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January 29, 1982

To: Members of the Executive Board  
From: The Secretary  
Subject: Turkey - Review of Stand-By Arrangement and Exchange System

Attached for consideration by the Executive Directors is a report on the review of the stand-by arrangement for Turkey. Draft decisions appear on pages 14 and 15.

It is proposed to bring this subject to the agenda for discussion on Friday, February 26, 1982.

Att: (1)



INTERNATIONAL MONETARY FUND

TURKEY

Review of Stand-by Arrangement and Exchange System

Prepared by the European Department and the  
Exchange and Trade Relations Department

(In consultation with other Departments)

Approved by L. A. Whittome and Manuel Guitian

January 28, 1982

I. Introduction

A three-year stand-by arrangement for Turkey in an amount equivalent to SDR 1,250 million (625 per cent of the then quota, 416.7 per cent of the present quota) was approved by the Executive Board and became effective on June 18, 1980 (EBS/80/126, 6/4/80 and Sup.3, 6/19/80). Under the arrangement Turkey has thus far made six purchases, totaling SDR 660 million. These drawings brought Fund holdings of Turkish liras as of December 31, 1981 to 478.5 per cent of the present quota of SDR 300 million.

The mid-term review of the program for the first year of the stand-by took place at EBM/81/14 (1/28/81) on the basis of EBS/81/2 (1/4/81), and a program for the second year of the arrangement was approved at EBM/81/121 (9/11/81) on the basis of EBS/81/180 (8/24/80). Discussions with Turkish officials for the mid-term review of the second-year program were held in Ankara from December 4-17, 1981 and in Paris from January 17-20, 1982 by staff teams which included Messrs. Hole (Head, EUR), Hansen (EUR), Keller (ETR), Alexander (EUR) and, as secretary, Ms. Greasley (SEC). The Turkish representatives included officials of the Ministry of Finance, the State Planning Organization and the Central Bank. In Ankara, the mission also met with the Minister of Finance, Mr. Erdem.

In the attached communication to the Managing Director, the Minister of Finance reviews recent developments under the stabilization program and sets out the Government's policy intentions for the period ahead. Credit limits are also proposed for the period January-June 1982. The next purchase under the stand-by, equivalent to SDR 100 million, is subject to Board approval of these limits, as well as of other understandings.

Net disbursements by the World Bank to Turkey in 1980 amounted to US\$313 million, including US\$171 million under a first structural adjustment loan (of US\$275 million). A second structural adjustment loan, for

US\$300 million, was approved in May 1981, and in the first 11 months of 1981 net disbursements by the Bank reached US\$402 million, including US\$219 million of structural adjustment lending. Discussions between Bank staff and the Turkish authorities on the implementation of reforms in the areas of energy, taxation and the public enterprises were recently completed to the satisfaction of the Bank's management, and the second installment of the second loan is now being released. Discussions have also been initiated for a third structural adjustment loan.

## II. Performance under the Stand-by

### 1. Policy implementation

As noted in EBS/81/180, during the first year of the stand-by the authorities made a generally determined effort to implement the stabilization program agreed with the Fund, and this effort yielded encouraging results. By the time of the discussions in mid-1981, however, it had become clear that a stepping up of the adjustment effort was necessary as the result of a prospective, and theretofore unanticipated, reduction in 1981 in medium- and long-term capital inflows. In response to the tightened external constraint, the authorities undertook to strengthen policies in three principal areas. First, efforts would be reinforced to ensure a major reduction in the public sector's borrowing requirement; toward this end a restrictive limit was agreed, as a performance criterion, on budgetary transfers to the State Economic Enterprises, and subsidies on fertilizer were cut back. Second, the pace of monetary expansion would be reduced further. Third, exchange rate policy would be applied more vigorously. Implementation of this program is reviewed below. During the second half of 1981 all performance criteria continued to be observed.

#### a. The public finances

A substantial reduction has been brought about in the public sector's borrowing requirement. As a result both of tax reforms and of much improved expenditure discipline, the budget deficit of the Central Government is expected by officials to fall from 4 3/4 per cent of GNP in fiscal 1980 (year-ending February 1981) to 3/4 per cent of GNP in fiscal 1981 (Table 2). In addition, the financing requirement of the SEEs is estimated to have been reduced from nearly 11 per cent of GNP in calendar 1980 to close to 8 per cent in 1981 (Table 3).

The budget deficit now forecast by officials is slightly less than was foreseen at mid year. During the first nine months of the fiscal year, the year-on-year rates of growth in tax revenues and in expenditures (at 78 per cent and 43 per cent, respectively) corresponded with the forecast for the year as a whole. Implementation of continued expenditure

restraint in the remainder of the fiscal year is expected to be facilitated by the cash limit on transfers to the SEEs, which is seen as preventing a recurrence of the surge in such outlays that took place at the end of fiscal 1980. On the revenue side, a large increase in receipts is expected from certain taxes--notably those on banking transactions, following the substantial rise in deposits, credits and interest rates in 1981--whose payment is concentrated in the final months of the fiscal year. In addition, some delays in the payment of income tax by professionals and the self-employed are expected to be rectified before the year's end.

In contrast to the budget estimates, the reduction in the SEEs' financing requirement in 1981 is now thought to have been somewhat less than foreseen at mid year. While the profit and loss position of the enterprises is believed to have improved much as expected, total investment is estimated to have exceeded the mid-year projection by some LT 100 billion, or 23 per cent. Approximately LT 60 billion of this overrun reflected valuation factors or was met from additional funds (earmarked for energy projects) from the World Bank's structural adjustment lending program, and thus did not entail domestic financing; the balance was met by short-term borrowing, especially from the commercial banks.

The estimated reduction in the SEEs' overall loss (LT 16 billion) appears to have been achieved in the face of a significant increase (LT 27 billion) in so-called "duty losses"--i.e., losses resulting from the imposition of price controls by the Government. So-called "operational profits," meanwhile, almost doubled (see Table 3). This strengthening had its origin primarily in the more flexible pricing policy followed from mid year onward, and particularly in substantial increases in energy prices. While first steps were also taken to deal with the critical problem of overmanning and to raise the quality of management, the progress made was somewhat slower than had been hoped.

#### b. Monetary developments

During the second half of 1981 all credit limits continued to be observed (Table 4). The rate of monetary expansion, however, proceeded faster than programmed (Table 5). This came about in the wake of a sharp strengthening in the balance of payments, arising in part from an unexpectedly rapid increase in current receipts and in part from a marked turnaround in leads and lags (see below). Thus, as against the expectation at mid-year that some LT 90 billion of central bank credit might be absorbed through the balance of payments, little change in fact took place in the net foreign assets of the Central Bank during the second half of the year. With the growth in net domestic assets of the Central Bank being limited by a much smaller amount than the shortfall in external absorption, the growth in reserve money exceeded expectations, increasing (on a year-on-year basis) by close to 50 per cent in the second half of 1981, against a program target of somewhat less than 40 per cent.

The broader monetary aggregates likewise expanded faster than intended. From a year-on-year rate of 60 per cent in the first half of the year, the growth in M2 is likely to have slowed only to 56-57 per cent, rather than to 45-50 per cent as programmed. However, with the recorded rate of inflation--and, it may be presumed, inflationary expectations--declining somewhat faster than foreseen at mid-year, while deposit interest rates remained basically unchanged, there was a continued sharp growth of time deposits <sup>1/</sup> and the overall demand for money may well have increased more strongly in the program period than was assumed earlier. At the same time, the upturn in economic activity is now thought to have been somewhat greater than projected at mid-year. A good part of the overshooting of the M2 target, therefore, is likely to have been matched by an increased demand for liquidity. Part, though, may have left some overhang of liquidity, the effects of which on the balance of payments and on price developments were not immediately forthcoming given the relatively restrictive trade and payments system and normal time lags in the transmission process.

#### c. External policies

External competitiveness was strengthened substantially in the period under review. With a more determined application of the exchange rate system introduced on May 1, 1981--under which the rate is set daily--the nominal effective exchange rate of the lira was reduced by some 19 per cent, and the real effective rate by more than 9 per cent, between the end of June and the end of December. In the process the real effective rate was brought back to the position which obtained immediately following the sizable depreciation of the lira in January 1980, at the outset of the stabilization program.

Progress also continued to be made toward the elimination of external payments arrears. As of the end of October, arrears outstanding had been reduced to US\$321 million, from US\$785 million at end-June and US\$2,350 at the peak at end-March 1980. In addition, advances were made in rationalizing the exchange system, through the elimination of the multiple currency practices arising from the special rates for transfers for study abroad and for the importation of fertilizer and pesticides.

#### 2. The economy's response

With policies proceeding broadly on track, the stabilization program continued to meet with encouraging success in the period under review. For the year as a whole, the critically important program targets--the rate of inflation, the growth in foreign exchange earnings and, with these, the external current balance and the rate of economic growth--are all estimated to have been met or exceeded.

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<sup>1/</sup> This was mirrored in a much faster deceleration in the growth of M1 (from 46 per cent in the first half of the year to 32 per cent, year-on-year, in July-November) than in the broader monetary aggregates.

With domestic demand remaining under restraint while the availability of key goods continued to improve, and with the growth in wage costs held in check by a firm incomes policy, inflation decelerated further in the second half of the year. By November, the rate of rise in consumer prices--as measured by an average of the principal indices--had slowed to 31 per cent (year on year), from 35 per cent in June and 90 per cent at the end of 1980. For the year as a whole, the change in the GDP deflator is estimated to have approximated the 40 per cent rate originally targeted, compared with 100 per cent in 1980.

The improvement in the current account of the balance of payments, meanwhile, gained considerable momentum. This was spearheaded by a striking acceleration in export growth, from 50 per cent (year-on-year) in January-June to 80 per cent in July-November, as producers continued to react to weak domestic demand, to a more competitive exchange rate and improved export incentives, and to specific opportunities in neighboring countries. The growth continued to be directed principally to markets in the Middle East and North Africa (Iraq, Libya, Iran and Saudi Arabia together absorbed 60 per cent of the increase in exports between January-October 1980 and January-October 1981 and took fully 30 per cent of Turkish exports in the latter period against 10 per cent in the former), and it continued to be led by exports of manufactures, which more than doubled year-on-year and accounted for nearly half of all exports in January-October 1981 against 36 per cent in the corresponding period of 1980. At the same time, the growth in workers' remittances and other invisible receipts remained strong, with the latter buoyed up by a sharp increase in earnings from transportation and transit trade. For 1981 as a whole, external current receipts are now estimated to have been some US\$400 million higher than foreseen at mid-year (and fully US\$1,400 million more than forecast at the beginning of the year), and to have reached the equivalent of 13 per cent of GNP, against 9 per cent in 1980. With a reduction of some 10 per cent in the volume of oil imports--related in part to the increase in energy prices effected during the year--the growth in foreign exchange earnings is estimated to have permitted both a sizable increase (close to 20 per cent) in the volume of non-oil imports and a reduction in the current account deficit to 4 per cent of GNP from 5 3/4 per cent of GNP in 1980 (Tables 1 and 6).

As foreseen at mid-year, medium- and long-term capital inflows fell sharply between 1980 and 1981 and covered only half of the current account deficit. But the remaining gap appears to have been more than closed by a major turnaround in leads and lags, consequent on the implementation of realistic exchange rate and interest rate policies. The resulting overall surplus, together with purchases from the Fund, permitted some rebuilding of reserves, although gross reserves still fell in relation to imports.

With the improvement in the real foreign balance, and with an upturn in public investment, real GNP, after declining in 1980, is estimated to have expanded by close to 4 1/2 per cent in 1981. This compared with a

target growth rate at the beginning of the year of 3 per cent. Private sector demand remained depressed. The growth of consumption was contained by incomes policy restraint as well as by a shift of demand from goods to money as interest rates became steadily more attractive in real terms, while private investment remained subdued in circumstances of still low, if rising, levels of capacity utilization and relatively high interest rates. With little growth of output in agriculture and construction, and with the relatively strong recovery in industrial production deriving mainly from an increase in productivity, the pickup in economic activity is not believed to have made much of a dent in unemployment, which thus remained at about 15 per cent of the labor force.

### III. Program for the Period Ahead

#### 1. Overview

While pleased with the progress made during the past year, the authorities have no illusions about the still considerable adjustment task that lies ahead. Simply put, during the next 2-3 years the economy needs to be positioned to be able (i) to absorb smoothly the impact of the significant reduction in the net use of Fund resources that is in prospect after 1982; (ii) to reduce the reliance on other official balance of payments assistance on concessional terms; and (iii) to meet the much-enlarged debt service burden that will emerge after mid-1984 when the benefit of present rescheduling arrangements expires. At the same time, external reserves need to be strengthened so as to reduce the economy's still acute vulnerability to external shocks. If the growth of imports, and thus of activity, is not to be held down at an unsatisfactorily low pace, and if there is not to be too rapid a build up in nonconcessional debt in place of official foreign assistance, all this will require that the share of foreign exchange earnings in GNP should continue to increase, and that of the external current deficit to decline.

Mindful of this, and of the importance of continuing to wind down the rate of inflation, the authorities intend to persevere on the policy course that has been set. Three key elements of the program for the period ahead are to be a decrease in the rate of monetary expansion; a reduction in the public sector's borrowing requirement, via a further strengthening in the financial self-reliance of the SEEs; and a continued vigorous implementation of exchange rate policy. In addition, the incomes policy apparatus set up in 1981 is to remain in place, with the aim of limiting wage and salary increases approximately to the target rate of inflation. The authorities believe that, with this program, it will be possible to reduce the current account deficit to some 3 per cent of GNP and to bring inflation down to about 25 per cent in 1982, while at the same time maintaining broadly the same rate of real GNP growth as in 1981.



## 2. The monetary program

The credit limits that the Minister of Finance is proposing for the period January-June 1982 are set out in Table 4. They have been drawn up within a framework which is designed to provide for a rate of monetary expansion for 1982 as a whole which would be broadly consistent with the official targets for inflation and real economic growth, but which also provides--of necessity, as discussed below--for a relatively large increase in central bank credit in the first half of the year. In view of continuing uncertainties, not least in structural relationships in the monetary accounts and in the likely development of official external assistance, limits for the second half of the year will be put forward at the time of the mid-1982 review in July.

Because of difficulties in exporting certain commodities, especially large crops of hazelnuts and raisins--on account, variously, of inappropriate pricing, intensified competition on the European market, and the imposition by the EC of certain restrictions--the Turkish Agricultural Cooperatives were not able in the latter part of 1981 to generate the resources needed to pay the farmers. This led the Government, in the first banking week of 1982, to instruct the Central Bank to extend exceptional credits to the Cooperatives. These credits, which by themselves contribute an additional 5 1/2 percentage points to the year-on-year growth of reserve money, cover two thirds of the Cooperatives' debts to the farmers. Various steps are being taken, including price adjustments, to get exports of the affected commodities moving, but it is not expected that net central bank credit to the Cooperatives will be reduced from its present level during the first half of the year since settlement of the remaining debts outstanding to the farmers is to have first claim on the resources accruing from such exports. As it will also not be possible, in the first half of the year, fully to offset the exceptional agricultural credit by reducing credit to other borrowers, the proposed increase in the net domestic assets of the Central Bank is higher than would otherwise have been necessary.

The NDA limits being proposed are estimated to be consistent with a year-on-year growth in reserve money and in M2 of some 45 per cent in the first half of 1982, against 49 per cent and 56 per cent, respectively, in the second half of 1981 (Table 5). Given the expected growth in real GNP, a rate of M2 expansion of this order is likely, in the view of the staff, to be compatible with a contemporaneous increase in the GNP deflator of around 32-33 per cent. The key assumptions underlying these estimates are two. First, the net foreign assets of the Central Bank will fall by the equivalent of some US\$250-300 million--a smaller figure than that assumed in any previous six-month period, in recognition of the reduced reliance of the economy on official borrowing to finance the current

account deficit. <sup>1/</sup> Second, it is assumed that both the reserve money multiplier with respect to M2 and the income velocity of circulation of M2 will remain substantially unchanged between the second half of 1981 and the first half of 1982; this would imply little change in the former also between the first halves of 1981 and 1982, but a decline in the latter of perhaps 5 per cent. In the latter connection, the authorities have indicated that, at least through mid-year, they intend to hold deposit interest rates broadly unchanged.

The authorities recognize that, with the proposed credit program, there will need to be a greater absolute degree of credit restraint in the second half of the year if monetary expansion for the year as a whole is to be limited to a rate which would be consistent, given the expected growth of real GDP, with a rate of inflation in the order of 25 per cent. The Turkish representatives noted that such an absolute reduction in credit expansion would be facilitated by the nonrecurrence of exceptional credits to the Agricultural Cooperatives and by the seasonally lower credit needs of the public sector. The Minister of Finance, in his letter, has affirmed the Government's intention to exercise the necessary restraint.

### 3. The public finances

The monetary program outlined above entails a reduction in 1982 in central bank credit to the public sector. In line with this, the fiscal program calls for the public sector borrowing requirement to be held essentially unchanged in nominal terms--with a projected increase in the financing requirement of the Central Government being approximately offset by a reduction in that of the SEEs--and for the Central Government to rely proportionately more than in 1981 on borrowing from outside the Central Bank to finance its deficit.

#### a. Central Government budget

As a preliminary to moving the budget year to a calendar-year basis in 1983, and thereby synchronizing the policy planning process, the budget for 1982 will apply only for a 10-month period, March-December. The proposed budget provides for much the same deficit in nominal terms as officials look for in fiscal year 1981 (Table 2). Scaling up the 10-month estimates to a 12-month basis would suggest a growth in both revenue and expenditure of 35 per cent--or somewhat more than the officially projected growth of nominal GNP in 1982--and an unchanged budget deficit in relation to GNP (of some 3/4 per cent of projected GNP).

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<sup>1/</sup> As a safeguard against a substantive overestimate of the absorption of liquidity through the balance of payments, the letter from the Minister of Finance provides for consultation with the Fund in the event of a significant deviation in the Central Bank's net foreign assets from the assumed path.

The revenue estimate for 1982 is predicated on an implicit elasticity of tax revenue to GNP of 1.05 (compared with an estimated 1.65 in 1981, when the tax reform took effect, and approximately 1.00 in the second half of the 1970s) and on a relatively strong increase in nontax revenue (which accounts for a little over 10 per cent of the total). No new tax increases are proposed. Indeed, the rate of corporation tax is to be reduced from 50 per cent to 40 per cent and the minimum rate of income tax lowered from 40 per cent to 39 per cent. At the same time, there will be no recurrence in 1982 of the double taxation of professionals and self-employed that resulted in 1981 from the shift to taxation of the current year's income in addition to that of the previous year. Against this, revenue growth is expected to benefit from an intensified implementation of the tax reform, the yield from which in 1981 fell short of official expectations, as well as from the fact that a significant proportion of tax revenue still relates to income and transactions of the preceding year, which in the case of 1981 was one of faster nominal income growth than is expected for 1982. As to expenditures, all components other than transfers to the SEEs are set to rise somewhat faster than GNP. Within the total, the share of current expenditure and transfers is to decline, and that of investment to increase (see below). The Turkish representatives noted that the Government was determined to build on the expenditure discipline achieved in 1981, and it was their confident expectation that outlays would, in fact, be held below appropriations in fiscal 1982.

b. State Economic Enterprises

The 1982 program for the SEEs calls for a reduction in their financing requirement amounting to the equivalent of 2 1/2 percentage points of GNP. This is to be brought about by a shift into overall profit of the enterprises, by a further reduction in nominal terms in the rate of inventory accumulation, and by limiting their fixed investment to about 90 per cent of the estimated 1981 level at constant prices (Table 3).

The program projections, however, are subject to much wider margins of error than usual since, in 1982, SEE managers--with few exceptions--are to be given full responsibility to manage and set prices. As guidelines, the managers have been instructed to give overwhelming priority to operational performance and much lower priority to their investment programs, with the specified levels of investment to be regarded essentially as ceilings. This is a clear and radical break from the past. The big unknown is how managers will react. The authorities recognize that a significant improvement in operational efficiency will take time to bring about, especially given the existing quality of management and the bar on dismissal of redundant labor. They thus would not be surprised if the profit and loss result turned out weaker than projected and if inventory accumulation were greater. But in such circumstances, and to the extent that borrowing on market-related terms was not increased beyond program estimates, they would also expect a broadly countervailing reduction in fixed investment from the amount projected, since the program again

provides explicitly for a cash limit on the amount of budget funds and central bank credit that is to be made available to the enterprises.

Budgetary transfers to the SEEs are to be limited to LT 243 billion in 1982, entailing a reduction in real terms of more than 20 per cent from the estimated level in 1981. Of the 1982 total, LT 10 billion is to be disbursed in January-February and is subject to an existing understanding, in the context of the stand-by, on the maximum level of such transfers in fiscal 1981. As to the disbursement of the balance (LT 233 billion) during March-December, a time path has been estimated, and if at either the middle or the end of the year this has been exceeded, the Government will consult with the Fund. Direct borrowing from the Central Bank, meanwhile, will be limited to one SEE, the official wheat exporting agency, (compared with two SEEs in 1981) and to LT 20 billion (LT 22 billion in 1981).

Even with these constraints, the possibility remains of excessive recourse by the SEEs to short-term borrowing to cover funding needs not met from their own resources. The Turkish representatives said that if this were to occur, their ultimate sanction would be to remove the managers responsible. In order to keep abreast of the developing situation, monitoring arrangements were being strengthened and a monthly reporting system was being put in place for all SEEs covering a wide range of variables (selected data from which are to be provided to the staff). In addition, it was intended that three full balance-sheet review exercises should be conducted during the course of 1982.

#### c. Public sector investment

Notwithstanding both a significant pruning of projects and the planned cutback in real terms in fixed capital formation by the SEEs, total public sector investment in 1982 is projected to rise by 6 per cent for a second consecutive year. The authorities accept the view that a continuation of this trend over the medium term would be inimical to the stabilization and restructuring effort inasmuch as it would tend either to be inflationary or to crowd out the private sector. However, they believe that the 1982 program, by itself, is supportable on three main grounds. First, high priority is given to energy, infrastructural and agricultural projects, while industrial investment has been downgraded. This would serve as a complement to the adjustment process. Second, there is felt to be little risk in the near term of crowding out private investment, demand for which remains subdued primarily as a result of still large reserves of unutilized capacity. Third, even allowing for some slippage from projection, public sector savings can be expected to increase more than commensurately with the growth in investment, while the external balance is not expected to be strained by the foreign exchange component of the planned expenditures.

#### 4. External policies

The broad principles that have guided external policies during the past year are to continue to apply in the period ahead. The Government remains determined, first and foremost, to ensure that the exchange rate is adjusted in timely fashion and, as a minimum, in amounts fully sufficient to compensate for price differentials between Turkey and its principal partner countries. If the exchange rate is not adjusted accordingly, the authorities will consult with the Fund pursuant to understandings reached when the program for the second year of the stand-by was formulated. The Government has also reaffirmed its intention to settle the remaining external payments arrears by June 1982.

#### IV. The External Outlook

The authorities consider that with the steadfast implementation of the foregoing program, there is good reason to look for a further reduction in the external current deficit in 1982 while securing an increase in the volume of imports consistent with the targeted growth in GNP. The staff concurs with this view.

With a momentum now under way, exports are projected by officials to rise by 30 per cent in U.S. dollar terms in 1982. Exports of manufactures are forecast to increase by some 40 per cent (against more than 100 per cent in 1981) and agricultural exports by close to 20 per cent (25 per cent in 1981). Workers' remittances are expected to increase by a little over 10 per cent, reflecting both the carry-over effect of the strengthening of the deutsche mark vis-a-vis the U.S. dollar in the latter part of 1981 and an increase in the number of workers in Saudi Arabia and Libya. With other invisibles also forecast to show good growth, total current receipts are projected to reach the equivalent of 17 per cent of GNP. Following a reduction in market rates, interest payments are now expected to absorb somewhat less of such earnings than was anticipated in mid-1981. Correspondingly, officials expect to be able to finance an import bill of US\$10 billion while at the same time reducing the current account deficit to US\$1.8 billion, or 3 per cent of GNP.

It is difficult, in the current circumstances of the Turkish economy, to evaluate with any precision the outlook for exports. Clearly, the impressive growth since late 1980 has stemmed in part from a number of factors which may be characterized as special, temporary, or once-for-all in nature, viz., the restoration of domestic order and industrial peace; the conflict between Iran and Iraq; and the depressed level of domestic demand. Equally, however, the stabilization program has effected a perceptible improvement, which is continuing, in the profitability of production for exports as opposed to the domestic market. At the same time, Turkey remains a marginal supplier in most markets and its export base is still relatively small, so that sizable increases in percentage terms remain feasible.

Even taking a less sanguine view than do officials of export prospects in 1982, one would not necessarily look for a very much higher trade deficit for two reasons. First, there has been a rapid development in 1981 of processing activity for re-export, with a high import content and low value-added; a reduction in the growth of such exports, which are directed particularly to markets in the Middle East, would thus have only a modest impact on the trade balance. Second, and more important, the projected import bill appears, in the view of the staff, to contain some safety margin inasmuch as it allows --in addition to an increase in volume of some 6 per cent--for an increase in prices in dollar terms of some 7 per cent. This is significantly more than the staff currently expects the increase in industrial countries' export prices and in oil prices to be in 1982. *Ceteris paribus*, if the increase in import prices were one half of that projected by officials, the programmed volume of imports would cost US\$400 million less; for a given trade balance, this would reduce the "required" growth in exports to 21 per cent (from the 30 per cent forecast).

A current account deficit of the order projected should be financeable. Medium- and long-term capital inflows in the pipeline--including pledges outstanding from the 1981 OECD Special Assistance program, as well as prospective drawings under a third IBRD structural adjustment loan--are estimated to amount to more than US\$1.1 billion. After allowing for prospective purchases from the Fund, financing in an amount of some US\$0.4 billion would need to be found from other sources, at a time when normal trade credits seem to have become more readily available.

#### V. Staff Appraisal and Proposed Decisions

The stand-by arrangement for Turkey has now reached its half-way mark. The progress made thus far has clearly matched, if not exceeded, expectations at the outset. Adjustment of the exchange rate and of interest rates has helped to bring about an impressive growth in exports and workers' remittances, as well as a marked turnaround in short-term capital flows. An essential adjunct has been a more resolute program of domestic demand restraint via financial and incomes policies. This has helped to offset a still large anti-export bias and, together with an improved availability of goods, to bring down the rate of inflation. The lessening in both external and internal imbalances that has resulted can be viewed with considerable satisfaction by the authorities.

This said, the imbalances that remain are still unsustainably large. There can, thus, be no relenting yet from the stabilization program.

On the external side, the essential task remains to reduce the dependence on official assistance, to meet the debt service that looms around the middle of the decade, and to strengthen reserves. Despite the strong growth in external current receipts, the reduction in interest rates on international markets, and the levelling off in oil prices that

occurred in the second half of 1981, the scale of this task remains very considerable by any standards, in that foreign exchange earnings will need to continue rising substantially faster than the growth foreseen in markets for a number of years to come. The task would, moreover, be all the larger if official medium- and long-term capital flows, which fell sharply in 1981, were to be reduced further in the near-term future. With adherence to the present policy stance, especially in regard to the exchange rate, and with no major change in conditions in Turkey's most rapidly growing export markets, the balance of payments can, however, be expected to strengthen further in 1982 and external adjustment to proceed at a satisfactory pace.

The inflation target sought by the authorities in 1982 is ambitious, given the surge in monetary growth around the turn of 1981, rising income aspirations, and the implications for domestic prices of exchange rate policy. While the proposed credit program for the first half of the year implies a relatively rapid rate of monetary expansion, this need not invalidate the basic aim of securing a marked further deceleration in inflation in 1982. Attainment of this objective will, however, require much greater credit stringency in the second half of the year than is envisaged in the first. In the intervening period to mid-year, meanwhile, it is crucial--given both the recent and prospective growth of liquidity in the economy--that interest rate policy should continue to sustain the demand for money balances and that the pace of monetary expansion should not exceed that now foreseen. It is equally crucial, especially given the ban on dismissing labor, that incomes policy should not validate a faster growth in labor costs than the target rate of inflation.

The strengthening achieved in the public finances in 1981 is very much to be welcomed. Public sector savings will nonetheless have to be increased further in 1982 if the rate of credit expansion is to be reduced without impinging on the availability of finance to the export sector. Such an increase is all the more necessary in view of the fact that the public sector borrowing requirement, even though diminished, remains large in relation to the capacity of organized financial markets, and of the fact that a further increase is planned in public sector investment in relation to GNP in 1982.

The major contribution to the needed strengthening of the public finances must be looked for from a further improvement in the self-reliance of the SEEs. The authorities recognize this and have set in train a new approach in 1982 under which SEE managers have been instructed to focus above all on operational results and to fulfil their investment programs only to the extent that they can satisfactorily fund them. In conjunction with this, the Government has explicitly disassociated itself from unlimited deficit financing by fixing a cash limit on budgetary transfers to the enterprises which is substantially reduced in real terms from the 1981 level. This is an important step in the right direction and contrasts markedly with a long history of the enterprises being encouraged at

virtually any cost to achieve, if not to exceed, investment targets, while having their prices controlled at too low levels. This said, it would be imprudent not to expect some slippage in 1982 from the program estimates, given the management constraint and the modest scope in the short run for reducing costs (especially labor costs). If such slippage is to be limited, and a meaningful reduction thereby attained in the SEEs' financing requirement, it is essential that the authorities remain vigilant to the developing situation and--notwithstanding the shift to greater managerial autonomy--exercise forceful moral suasion, as needed.

In sum, there is a need to persevere on the existing policy course and to stand ready to address any significant deviations from the program. Steadfast application of the policies set out in the letter of the Minister of Finance would meet this need and would well deserve the Fund's continued support.

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Following the progress made in 1981 in rationalizing the exchange system, only one multiple currency practice now remains, namely that which results from the operation of the retention scheme for foreign exchange earnings from specified exports and from contracting abroad (see SM/81/180). Fund approval of this practice was recently extended until the present Board review (EBS/81/250). As noted in EBS/81/250, the importance of the scheme does not lie in the exchange premium, which is small, but in the assured access of exporters to foreign exchange. The authorities intend to eliminate the scheme as soon as the trade and payments situation has normalized but are anxious, for the time being, not to disturb the export regime. In view of this, and of the abolition of the other multiple currency practices, the staff recommends that approval of the practice be renewed until the end of 1982.

\* \* \* \* \*

In light of the foregoing, the following draft decisions are proposed for adoption by the Executive Board:

- I. 1. Turkey has consulted with the Fund pursuant to paragraph 3(e) of the stand-by arrangement for Turkey (EBS/80/126, Supp.3, 6/19/80) as modified by paragraph 3(b) of Decision No. 6836-(81/67), April 24, 1981, and paragraph 3(b) of Decision No. 6945-(81/121), September 9, 1981 in order to reach understandings regarding the circumstances in which further purchases may be made.



2. The communication from the Minister of Finance of Turkey dated January 27, 1982 proposing credit limits for the period January-June 1982 and limits on budgetary transfers for the period March-December 1982 shall be annexed to the stand-by arrangement for Turkey and the letter dated June 2, 1980 and the tables annexed to it shall be read as modified by this communication.

II. In view of the circumstances of Turkey, the Fund approves the retention by Turkey of the multiple currency practice described in EBS/82/19 (1/29/82) until December 31, 1982.

Table 1. Turkey: Selected Indicators

	1980	1981		1982
	Actual	Estimate at mid-year	Current estimate	Program/Offi- cial Projection
(Percentage change)				
<u>Growth and inflation</u>				
Real GNP	-1	3	4 1/2	4 1/2
GNP deflator	103	40	40	25
(Percentage change; U.S. dollar terms)				
<u>External trade</u>				
Exports	28 1/2	44	54 1/2	30
Prices	16	6 1/2	8 1/2	6 1/2
Volume	10 1/2	35	42 1/2	22
Imports	51	11	15	13 1/2
Prices	37 1/2	7	9	7
Volume	10	3 1/2	5 1/2	6
(In per cent of GNP)				
<u>External ratios</u>				
Current receipts	9 1/4	12 1/2	13	17
Exports	(5)	(7)	(7 1/2)	(10 1/4)
Other	(4 1/4)	(5 1/2)	(5 1/2)	(6 3/4)
Imports	-13	-14 1/2	-14 3/4	-17 1/2
Interest payments (accrued)	-2	-2 1/2	-2 1/4	-2 1/2
Current balance	-5 3/4	-4 1/2	-4	-3
External debt	33	...	36	40
Debt service in per cent of current receipts 1/	(23)	...	(23)	(24)
(In per cent of GNP)				
<u>Public sector finances</u>				
Central Government				
Budget balance	-4 3/4	-1	-3/4	-3/4
Financing balance	-4 1/4	-2	-1 1/4	-1 1/4
SEEs				
Financing balance	-11	-6 3/4	-8 1/4	-5 3/4
(not covered by Central Government)	(-7 3/4)	(-3 1/2)	(-4 1/2)	(-3)
(Average percentage change)				
<u>Money and credit</u>				
Central Bank NDA 2/	47 1/2	40 1/2	36	35 1/2 3/
Reserve money	51 1/2	35-40	49	45 4/
Reserve money multiplier	3 1/2	7	4 1/2	-- 4/
M2	56 1/2	45-50	56 1/2	45 4/
Income velocity of M2	29	-5	-7	-5 4/
Interest rate on 12 month deposits (end-year)	33	...	50	...

Source: Data provided by the Turkish authorities.

1/ After debt relief.

2/ Percentage change during the year.

3/ End-June 1982 over end-June 1981.

4/ First half of 1982 over first half of 1981.

Table 2. Turkey: Consolidated Budget 1/

(In billions of Turkish liras)

	1980	1981		1982
	Actual	Estimate in June 1981	Current estimate	10-month budget Mar. - Dec.
Revenues	<u>855</u>	<u>1,485</u>	<u>1,485</u>	<u>1,665</u>
Expenditures	<u>1,063</u>	<u>1,548</u>	<u>-1,525</u>	<u>-1,715</u>
Personal	335	445	435	490
Other current	162	331	320	346
Investment	167	338	320	372
Transfers	399	434	450	508
Of which: to SEEs	(213)	(214)	(214)	(233)
Budget balance	<u>-208</u>	<u>-63</u>	<u>-40</u>	<u>-50</u>
Change in accounts payable, net	16	-62	-40	-41
Financing balance	<u>-192</u>	<u>-125</u>	<u>-80</u>	<u>-91</u>
Foreign borrowing	7	-33	-33	-15
Domestic borrowing	207	158	113	106
Central Bank	(109)	(95)	(85)	(40)
Other	(98)	(63)	(28)	(66)
Other financing	-22	--	--	--
<u>Memorandum items</u> (in per cent of GNP):				
Revenues	19.3		22.4	23.2 <u>2/</u>
Expenditures	-24.0		-23.0	-23.8 <u>2/</u>
Of which: Transfers to SEEs	(-4.8)		(-3.2)	(-2.9) <u>2/</u>
Budget balance	-4.7		-0.6	-0.6 <u>2/</u>
Financing balance	-4.3		-1.2	-1.1 <u>2/</u>

Source: Ministry of Finance

1/ For 1980 and 1981, fiscal year data (March-February); for 1982, the data refer to the ten-month period March-December only. Beginning in 1983 the fiscal and calendar years will correspond.

2/ For comparative purposes, the ten-month data have been multiplied by 1.2 in order to put them broadly on a 12-month basis, but with the exception that transfers to the SEEs have been estimated separately.

Table 3. Turkey: Accounts of the SEEs  
(In billions of Turkish liras; calendar year data)

	1980	1981		1982
	Actual	Estimate in June 1981	Current estimate	Official estimate
Sales revenue	<u>1,146</u>	<u>1,850</u>	<u>1,780</u>	<u>2,601</u>
Total expenditure	<u>1,169</u>	<u>1,855</u>	<u>1,787</u>	<u>2,554</u>
Wages and salaries	238	294	321	380
Purchases of goods and services	898	1,525	1,417	2,103
Other	33	36	49	71
Profit/loss before taxes	<u>-23</u>	<u>-5</u>	<u>-7</u>	<u>47</u>
Duty losses <u>1/</u>	-75	-85	-102	-83
Operational profit	52	80	95	130
Total investment	<u>459</u>	<u>433</u>	<u>534</u>	<u>540</u>
Fixed investment	281	316	408	472
Increase in stocks	178	117	126	68
Financing requirement	<u>482</u>	<u>438</u>	<u>541</u>	<u>493</u>
Depreciation, taxes, etc.	9	-10	-3	1
Budgetary transfers	149	249	238	243
Borrowing from Central Bank	50	40	22	20
Borrowing from State Investment Bank	16	25	27	34
Foreign borrowing <u>2/</u>	67	53	113	68
Short-term borrowing (including change in accounts payable)	191	81	144	127
<u>Memorandum items (in per cent of GNP):</u>				
Profit/loss before taxes	-0.5		-0.1	0.5
Total investment	10.4		8.1	6.2
Financing requirement	10.9		8.2	5.7
Adjusted own resources <u>3/</u>	(1.4)		(1.4)	(1.5)
Budgetary transfers	(3.4)		(3.6)	(2.8)
Borrowing	(6.1)		(3.2)	(1.4)

Source: Ministry of Finance.

1/ Losses resulting from the retention of price controls by the Government for social reasons.

2/ Including lira counterpart of IBRD structural adjustment loans.

3/ Defined as "operational profit" plus "depreciation, taxes, etc."

Table 4. Turkey: Credit Limits

(In billions of Turkish liras)

		Net Domestic Assets of the Central Bank		Net Central Bank Credit to the Public Sector	
		Limit	Actual	Limit	Actual
1981	July-September <u>1/</u>	765	729	527	515
	September <u>2/</u>	790	735	540	518
	October-December <u>1/</u>	836	809	554	539
	December <u>2/</u>	852	814	558	540
-----					
1982 <u>3/</u>	January-March <u>1/</u>	849	...	548	...
	March <u>2/</u>	863	...	554	...
	April-June <u>1/</u>	900	...	571	...
	June <u>2/</u>	920	...	582	...

Source: Information provided by the Turkish authorities.

1/ Average of last reporting date in each month.

2/ Average of each weekly reporting date during the month.

3/ Beginning January 1, 1982, certain accounting changes have been made in the definition of the credit aggregates. Consequently, the numbers are not comparable with the 1981 figures.

Table 5. Turkey: Summary of Monetary Developments

	1980	1981		I	1981		1982
	Dec.	June	Dec.		Program	Actual	I
			Program Actual		Program	Actual	Program
(In billions of Turkish liras)				(Percentage change over corresponding half of previous year)			
Reserve money	445	537	602 664	51	35-40	49	45
Net foreign assets	-162	-164	-250 -161				
Net domestic assets	607	701	852 825	45	38	32	36
Credit to public sector	(420)	(495)	(558) (546)				
Credit to private sector	(272)	(326)	(414) (380)				
Other items	(-85)	(-120)	(-120) (-101)				
Memo item: M2	809	1,025	1,196 <u>1/</u>	60	45-50	56 <u>2/</u>	45

Source: Information provided by the Turkish authorities.

1/ End-November.

2/ Partly estimated.

Table 6. Turkey: Balance of Payments

(In millions of U.S. dollars)

	1980	1981		1982
	Revised	Estimate at mid-year	Current estimate	Projection
Trade balance	-4,757	-4,300	-4,300	-4,150
Exports, f.o.b.	2,910	4,200	4,500	5,850
Imports, c.i.f.	-7,667	-8,500	-8,800	-10,000
Services balance	1,338	1,680	1,940	2,350
Workers' remittances	2,071	2,500	2,550	2,850
Interest payments (before debt relief)	-1,138	-1,520	-1,385	-1,450
Tourism	212 )		275	350
Other services (net)	193 )	700	500	600
Current balance	-3,419	-2,620	-2,360	-1,800
Capital account (long- and medium-term)	2,325	1,721	1,155	1,135
Project and suppliers' credits	547	750	750	850
Program loans	377	425	430	500
Private foreign capital <u>1/</u>	131	180	155	235
Petroleum loans	215	250	50	--
Loans from banks	165	--	-200	--
Of which:				
Acceptance credits (net)	(-58)	(--)	(-200)	(--)
Eurocurrency loans	(223)	(--)	(--)	(--)
Special assistance under the auspices of the OECD	996	736	400	400 <u>2/</u>
Debt repayments (before debt relief)	-1,556 <u>3/</u>	-1,470	-1,280	-1,400
Debt relief	1,450	850	850	550
Principal	(980)	(600)	(600)	(450)
Interest	(470)	(250)	(250)	(100)
Short-term credits, errors and omissions <u>4/</u>	474	--	1,306	400 <u>5/</u>
SDR allocations	27	24	24	--
Overall balance	-593	-875	125	-265
Financing <u>6/</u>	593	375	-125	265
Net use of Fund resources	475	375	375	320
Accumulation of arrears	--	--	--	--
Reduction in net official reserves other than arrears and IMF	118	--	-500	-55 <u>5/</u>
Increase in liabilities other than arrears and IMF	(418)	(--)	(...)	(...)
Reduction in assets	(-300)	(--)	(...)	(...)
Financing gap	--	500	--	--

Source: Information provided by the Turkish authorities.

1/ Includes imports with waiver.

2/ Represents amount expected to be disbursed from 1981 pledges only.

3/ Includes debt service payments arrears of US\$315 million accumulated in 1979.

4/ Residual.

5/ Notional figures.

6/ Net of valuation changes and position of commercial banks.

Turkey: Fund Position  
(As of December 31, 1981)

Quota:	SDR 300 million
Fund holdings of Turkish liras:	SDR 1,435.6 million or 478.5 per cent of quota, of which:
	CFF SDR 127.5 million, or 42.5 per cent of quota
	Oil facility SDR 52 million, or 17.3 per cent of quota
	SFF SDR 780 million, or 260 per cent of quota
SDR holdings:	SDR 0.2 million; (0.16 per cent of net cumulative allocation of SDR 112.3 million)
Distribution of profits:	US\$24 million
Gold distribution:	129,230 fine ounces

January 27, 1982

Mr. de Larosiere  
Managing Director  
International Monetary Fund  
Washington, D.C.20431  
USA

Dear Mr. de Larosiere:

1. In accordance with paragraph 5 of the letter to you of July 22, 1981, the Government of Turkey has reviewed external competitiveness, the budget and the finances of the State Economic Enterprises, and has drawn up proposed limits on net domestic assets of the Central Bank and net central bank credit to the public sector for the period January 1 to June 30, 1982.
2. Considerable further progress has been made since mid-year toward the achievement of the objectives of the stand-by arrangement. For 1981 as a whole, the rate of inflation has been reduced to below 40 per cent and, at the same time, there has been a renewal of economic growth, with real GDP rising by more than 4 per cent. As a result of the policies that have been followed to restructure the economy and give it a greater external orientation, the balance of payments strengthened markedly in 1981, despite a substantial net decline in inflows of capital on concessional terms. With exports growing by over 50 per cent in U.S. dollar terms and with workers' remittances and foreign exchange earnings from services also showing strong growth, we were able to achieve a needed growth in import volume while, at the same time, rebuilding our reserves from low levels.
3. For 1982, the Government aims at maintaining the rate of growth realized last year, while achieving a further reduction in the rate of inflation. As in 1981, an important part of the economic recovery will need to come from the export sector if imports on the scale required are to be financed. The Government will therefore persevere with its policy of fiscal and monetary restraint; it will maintain interest rates at positive levels in real terms for savers and general borrowers; and it will continue to follow a flexible exchange rate policy.
4. The budget for 1982, which will apply only for a 10-month period in order that, from 1983 onward, the fiscal and calendar year will coincide, provides for a further reduction in the Government's financing requirement. Firm expenditure discipline will continue to be observed. Revenue growth is expected to benefit from an intensified implementation of tax reform measures introduced in 1981.
5. Following the progress made in 1981, the Government also intends to step up its efforts to increase the financial self-reliance of the SEEs. A radically new approach is to be followed, under which (a) the managers will be given virtually full autonomy to manage and to adjust prices; (b) the principal focus will be placed on



operational results; and (c) the investment programs of the enterprises will take the form essentially of ceilings. If the enterprises' profits and their borrowing from outside the public sector, or both, fall short of initial projections, the Government would expect, and will accept, a lower level of investment than programmed. We have improved our monitoring of the operations of the SEEs and intend to continue to follow developments closely in what will be an important year of transition. As regards the financing of the SEEs, direct borrowing from the Central Bank will be restricted further in 1982; only one enterprise, the official wheat purchasing agency, will have direct access to central bank credit. In addition, budgetary transfers to the SEEs will be limited to LT 233 billion in March-December 1982, compared with an estimated LT 204 billion in March-December 1981. A timepath for the disbursement of these transfers has been agreed, and if at either the middle or the end of 1982 this is exceeded, the Government will consult with the Fund.

6. Proposed limits have been established on net domestic assets of the Central Bank and net central bank credit to the public sector for the period January 1, 1982, to June 30, 1982. These are presented in the annexed table. Owing to difficulties in exporting two important agricultural commodities, net central bank credit to the Agricultural Cooperatives has had to be increased significantly in early 1982. As it will not be possible, in the first half of the year, to offset this fully by reducing credit to other borrowers, the proposed increase in the net domestic assets of the Central Bank is somewhat higher than would otherwise have been necessary. It is the Government's firm intention to hold the absolute increase in net domestic assets of the Central Bank in the second half of 1982 sufficiently below that proposed in the first half as to ensure that the rate of monetary growth for the year as a whole will be consistent, given the expected growth of real GDP, with a rate of inflation in the order of 25 per cent. In the drawing up of the credit program, an increase in net foreign liabilities of the Central Bank of about US\$250-300 million is assumed between end-December 1981 and end-June 1982. It is understood that if the change in net foreign liabilities were to differ significantly from projection, the Government will consult with the Fund.

7. The Government has continued to make considerable progress toward the elimination of external payment arrears, both via rescheduling operations and via some settlements in foreign exchange. As of the end of October 1981, arrears outstanding amounted to US\$321 million, compared with US\$785 million at end-June 1981 and US\$2,350 million at end-March 1980. Further progress has also been made in rationalizing the exchange system through the elimination of the multiple currency practices arising from the provisions for student transfers and the special rate applicable for the importation of fertilizer and pesticides. The Government reaffirms its intention to settle the remaining external payments arrears by June 1982, and to accumulate no new arrears during the remaining period of the stand-by arrangement.

8. The Government intends to continue its policy whereby the exchange rate for the lira is determined daily in the light of developments both in international currency markets and in domestic relative to foreign prices. Adherence to this policy, through its contribution to the maintenance of external competitiveness, is viewed as a cornerstone of our program to strengthen and restructure the Turkish economy.

Yours sincerely,

Kaya Erdem  
Minister of Finance

Turkey: Limits on the Net Domestic Assets of the Central Bank  
and on Net Central Bank Credit to the Public Sector 1/

(In billions of Turkish liras)

	Limits on	
	Net domestic assets of the Central Bank	Net Central Bank credit to the public sector <u>2/</u>
January-March 1982 <u>3/</u>	849	548
March 1982 <u>4/</u>	863	554
April-June 1982 <u>3/</u>	900	571
June 1982 <u>4/</u>	920	582

1/ The concepts used in calculating these limits and adjustments to be made are set forth in a separate technical memorandum. The limits will be reduced by the amount of any net cumulative disbursements of balance of payments support loans after May 25, 1979 which are not included in the foreign liabilities of the Central Bank or for which a corresponding deposit in a blocked account of the Central Bank has not been made or maintained in full.

2/ Net Central Bank credit to the public sector is defined as the net of all Central Bank assets and liabilities to all public sector entities comprising, inter alia, the Central Government, annexed budget, the Monopolies Administration, revolving funds, local authorities, and all State Economic Enterprises. Amounts of repayments of principal and interest in respect of the Central Government's and other public sector entities' external debt, which have not by the due date been deposited with the Central Bank, are also included in the Central Bank credit to the public sector.

3/ Average of last reporting date in each month.

4/ Average of each weekly reporting date during the month.