restore confidence in the Turkish economy.

Despite considerable improvements in the current external deficit, more progress would be needed to safeguard the long-term position of the overall balance of payments, Mr. Casey considered. Sound demand management policies should be pursued in combination with a flexible exchange rate policy designed to ensure competitiveness. Further liberalization of the trade and payments system would also be needed, together with a greater diversification of exports. To the extent that foreign financing continued to be required, the Committee on Foreign Borrowing should manage the debt profile and ensure that borrowed resources were put to good use. As mentioned by Mr. de Groote, medium-term syndicated loans would seem to be appropriate debt instruments.

With regard to the possibility of a follow-on program with the Fund, Mr. Casey observed that the Fund's holdings of Turkish lira currently stood at 540 per cent of Turkey's quota, with further drawings from the Fund still to be made. Presumably, the resources available for any follow-on program would be limited unless accelerated repurchases were made or unless there were an augmentation after the Eighth General Review of Quotas. He would appreciate clarification from the staff on that matter. In any case, he agreed that the main issues to be addressed in any follow-on program were those that had been mentioned by Mr. Taylor and Mr. Erb.

The current external deficit was expected to be reduced to 1.8 per cent of GDP in 1983 despite a deceleration in export volumes, Mr. Casey noted. In that regard, he wondered why workers' remittances were continuing to recover in 1983, given the still sluggish economic conditions in Europe. Perhaps the recovery was related to the strengthening of some European currencies vis-à-vis the U.S. dollar; or perhaps it was tied to the general restoration of confidence in the Turkish economy. The recent softening of oil prices could be of benefit in one sense but could also mean less demand for Turkish products by Middle Eastern countries. He would appreciate any comment that the staff could provide on the possible net effect of such developments on the trade balance in Turkey.

The Turkish authorities had gone a long way toward resolving the difficulties that had arisen in 1982 in connection with the Kastelli crisis, Mr. Casey observed. However, there remained significant risks in the area of monetary policy. One was related to assumptions about the fall in the velocity of circulation, which might not materialize because of recent reductions in deposit interest rates; the other concerned the potential for a further injection of liquidity through the balance of payments and the possibility that the multiplier of high-powered money could increase. Still, he was satisfied with the structural improvements that had been made in the financial markets--including the performance criterion relating to the reserve requirement obligations of banks--as well as the consultation procedures, which should provide adequate safeguards against the risks he had mentioned. One remaining reservation concerned the encouragement that had been given to the nine largest banks in Turkey to establish interest rates jointly. Collusion, rather than competition, might be the result of such an approach; he would be grateful for further staff comment.

With regard to the public sector, Mr. Casey noted that there had been some slippages on the revenue side. While the authorities were clearly prepared to offset those slippages through further expenditure cuts, more attention should perhaps be paid to the structure and administration of revenue. Finally, on the state economic enterprises, the authorities had evidently made a number of reforms, ranging from curbs on expenditure to lower access to central banks. However, the World Bank was clearly not satisfied with the progress made in the structural reform of state enterprises, and, as others had noted, the second tranche of a structural adjustment loan to Turkey had been withheld for the time being.

Mr. Salehkhou observed that, since the previous review of the stand-by arrangement with Turkey, the economy had registered further gains as a result of scrupulous observance by the authorities of the provisions of the adjustment program. Indeed, apart from the performance criterion relating to the amount of absorption of bank liquidity--a waiver of which had been granted on January 12, 1983--all performance criteria under the program had been met. It was to be hoped that the criteria, particularly those relating to trade and payment restrictions and the maintenance of external competitiveness, would continue to be observed by the Government well beyond the June conclusion of the present stand-by arrangement.

In the real sector of the economy, GNP growth for 1982 was estimated at 4.4 per cent in real terms, Mr. Salehkhou noted. That growth and the domestic sector's contribution to it were small by developing countries' standards. Part of the problem was related to the growth of real fixed investment, which, in 1982, had been less rapid than in the preceding year. With GNP growth stemming mainly from exports and the external sector of the economy, the rise in the civilian labor force could not be domestically absorbed, and the rate of unemployment had grown as a consequence. The staff and the authorities had predicted a 5 per cent increase in GNP for 1983, mainly on the strength of domestic demand; however, the achievement of that target would depend to a great extent on the success of efforts to raise business confidence, private fixed investment, and private savings. Continued structural reform in the banking sector would be helpful in that regard.

Turkey had experienced marginal success in reducing inflation in 1982--with wages and salaries falling in real terms--which should help public finances, Mr. Salehkhou remarked; for 1983, the Government was aiming to reduce inflation further to 20 per cent. On the external side, exports had increased substantially during the past two years, partly because of an otherwise undesirable geopolitical situation in the region. Since the situation was transitory, however, the Government was probably correct in expecting more modest growth in 1983 and beyond.

The economic viability of the state economic enterprises should be given urgent attention in 1983, since any weakening in their financial position would adversely affect the Government's accounts, Mr. Salehkhou commented. The financing burden of the enterprises exerted heavy pressure on the budget, especially since they played such a large role in the economy, accounting for approximately 30 per cent of all fixed investment and generating about 8 per cent of GNP. A series of reforms in the public enterprises had been initiated in 1980, with a view to eventually restoring profitability. In that context, steps had been taken to restructure pricing policies, improve efficiency, and strengthen management. In 1981 and 1982, additional measures had been implemented, mainly to deal with the problem of overstaffing and to rationalize investment expenditures. Despite all efforts, however, the pace of progress in restructuring the state economic enterprises had not been encouraging. Given the slippage in 1982, a further rationalization of pricing decisions and a more independent, market-oriented management approach would be needed to continue the reforms already initiated.

Table 11 in the Annex to EBS/83/17 projected a sizable figure for "duty losses" for 1983, Mr. Salehkhou concluded. There appeared to be scope for reducing those losses, which had resulted from the imposition of mandatory prices by the Government. Smooth commercial operation of the state economic enterprises would greatly alleviate the current problems. In that connection, following the authorization by the Consultative Assembly in June 1982 to reorganize the state enterprises by decree, the authorities had established reform measures under which, inter alia, manufacturing enterprises would be removed from direct ministerial control, directed to operate on strictly commercial principles, and permitted to issue equity capital. He would welcome staff comment on the status of the implementation of those measures. Finally, the authorities should be commended for their efforts and perseverance in implementing the stand-by program, and he could therefore support the proposed decision.

Mr. Janjua observed that, during the two-and-one-half years of the stand-by program thus far, Turkey had made considerable progress toward reducing the external and internal imbalances in its economy. Since the previous Board discussion on Turkey in August 1982, the authorities had persevered in their effort to rehabilitate the real sector of the economy, and the balance of payments had strengthened beyond the program targets, with exports increasing at a record pace. The economy had moreover registered a growth rate of 4.4 per cent during 1982, and, while the rate of inflation during the second quarter of the year had been a source of concern, subsequent developments indicated a considerable deceleration in the rate, despite better than expected improvements in the balance of payments, increases in the prices of electricity, coal, petroleum, cement, textiles, sugar, and transport fares in late 1982, and a flexible exchange rate. The achievements of the authorities had been realized despite recessionary conditions in the world economy and protection in a number of Turkey's export markets. The authorities had strictly adhered to the program and had reacted quickly to the problems. Moreover, because the adjustment measures taken had contributed to growth and stability, Turkey's credit rating had also begun to improve.

During 1982, the successful implementation of the program had involved difficult decisions, Mr. Janjua continued. The tightening of monetary policy had been regarded by the staff as the cornerstone of the Government's economic strategy, and it was a reflection of the determination of the authorities that they had been able to accomplish the difficult task of keeping the rate of monetary expansion broadly on track while avoiding a crisis in the banking system. Better than expected improvements in the current account had added to the areas that could be controlled by monetary policy. While the implementation of policies had been marked by some deviation from the program targets, all targets in the monetary field had been achieved. The authorities had mopped up excess liquidity and had introduced a wide range of measures to further strengthen the financial structure of the banking system and to reinforce public confidence.

Despite some slippages on the fiscal side, the thrust of fiscal policy remained properly directed, Mr. Janjua said. Public sector borrowing requirements had declined by 1 percentage point as a proportion of GNP, and a similar result was expected for 1983. Through various measures, the authorities had shown their determination to tailor expenditure to any revenue shortfall, although they recognized the need for generating additional revenue and were thus further reviewing the tax system.

The decisions taken by the authorities with respect to the state economic enterprises had yielded some positive results, including a substantial increase in profits, Mr. Janjua went on. The authorities had indicated that they would continue with a flexible pricing policy; greater access to central bank financing and higher than budgeted transfers would not be permitted in cases of shortfalls in self-financing of the public enterprises or of financing from other sources. It was to be hoped that progress in correcting the structural problems of the state economic enterprises could be accelerated, although the problems should be viewed in a medium-term perspective. He was glad that the authorities remained committed to introducing necessary reforms and improving the economic efficiency in finances of the public enterprises so that they did not place the economy under undue pressure.

An important aspect of the activities of the state enterprises as well as of economic growth in the medium term was the level of investment in the economy, Mr. Janjua remarked. During 1982, the growth of fixed investment had been 3 per cent--the same as in 1981--which was half the program level; in 1980, fixed investment had declined by about 11 per cent. While the depressed level of investment had presumably contributed to the slowdown in inflation and to the ability of the authorities to observe all performance criteria, it had implications for employment and for production, particularly for the medium term. Given the increasingly important role of the external sector in the mid-1980s, depressed investment could constitute a constraint on Turkey's production and exportable surplus.

During the remainder of the program period, through June 1983, the authorities intended to continue with present policies, Mr. Janjua observed. Further improvements in the balance of payments, budgetary position, profits of the state economic enterprises, and inflation were expected to be realized, together with a higher growth rate. In the circumstances, he could support the proposed program. Turkey had made a significant effort to implement needed reforms, and the economy had made visible gains through the policies adopted. As indicated by Mr. de Groote, the authorities intended to continue the adjustment effort and to consolidate the gains already made. If the internal and external imbalances were significantly reduced and Turkey's creditworthiness were to improve, it should be possible for the authorities to maintain the momentum of their adjustment effort.

Mr. Caranicas recalled that, during the discussions in February and August of 1982, the Executive Board had expressed satisfaction at the remarkable success achieved by the Turkish authorities in implementing the three-year stand-by arrangement. As the arrangement was nearing completion, he welcomed the opportunity to look once again at the performance of the economy and to draw some conclusions about the prospects for its viability after the program period.

The target for reducing inflation had been exceeded, Mr. Caranicas observed; current estimates showed a 27 per cent increase in the GNP deflator in 1982, as compared with a revised target of 32-33 per cent. That alone was a remarkably positive outturn, although the stand-by program called for a further decline in inflation to 20 per cent in 1983, to be achieved by a continued emphasis on fiscal and monetary restraint in combination with a somewhat rudimentary incomes policy. Nonetheless, some perplexities remained on the inflation front. Despite a shortfall in revenue collection, public finances appeared to be strong, which should serve to bring about some degree of disinflation. According to the staff, revenues were projected to increase substantially in 1983, with a particularly sharp rise in nontax revenues. He would appreciate some clarification by the staff about the factors underlying the assumed revenue increase.

In the monetary sphere, the limited efficacy of the techniques of monetary control at the authorities' disposal had long been at the root of Turkey's economic management problems, Mr. Caranicas considered. Some additional uncertainty was created by the financial innovations recently instituted, which might make it difficult to predict the responses of market agents. Another problem was related to the lagged effects on prices of the higher than targeted monetary expansion. The staff's argument that money supply growth in 1983 would be consistent with inflation and output targets was contingent upon an assumed decline in velocity, following an already sizable drop in 1982. Given the current downward trend in deposit rates, he wondered whether the additional liquidity injected into the economy in 1982 could be absorbed and whether there would not be an acceleration of inflation.

An important question to be asked in the review of the stand-by arrangement was the extent to which the external position of the country would be sustainable in the period beyond the arrangement when there might be less external assistance available, Mr. Caranicas commented. The answer to that question was the best way in which to assess, ex post, the viability and success of an adjustment program worked out by the Fund. Drawing the attention of his colleagues to the medium-term balance of payments scenarios prepared by the staff for the August 1982 review of the stand-by arrangement, he noted that the balance of payments assistance in 1980/81 had covered a large percentage of Turkey's import bill and debt service. That percentage had increased to 17 per cent in 1982, and, using figures supplied by the staff, he calculated that it would probably decrease to about 15 per cent in 1983. In that connection, he had found the World Bank's suspension of the second tranche of its structural loan to be somewhat disturbing. In the August discussion, it had been suggested that a new outflow of foreign exchange might be expected beginning in 1983 and running through 1986. The solution preferred by the staff was a combination of a smaller current account deficit and renewed borrowing from commercial sources. Naturally, however, the new borrowing would result in higher debt service ratios, as indicated in Table 6 of EBS/83/17. The implied growth of exports in such a scenario was 10 per cent a year in volume terms, and all other projections hinged crucially on the realization of that assumption about export growth. In the circumstances, it would be important to assess whether appropriate policies were in place that could bring about such an outcome. He himself had some reservations on that point.

In 1982, the effective exchange rate had depreciated only modestly in real terms, Mr. Caranicas observed. According to paragraph 9 of the January 3, 1983 letter from the Minister of Finance, the authorities were determined to continue aiming toward the maintenance of existing external competitiveness. Perhaps a more active exchange rate policy was warranted in the circumstances. He therefore welcomed the assurances of the authorities that they would consult with the Fund if competitiveness should falter and, in the words of the Minister of Finance, would "reach such understandings as may be necessary."

Finally, with respect to the possibility of a follow-on arrangement with Turkey, Mr. Caranicas noted from the Appendix I on page 19 of EBS/83/17 that the Fund's holdings of Turkish lira as a percentage of its quota were quite substantial. Unless repurchases were accelerated or calculations were made on the basis of quotas proposed under the Eighth General Review, Turkey was at present close to its limit on borrowing from the Fund. Turkey's record of cooperation with the Fund was a long and good one, and thought should perhaps be given to the problems that might arise with a follow-on program for which there was not a great deal of available financial support. Fund management should look closely at the problems that could arise not only for Turkey but for other countries as well that might reach the limits of access to Fund resources before quotas were increased under the Eighth General Review.

Mr. Erb remarked that, while the possibility of a follow-on program with Turkey could not be ruled out, the level of the Fund's holdings of Turkey's currency and the overall limits on access to Fund resources, made it unlikely that a follow-on program would result in any significant net new flows of resources from the Fund. In the circumstances, any new Fund program would play mainly a catalytic role, serving to ensure potential and existing creditors that the adjustment process within Turkey was continuing.

The Acting Chairman observed that the figures in the table in Appendix I on page 19 of EBS/83/17 had been referred to by some Directors in suggesting that Turkey had nearly reached the limit of its access to Fund credit. However, to produce an accurate figure from the table for use of credit tranche resources, it was necessary to deduct the member's subscription, which was equal to 100 per cent of its quota. Without making any predictions about the potential size of a future stand-by arrangement with Turkey, he did wish to note that something over 100 per cent of quota was available at present, and the figure could be larger if repurchases were effected in the meantime.

The staff representative from the European Department added that the schedule of repurchases for Turkey from mid-June 1983 to mid-June 1984 called for repurchases of approximately SDR 150 million. Hence, under any reasonable assumptions about the size of the future stand-by arrangement, net purchases would be relatively modest.

Mr. de Vries remarked that the comments by the Acting Chairman and the staff representative from the European Department were somewhat at odds with his own understanding of Fund credit policies. It was clear that the total amount of credit under all facilities was not to exceed 600 per cent of a member's quota, but the operative word was "credit." The remarks by staff and management seemed to suggest that total Fund holdings could reach an outside limit of 700 per cent of quota. He would appreciate further clarification from the staff.

Mr. de Groote said that he was grateful for the apparent acceptance by his colleagues of the likelihood of a follow-on arrangement with Turkey as well as for the indication of the amounts of financing that might be available from the Fund. If and when the Turkish authorities began negotiations on a further stand-by arrangement, he understood that the Fund would take account of the policies to be pursued by the authorities as well as of the available financial support from the Fund in any proposal that might be brought to the Executive Board.

Mr. Morrell stated that he could join others in supporting the proposed decision on the review of the stand-by arrangement for Turkey. The authorities had made commendable progress under the program, achieving a substantial improvement in the current account of the balance of payments while reducing inflation and maintaining the growth of real output. All program objectives had been achieved or exceeded, which was remarkable in view of the unfavorable external environment, particularly the trade barriers in some of Turkey's traditional export markets. The improvement in the current account could be attributed to the flexible exchange rate policies pursued by the authorities. He agreed with the staff that flexible management of the exchange rate must be continued if Turkey was to reach a balance of payments position that could be sustainable without large-scale external assistance.

The structural changes introduced in the financial system in Turkey should help to avoid any further loss of confidence in individual institutions or in the financial system generally, Mr. Morrell considered. Most of the changes had a prudential purpose, including those related to the reform of interest rate policy, which should help to restore interest rate margins. However, he was not entirely certain about the extent to which the lower deposit rates would be passed on to the borrowers; there appeared to be some inconsistency between the statement by the staff in paragraph (ii) on page 8 of EBM/83/17 and the suggestion by Mr. de Groote that the real interest rate on deposits had been lowered to reduce the cost of borrowing. He also wondered how the relatively small reduction in the overall real net interest earnings of depositors fitted in with the assumption of an increase in the private savings ratio. It seemed odd that the staff would be forecasting an increase in private savings while, at the same time, talking about a reduction in interest rates. Finally, like others, he was curious about the proposed procedure for setting interest rates in Turkey. A system which relied on agreement on a rate among banks allowed for the possibility of collusion, which could lead to higher rather than lower rates.

Mr. Malhotra considered that the stand-by program for Turkey had been a remarkable success in many ways. A reasonably high rate of growth of GNP had been maintained over the period; inflation had been reduced considerably since 1980, and the current account deficit--which had fallen from 6 per cent of GNP in 1980 to 2 per cent in 1982--was expected to fall to less than 2 per cent of GNP in 1983. Moreover, growth in exports over the program period had nearly doubled, and the budget deficit had been significantly reduced. Some uncertainty continued to surround the money supply, although the authorities had indicated that they would maintain contact with the Fund in order to ensure that it did not move out of line with targets. On the external side, the authorities had thus far followed a flexible exchange rate policy, and interest rates had been positive. In all, it appeared that the authorities had successfully implemented the stand-by program on a broad scale.

Despite the successes that had been achieved, Mr. Malhotra continued, further efforts would be necessary. For example, the authorities should pay close attention to reforms that would facilitate the raising of revenue. Emphasis should also be given to structural adjustment of the state economic enterprises; despite the efforts thus far to improve the working of the public enterprises, a number of deficiencies remained that would have to be addressed over the medium term. He was also concerned about what was happening to investment levels in the economy and about the impact of declining investment rates on employment.

Regarding the possibility of a follow-on arrangement with the Fund once the current program was concluded, Mr. Malhotra considered that continued cooperation between the Turkish authorities and the Fund would be valuable as a way of consolidating progress thus far. If the authorities indicated a willingness to continue or strengthen the policies begun under the current arrangement, the Fund should be willing to provide both technical and financial support for their efforts.

Mr. Senior stated that, like others, he could endorse the staff appraisal and the proposed decision. The Turkish authorities should be commended for the adjustment policies implemented in the previous year, which had led to a satisfactory real growth rate, a further decline in the inflation rate, and a significant improvement in the balance of payments. The consistent mix of policies embodied in the Government's economic program was noteworthy; monetary policy, for example, had been allowed to work efficiently, mainly because of a greatly improved fiscal framework and the increasingly flexible functioning of the labor and foreign exchange markets.

While the rate of growth of broad money had been greater than envisaged, Mr. Senior continued, nominal national income had been broadly in line with program targets, and the breakdown between prices and output had been slightly better than expected. Those positive developments might have been due to a decline in the opportunity cost of holding money brought about by lower inflationary expectations. The crisis experienced with a major nonbank financial institution in Turkey could also have had something to do with the decline in the velocity of circulation of M-2; when concentrated in a single nonbank financial institution--as in Turkey--such a crisis was frequently accompanied by an increased demand for precautionary balances, which was all the more plausible if account was taken of the wide-ranging set of measures implemented to buttress the financial system. It was possible that the Kastelli crisis and the reforms launched in the second half of 1982 had given rise to a structural change in the demand for M-2 such that its rate of growth no longer accurately reflected the stance of monetary policy. Assuming that such a structural change had occurred, it would be helpful if the staff could provide information on the evolution of other monetary aggregates; in particular, it would be interesting to know the behavior of M-1 and the corresponding reserve multiplier during 1982. In the absence of such an analysis, however, he would tend to agree with the view that monetary aggregates in terms of M-2 were not growing at excessive rates and were compatible with the projected movement on both the inflation and the balance of payments fronts.

Turning to the situation in the labor market, Mr. Senior observed that, despite a high rate of growth of real income and a policy of wage restraint throughout 1982, the unemployment rate was estimated to have risen during the year. He wondered whether the staff or Mr. de Groote could provide some sense of the evolution of unemployment over the previous two years. He would also be interested in hearing the staff's view about the major factors behind the rigidity of unemployment vis-à-vis wage restraint and real output growth. Finally, he wished to reiterate his commendation to the Turkish authorities for the strong adjustment effort already made and for their commitment to implementing further measures that might be warranted.

Mr. Jaafar expressed satisfaction at the overall performance of the Turkish economy under the program, noting that progress in three areas deserved particular commendation. First, the authorities had achieved a rate of growth much higher than that achieved in many other countries during the period; second, the inflation rate had been reduced significantly from the levels of previous years; and, third, the current account deficit had been cut in half. His only concern was related to the increase in the money supply in 1982, which had exceeded the targeted limit. The slippage had resulted from overperformance in the external sector, where the current account deficit had been significantly below what had been envisaged in the program. A similar slippage might occur in 1983, given the recent changes in oil prices. The staff had assumed only a 3 per cent decline in oil prices, but recent developments suggested that it could be more significant. If so, overperformance could again take place on the external side in 1983 unless steps were taken to neutralize the surge in liquidity. In the circumstances, he urged the authorities to monitor the liquidity situation carefully and to take whatever steps were necessary to ensure that it did not get out of hand.

The staff representative from the European Department observed that, while agreeing that performance with respect to monetary policy had been acceptable, Directors had indicated concern that excess liquidity might have been generated in 1982 and that the program for 1983 held the potential danger of excess monetary expansion. Many of their concerns rested on assumptions about the velocity of money, about which it was difficult to make a prediction for 1983. On the one hand, it was possible to assume that the declining trend of velocity would bottom out in 1983; at the same time, taking a longer historical view, it was likely that velocity would decline further in 1983 from its present level. The staff would be reviewing the issue of monetary expansion in its entirety when it next visited Turkey, and account would be taken of the comments of Executive Directors.

On interest rates, the staff shared the view of those who felt that the system for setting interest rates in Turkey could be oligopolistic, the staff representative noted. The authorities believed that the system would serve to encourage interest rate determination by market forces--because the banks involved were competing banks--rather than to establish rates by administrative means; nonetheless, the possibility existed for an agreement on interest rates that could be higher than appropriate.

The effort to introduce various reforms into the banking system was proceeding as planned, the staff representative remarked. The Government had set out the principles to be incorporated in new legislation, although the legislation itself had not yet been introduced or agreed in Parliament.

Little could be added to the comments of Executive Directors on the situation of the state economic enterprises, the staff representative remarked. Their operating performance had improved significantly, and pricing policies had been strengthened. However, the pace of basic structural reform continued to be slow.

Clear improvement had been registered in the budget situation, the staff representative commented. Unfortunately, that improvement had resulted from a worse than expected outcome in revenue collection in combination with more stringent control of expenditures, which had had an adverse impact on the level of investment. The staff hoped that the authorities' intentions to improve revenue collection would be realized, but it recognized that there were a number of stumbling blocks to progress in that area.

While there were few reliable statistics on unemployment in Turkey, the most informed guesses set the real level of unemployment at 15-20 per cent, the staff representative said. Whether official statistics or estimates were used, however, it was clear that unemployment had increased by at least 1 percentage point in 1982 and that the trend would unfortunately continue in 1983. The problem of unemployment was exacerbated by the fact that the outflow of workers that had taken place in large numbers in the 1970s was not continuing at present. Indeed, given the slowdown in construction projects in the Middle East and other oil exporting countries in North Africa, it would be prudent to ask whether there might not be a reflow of workers back into Turkey. Hence, the unemployment situation was not likely to be solved quickly, even with Turkey's relatively high rate of growth of 5 per cent.

On the external side, the staff representative said, he agreed with those Directors who had pointed to the importance of continuing to demonstrate flexibility in managing the exchange rate system. In fact, more action on the exchange rate might be called for, particularly given the difficulties that might be experienced in Turkey's main export markets and the fact that some countries competing with Turkey in those markets had been taking exchange rate action themselves. Both the exchange rate question and the related trade problem would be taken up in greater detail in the context of the forthcoming Article IV consultation with Turkey.

Remittances in 1982 had been affected by a number of factors, including the reduced level of activity and lower wage growth in Western Europe, exchange rate changes, and confidence problems that had arisen in connection with the Kastelli affair, the staff representative said. The authorities believed that some of those adverse factors would be reversed in 1983, which was why a modest improvement in remittances was being projected.

Commenting on the capital account, the staff representative noted that Turkey would need to re-establish its credit rating in the international capital markets so that it could replace the official aid that it had been receiving on concessional terms in recent years. There were signs that the improvement had already begun; for example, in 1982 a consortium loan for $200 million had been made available for the financing of agricultural exports, and discussions between the Turkish authorities and the commercial banks seemed to indicate that a significant--albeit gradual--recovery in Turkey's credit rating was in prospect.

Commenting on Turkey's relations with the Fund and the World Bank, the staff representative observed that the Bank had withheld disbursements of the structural adjustment loan primarily because it had not been satisfied with the pace of structural reform in the state economic enterprises. The disagreement was basically a matter of the timing rather than the implementation of the required corrections, and it was to be hoped that the World Bank mission currently in Turkey would be able to resolve the matter with the authorities. In any event, the leader of the World Bank mission would be providing the Fund staff with the latest information on the situation, so that the Fund mission could later visit Turkey with a full understanding of the World Bank's position. Basically, the World Bank believed, like the Fund, that it was essential to institute fundamental reforms in the state economic enterprise sector; the Bank took a particular interest in the matter--because it was more involved than the Fund in the sectoral analysis of the state enterprises--and hoped that, under the new reform, Turkey would accept the provision of technical assistance to certain individual state enterprises so that the management of those enterprises could be improved.

With respect to questions about a possible follow-on arrangement with the Fund, the staff representative observed that the Turkish authorities had already indicated to management that they would wish to hold discussions with the Fund staff on a possible one-year stand-by arrangement once the current three-year arrangement had ended. The specifics of such a program would no doubt focus on some of the policy areas that Executive Directors had touched upon in the current discussion. No thought had yet been given to the size of a possible stand-by arrangement with Turkey, although it was clear that the balance of payments need would not be as great in 1983 as it had been in the past, and projected substantial repurchases of credit tranche drawings would reduce the net amount available. More important than the amount of access to Fund resources would be the continued cooperation between the Fund and Turkey and the way in which that cooperation was viewed in the international arena. Finally, regarding a question by Mr. de Vries on the modification of the multiple currency practice in Turkey, he noted that, in the past, it had been possible for an exporter with the right to a retention quota to sell his foreign exchange at a rate other than the official rate. Under the new system, the exporter could retain the foreign exchange only for his own import needs and was unable to sell it at anything other than the official rate to a third party. In the staff's view, therefore, the features that had led to the multiple currency practice had been removed.

Mr. de Maulde, responding to the suggestion that the system for setting interest rates in Turkey could lead to collusion among the banks in setting higher than warranted rates, said that the system appeared to be directed toward a rate that was similar to the prime rate in the United States and to the base rate in France. Why was Turkey being criticized for following what was apparently a common arrangement in many countries?

The staff representative from the European Department replied that all banks in Turkey were obliged to remain within the limit established by the nine major banks. The staff considered that the interest rates established by the group of nine banks were perhaps too positive in real terms at present, and the staff would have felt better if the authorities had been able to influence the decision of the group of banks to ensure that the rates were in line with the overall monetary policy stance adopted.

The Deputy Director of the Exchange and Trade Relations Department, responding to a question by Mr. Suraisry, observed that it was common practice to include credit and other quantitative performance criteria throughout the entire period of the stand-by arrangement, including ceilings toward the end of the period, even if it was anticipated that the final drawing would take place before that time. As performance criteria, the end-period ceilings were not without operational significance; for example, the final drawing for Turkey under the program was scheduled for April and would be based on the observance of the March ceilings. However, if those ceilings were not observed, the drawing could not be made in April. If the May ceilings were observed, the drawing could be made before the end of the stand-by arrangement. Moreover, in cases where the member intended to request a new follow-on stand-by arrangement, the end-period ceilings had particular significance because they gave an indication of overall performance and served as a useful benchmark for the formulation of the follow-on program.

Regarding questions on the limits on access to Fund resources, the Deputy Director observed that the 600 per cent of quota ceiling was a cumulative limit, which meant that, at any given moment, total outstanding drawings under stand-by and extended arrangements could not exceed 600 per cent of a member's quota. The implication was that account had to be taken of repurchases. In the case of Turkey, the total use of Fund resources in the credit tranches at the end of the current stand-by arrangement would be equivalent to 492 per cent of quota, which would leave 108 per cent of quota, or SDR 325 million, as potentially accessible. Moreover, between June 1983 and June 1984 some SDR 150 million in repurchases were scheduled, so that the maximum amount of resources available over the period could be approximately SDR 475 million. Of course, the actual size of the stand-by arrangement would depend on various other considerations of the sort that had been outlined by the staff representative from the European Department.

The Acting Chairman wondered whether a first credit tranche drawing was counted for the purpose of the limits and whether the staff took account of repurchases due during the year of a proposed one-year stand-by arrangement in determining whether the limits on access would be reached.

The Deputy Director of the Exchange and Trade Relations Department replied that first credit tranche drawings were counted in the limits of 150 per cent of quota per year up to a maximum of 450 per cent of quota. On the second question, the 150/450 per cent limits did not take into account prospective repurchases, but the overall limit on access of 600 per cent of quota was interpreted as net of repurchases scheduled during the period to be covered by a proposed stand-by arrangement.

Mr. Caranicas considered that the fundamental nature of the issues surrounding access limits warranted careful study, perhaps in the context of the review of the decision on enlarged access, which was to take place before end-June 1983.

Mr. de Vries observed that access limits represented one of the most important features of the activities of the Fund, and he would look forward to a review of the matter before the end of June. In the meantime, he could not, prima facie, accept the sugestion that the 600 per cent limit on access referred only to the credit tranches.

The Acting Chairman remarked that the issue raised by Mr. de Vries and others could best be debated on the occasion of the review of the decision on enlarged access.

Mr. de Groote recalled that, since the beginning of the stand-by arrangement with Turkey in June 1980, he had had a number of opportunities to engage his colleagues in frank and open discussions on the Turkish economy. The atmosphere in the Board on those occasions had always been a positive one, in part because he had been able to indicate that the Turkish authorities were making progress along the lines recommended by the Fund. The current discussion was similar in that respect; the Turkish authorities envisaged further measures of adjustment designed to enable the economy to continue to progress, and those measures would be taken in due course.

Regarding questions on the structural reform of the state economic enterprises, Mr. de Groote observed that the Turkish authorities were in agreement with the World Bank on the need for further progress. There had already been an acceleration in the dismantling of the state economic enterprises, the introduction of new managerial techniques, and the reliance on market forces. As a result, there was currently no longer any financial reliance by the state economic enterprises on the budget. Other reforms were however necessary, and the withholding by the World Bank of a portion of the structural adjustment loan had served to highlight that need. The World Bank mission currently in Turkey had produced a number of positive suggestions for breaking the impasse, and he was confident that, within the coming three to five months, most of the required measures would be implemented. It was obvious to all--including the authorities--that, if the measures were not taken, the state economic enterprises could once again become a burden on the budget.

A number of Directors had expressed some concern about monetary developments in Turkey, Mr. de Groote recalled. The authorities considered that the flow of savings would continue to increase and that remittances would also increase moderately during 1983. A reduction was expected in the velocity of money, which was dependent upon a reduction in interest rates. Real rates would remain quite high, because the reduction in the rate of inflation was larger than the reduction in interest rates in general. The effect of any reduction in interest rates on velocity depended upon whether or not depositors reacted to movements in nominal or real interest rates. Assuming that they reacted to changes in real interest rates, a reduction in the velocity of money could be expected.

On a related matter, Mr. de Groote noted that Mr. Morrell had sensed some contradiction between a passage in his opening statement and a paragraph in the staff paper regarding interest rates. The staff had based its remarks entirely on nominal interest rates and, in that respect, had noted a reduction in the interest rates on time deposits; allowing for a drop in the withholding tax of nearly 5 percentage points, the reduction in after-tax nominal interest rates had been rather modest. He himself had taken another approach and had expressed everything implicitly in real terms. The real interest rate on time deposits before taxes was lower because of the general movement of real interest rates, and that should have an effect on the potential for the banks to reduce the cost of borrowing in real terms. One could in the circumstances envisage a resulting increase in investment. At the same time, however, the reduction in the withholding tax had maintained the real net interest rate for depositors at about the same level. The situation was thus one that might be attractive for some time because remuneration for depositors would be maintained in real terms while the real cost of borrowing by investors would be reduced.

On suggestions for diversification of exports, Mr. de Groote agreed that there was a need for greater competition for domestic producers and possibly for stronger action on the exchange rate. The exchange rate policy thus far had been flexible, but the authorities did not preclude the possibility of engaging in an even more active exchange rate policy if circumstances should warrant. A diversification of exports had already been taking place and had been accompanied by an important diversification in the productive structure of the Turkish economy, especially in the manufacturing of household goods, light equipment, and so on.

Some Directors had asked about the net effect of the shrinking Middle Eastern markets on Turkish exports, Mr. de Groote remarked. It was not an easy matter to determine the net impact of the shrinkage. On the one hand, the weakening of oil prices would reduce Turkey's petroleum bill substantially; at the same time, Turkish exporters and contractors would continue to have the advantage of close contact and traditional associations with neighboring Middle Eastern markets. However, he agreed with Mr. de Maulde that it might be useful to look more closely at the diversification of supply.

Several Directors had pointed to the insufficient inflow of private foreign investments in Turkey, Mr. de Groote recalled. Turkey was only just beginning a new period of opening up its economy, and several measures were envisaged that should provide incentives to foreign investment.

It was clear that progress on the inflation front had not been as favorable as might have been expected, Mr. de Groote said. However, incomes and wage policies were on the whole well oriented, and wages would remain well within the level of inflation. At the same time, the economy was beginning to see the supply effects resulting from increased investments in a number of areas supplying commodities for private consumption. On the whole, the Turkish authorities felt confident about meeting the targeted inflation rate for 1983.

With regard to the potential for a follow-on arrangement, Mr. de Groote observed that the Turkish authorities had held detailed conversations with the management and staff of the Fund and envisaged the possibility of a new stand-by arrangement at the conclusion of the present program. They were particularly concerned about maintaining cooperation with the Fund because the Turkish Government would be undergoing a period of political transition, and it would be important for the Fund to be seen as monitoring targets throughout that period to avoid giving the impression that the political transition might coincide with a change in economic policy. The authorities were not so much concerned about the amounts of financial resources available from the Fund to support such a program; rather, their preoccupation was with maintaining a framework for economic policy actions that would continue to be accepted by the new Government following the October elections.

The Turkish authorities, Mr. de Groote said, wanted to press forward on the road to recovery and industrialization so as to make Turkey a modern competitive country. They recognized that, if they were to achieve their aim of reducing the current high rate of unemployment, they would need to make continuing improvements in investment and in market penetration for exports in order to achieve a sustainable balance of payments position. Finally, the Turkish authorities wished to express their gratitude for the continued support they received from friendly nations, including Saudi Arabia, the United States, and Germany. They were conscious of the sacrifices made by such countries to provide that assistance and were happy to note that the Turkish situation was improving to the extent that less assistance would be needed in future than in the past.

The Executive Board then adopted the following decision:

Review of Stand-by Arrangement

1. Turkey has consulted with the Fund in accordance with paragraph 4(b) of Executive Board Decision No. 7189-(82/115), August 23, 1982, and paragraph 8 of the letter from the Minister of Finance of Turkey dated July 20, 1982 (EBS/82/130, 7/26/82) in order to reach understandings with the Fund regarding policies and measures that Turkey will pursue during the remaining period of the stand-by arrangement for Turkey (EBS/80/126, Sup. 3, 6/19/80).

2. The letter from the Minister of Finance of Turkey dated January 3, 1983 shall be annexed to the stand-by arrangement for Turkey, and the letter of July 20, 1982, together with the Memorandum attached thereto, shall be read as supplemented by the letter of January 3, 1983. Accordingly, the understandings referred to in paragraph 4(b) of Executive Board Decision No. 7189-(82/115) relating to the net domestic assets of the Central Bank of Turkey and the net Central Bank credit to the public sector shall be those referred to in paragraph 6 of the attached letter of January 3, 1983. Moreover, the understandings referred to in paragraph 4(c) of Executive Board Decision No. 7189-(82/115) shall be supplemented by the understandings described in the final sentences of paragraphs 4 and 6 of the attached letter of January 3, 1983 relating to transfers to the state economic enterprises, and the reserve requirements of banks, respectively.

Decision No. 7355-(83/43), adopted
March 4, 1983

2. EXECUTIVE DIRECTOR

The Acting Chairman bade farewell to Mr. Vidvei at the conclusion of his service as Alternate Executive Director.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/42 (3/2/83) and EBM/83/43 (3/4/83).

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/65 (3/1/83), EBAP/83/66 (3/1/83), EBAP/83/67 (3/1/83), EBAP/83/68 (3/1/83), and EBAP/83/69 (3/1/83) is approved.

APPROVED: August 12, 1983

JOSEPH W. LANG, JR.
Acting Secretary