REPUBLIC OF TURKEY

PRE-ACCESSION ECONOMIC PROGRAMME 2004

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BOXES

ABBREVIATIONS

ADSL	Asymmetric Digital Subscribers Line
ARIP	Agricultural Reform Implementation Project
BAĞ-KUR	Social Security Organization of the Self-Employed
BEC	Classification of Broad Economic Categories
BMIS	Budget Management and Information System
BOTAŞ	Petroleum Pipeline Corporation
BRSA	Banking Regulation and Supervision Agency
CBRT	Central Bank of the Republic of Turkey
CCMS	The Central Census Management System
CPI	Consumer Price Index
CMB	Capital Market Board
DEM	Deutsche Mark
DIS	Direct Income Support
DİV-HAN	Divrigi Hekimhan Mining Industry and Trading Inc.
EBF	Extra Budgetary Funds
EIB	European Investment Bank
EMRA	Energy Market Regulatory Authority
ERASMUS	European Community Action Scheme for the Mobility of University Students
ESA 95	European System of Accounts 1995
EU-15	The EU Member Countries Before Enlargement on May 1, 2004.
EUR	Euro
FOE	Futures and Options Exchange
FX	Foreign Exchange
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GNP	Gross National Product
IAC	Investment Advisory Council
IACS	Integrated Administration and Control System
ICT	Information and Communication Technologies
IEA	International Energy Agency
IFRS	International Financial Reporting Standards
ILO	International Labour Organization
IMF	International Monetary Fund
ISE	İstanbul Stock Exchange
İŞKUR	General Directorate of Turkish Employment Agency
JPY	Japanese Yen

KBI	Black Sea Copper Works Company
MEDA	Euro-Mediterranean Partnership
MERNİS	Central Demographic Administration System
MNE	Ministry of National Education
NAIRU	Non Accelerating Inflation Rate of Unemployment
NUTS	Official Nomenclature of Territorial Units for Statistics
OECD	Organization for Economic Co-operation and Development
PEP	Pre-Accession Economic Programme
PETKİM	Petrochemical Corporation
PHARE	Poland and Hungary: Action for the Restructuring of the Economy
PNDP	Preliminary National Development Plan
PPI	Producer Price Index
PSSP	Privatization Social Support Project
R&D	Research and Development
R&TTE	Radio and Telecommunication Terminal Equipment
RDA	Regional Development Agency
SCT	Special Consumption Tax
SDIF	Savings Deposit Insurance Fund
SEEs	State Economic Enterprises
SEKA	Turkish Pulp and Paper Production Corporation
SIS	State Institute of Statistics
SMEs	Small and Medium Sized Enterprises
SPO	State Planning Organization
SSK	Social Insurance Institution
TCDD	Turkish State Railways
TDİ	Turkish Maritime Transportation Company
TEDAŞ	Turkish Electricity Distribution Company
TEKEL	General Directorate of Tobacco, Tobacco Products, Salt and Alcohol Enterprises
TFP	Total Factor Productivity
TGNA	Turkish Grand National Assembly
TL	Turkish Lira
TRA1	Bayburt, Erzincan and Erzurum Provinces
TRA2	Ağrı, Ardahan, Iğdır and Kars Provinces
TRB1	Bingöl, Elazığ, Malatya and Tunceli Provinces
TR52	Karaman and Konya Provinces
TR72	Kayseri, Sivas and Yozgat Provinces
TR82	Çankırı, Kastamonu and Sinop Provinces
TR83	Amasya, Çorum, Samsun and Tokat Provinces

TR90	Artvin, Giresun, Gümüşhane, Ordu, Rize and Trabzon Provinces
TSPAKB	The Association of Capital Market Intermediary Institutions of Turkey
TÜPRAŞ	Turkish Petroleum Refineries Corporation
UNIDO	United Nations Industrial Development Organization
USD	US Dollar
VAT	Value Added Tax
WPI	Wholesale Price Index
YKr	New Kuruş
YTL	New Turkish Lira

INTRODUCTION

The candidate countries submit their Pre-Accession Economic Programmes (PEP) to the European Commission as a part of the requirements emanating from the Pre-Accession Fiscal Surveillance Procedure, every year regularly. Turkey prepared its first PEP in October 2001. The PEP 2004 covers the recent economic developments as well as projections and forecasts for the period of 2005-2007[1].

The PEP 2004 presents the implemented economic policies and the process of structural transformation in terms of Copenhagen economic criteria and EU membership perspective.

Further improvement of the existing social policies and thereby an increase in the welfare of the society will be possible by achieving a permanent stability in the economy through continued implementation of the current macroeconomic policies. The proposed economic policies in this programme aim at attaining a sustainable growth rate performance, lowering the inflation to single digit levels permanently, ensuring convergence of the fiscal deficits and the public debt stock to the Gross Domestic Product (GDP) ratios towards EU averages, bringing the inter-regional development differences of Turkey to EU levels, and thereby letting the per capita income level of Turkey converge towards the EU averages. These targets, set in the framework of Maastricht and Copenhagen economic criteria, constitute the main perspective in the determination of economic policies during the EU accession period.

The fiscal policy presented in the PEP 2004 aims to have the public debt stock to GDP ratio fall towards the EU average and to decrease the fiscal deficits permanently, to contribute to attaining a sustainable high growth rate and to support a permanent fall in inflation rate under the framework of Maastricht criteria. The monetary policy aims to reduce inflation to the targeted levels primarily, and then to secure and maintain the price stability in the medium term. The floating exchange rate regime, which means the exchange rate is determined by the demand and supply conditions in the market, will be continued. The priority in incomes policy is to stay in conformity with the disinflation policy foreseen in the implemented macroeconomic programme in the short run. In the medium term, the incomes policy will be determined taking into consideration the price stability, productivity and profitability conditions.

With the implementation of economic policies foreseen in this programme, which covers the period of 2005-2007, the average annual GDP growth rate is expected to be around 5 per cent and inflation rate is expected to decrease to single digit levels.

The achievement of macroeconomic targets, particularly the growth and inflation rates, foreseen in the Programme and of a permanent stability environment in the economy will be possible with the implementation of structural reforms. Moreover, further improvements in the functioning of the market economy and attainment of a highly competitive economic structure are also closely related with the performance of structural reforms. The reforms, which have been implemented in meeting the

[1] The PEP 2004 has been prepared under the coordination of Undersecretariat of State Planning Organization with the contributions of Ministry of Foreign Affairs, Ministry of Finance, Ministry of National Education, Ministry of Health, Ministry of Transportation, Ministry of Agriculture and Rural Affairs, Ministry of Labour and Social Security, Ministry of Industry and Trade, Ministry of Energy and Natural Resources, Undersecretariat of Treasury, Undersecretariat of Foreign Trade, Central Bank of Republic of Turkey, Secretariat General for the EU Affairs, State Institute of Statistics, Privatization Administration, Capital Markets Board of Turkey, Turkish Competition Authority, Banking Regulation and Supervision Agency, Saving Deposit Insurance Fund, Telecommunications Authority, Energy Market Regulatory Authority and Council of Higher Education.

Copenhagen economic criteria, are also essential for the structural transformation in the economy. In this respect, the structural reforms will play a crucial role in continuation of a successful convergence process with the EU.

A restructuring of the public sector aiming at improving the efficiency, the Rule of Law, respect to human rights, transparency and participation in the public administration is targeted. The free market and competition-oriented strategies will be taken up seriously by privatization; thereby the significance of public sector in production of commodities will be reduced, while its regulatory and supervisory roles will be enhanced. Public services will be provided by local administrations in the context of decentralization, and hence the efficiency and productivity in the economy will increase. Moreover, restructuring the banking sector so as to meet the financing needs of the real sector, strengthening the role of regulatory institutions for a well functioning market mechanism, enhancing the role of private sector in the economy by creating a favorable investment environment for both domestic and foreign investments, and developing a highly competitive agriculture sector are among the other important targets foreseen in the programme. With the implementation of the structural reforms, reducing regional development gaps, minimizing the imbalances in education, health, and social security, and improving the quality of labour through various social policies are intended. Meanwhile, structural regulatory reforms in information and communication technologies and energy sectors are expected to contribute in opening these sectors to competition.

The Pre-Accession Economic Programme for 2004 consists of four chapters. In the first chapter, a summary of recent economic developments in the Turkish economy is given. The second chapter presents the main macroeconomic targets for the Programme period and the economic policies to be implemented in order to attain these targets. This chapter also includes a set of macroeconomic forecasts and projections of the baseline scenario and evaluates the risks that may arise in realising the baseline scenario and the impact of these risks on the main macroeconomic variables. The third chapter presents the policy framework for the attainment of a sustainable fiscal stance as well as the targets and projections for the budget and debt management during the programme period. This chapter also deals with the fiscal risks and assesses their impacts. The final chapter discusses in detail, the structural reforms to be implemented in order to attain a sustainable high growth environment, to strengthen the market economy and to enhance competitiveness.

1. RECENT ECONOMIC DEVELOPMENTS

1.1. Growth and Employment

Turkish economy, which contracted significantly after the financial crisis in 2001, has embarked on a steady growth path as a result of attained confidence environment in the markets due to macroeconomic stability that has been accomplished by implementation of the economic programme and structural reforms in determination together with the political stability acquired at the end of 2002.

Following the growth rate of 7.9 per cent achieved in 2002, the economy maintained its high growth performance in 2003 and grew by 5.8 per cent, in excess of the programme target. The growth in 2003 came from the recovery of domestic demand as well as the high performance observed in exports of goods and services. The high rates of value-added growth recorded in industry, commerce and transportation sectors were decisive in this development although there was a decline in the value-added of the agricultural sector due to cyclical effect. While value-added decreased by 2.5 per cent in agriculture, it increased by 7.8 per cent in industry and 6.7 per cent in services sectors.

In 2003, total final domestic demand, private fixed capital investments and total fixed capital investments increased by 6.5 per cent, 20.3 per cent and 10 per cent, respectively. The rate of increase in private sector machinery and equipment investments reached 46.1 per cent.

Table: 1. 1. Growth Rates and Demand Components

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

	Annual		By Quarters 2003				By Quarters 2004	
	2002	2003	I	II	III	IV	I	II
Agriculture	6.9	-2.5	2.0	-0.8	-0.6	-9.6	-7.5	3.4
Industry	9.4	7.8	8.8	4.2	9.1	9.2	10.3	14.9
Services	7.5	6.7	8.2	4.5	6.5	8.0	11.4	13.9
GDP	7.9	5.8	8.1	3.9	5.5	6.1	10.1	13.4
GNP	7.9	5.9	7.4	3.6	5.6	7.2	12.4	14.4
Total Consumption	2.5	5.6	6.9	2.3	5.2	8.0	9.9	13.6
Public	5.4	-2.4	-2.3	-2.0	-0.7	-4.2	2.4	-7.9
Private	2.1	6. 6	7.8	2.9	5.8	10.3	10.6	16.4
Gross Fixed Capital Formation	-1.1	10.0	11.7	6.3	3.0	19.2	52.6	51.7
Public	8.8	-11.5	-34.8	-14.6	-22.7	5.0	-11.3	-9.1
Private	-5.3	20.3	22.6	14.2	16.4	30.1	60.6	68.7
Total Final Domestic Demand	1.7	6.5	7.7	3.2	4.7	10.6	17.5	22.5
Total Domestic Demand	9.3	9.3	10.9	8.5	7.0	11.3	19.1	21.1

Source: SIS

The high growth performance observed in the economy since 2002 has further strengthened in the first half of 2004. In this period, GDP has recorded an increase of 11.9 per cent. The growth rate of value-added in both industry and services sectors realized as 12.7 per cent. Private sector fixed capital investment increased by 65.1 per cent, while private consumption increased by 13.5 per cent. In this period, the increase in private sector machinery and equipment investment was as high as 94.1 per cent. Total final domestic demand grew by 20.1 per cent in the same period. There was an increase of 13.1 per cent in exports of goods and services. As it was the case in 2003, the growth in 2004 mainly came from the high performance in exports of goods and services as well as private consumption and investment expenditures. Developments in recent years point out structural changes towards an enhanced market economy. The achieved high output increases in the economy have mainly come from private sector while public sector consumption and investment expenditures have shrunk due to tight fiscal policies being implemented.

Production indicators point out that the high growth observed in the economy is still continuing, though a considerable slowdown in growth rates was observed in the third quarter. According to the monthly industrial production index, following an increase of 13.3 per cent in the first half of 2004, industrial production recorded an increase of 8.8 per cent in the third quarter compared to the same period of the previous year. The increase in industrial production during the January-September period of 2004 was realized as 11.7 per cent. On the other hand, capacity utilization rate in the manufacturing industry was 81.2 per cent on average in the January-October 2004 period.

Considering the developments in the labour market, it is observed that the continuing high growth trend since 2002 did not reflect itself in employment figures.

According to the results of the Household Labour Force Survey by the State Institute of Statistics (SIS), total employment declined by 1 per cent in 2003 compared with the previous year. Considering sectoral employment, a decrease of 3.9 per cent in agriculture and 2.7 per cent in industry sectors were observed, contrary to the increase in 0.7 per cent in construction and 2.1 per cent in services. The efforts to improve productivity in the industrial sector hindered employment growth despite the high rates of output growth.

Table: 1. 2. Developments in the Labour Market

	Annual		By Quarters					
			2003				2004	
	2002	2003	I	II	III	IV	I	II
Civilian Labour Force (Thousand Persons)	48,041	48,912	48,587	48,799	49,022	49,250	49,482	49,694
Labour Force Participation Rate (Per cent)	49.6	48.3	47.5	49.4	50.5	47.1	45.9	49.2
Employment (Thousand Persons)	21,354	21,147	20,244	21,696	22,411	20,811	19,902	22,188
Agriculture	7,458	7,165	6,639	7,731	8,389	6,799	6,412	7,820
Non-agriculture	13,896	13,982	13,605	13,965	14,022	14,012	13,490	14,368
Unemployment Rate (Per cent)	10.3	10.5	12.3	10.0	9.4	10.3	12.4	9.3

Source: SIS

The unemployment rate in Turkey rose to 10.5 per cent in 2003, increasing by 0.2 points compared with the previous year. Maintaining the same level as the previous year, the unemployment rate in the non-agricultural sectors was realized as 15 per cent. In 2003, the unemployment rate in urban areas was recorded as 13.8 per cent, decreasing by 0.4 points compared with the previous year. The unemployment rate in rural areas increased by 0.8 points and reached to 6.5 per cent. The unemployment rate among the young educated population declined from 29.1 per cent in 2002 to 27.8 per cent in 2003. At the same time, the labour force participation rate was 48.3 per cent in 2003, decreased by 1.3 percentage points from the previous year level.

In the second quarter of 2004, total employment in Turkey increased by 2.3 per cent compared to the same period of the previous year. Employment increases were recorded in all sectors during this period. These figures suggest that the recovery in the real sector has begun to show its effects on employment. It is observed that the limited increase in construction sector employment in 2003 continued by getting stronger in the first half of 2004. In this sector, employment increased by 6.7 per cent in the second quarter of 2004 while it increased by 7 per cent in the first quarter.

In the second quarter of 2004, the unemployment rate in Turkey fell down to 9.3 per cent, decreasing by 0.7 percentage points compared to the same period of the previous year. In the same period, the labour force participation rate maintained its previous year level of 49.2 per cent. However, the decline in the labour force participation rate for women in rural areas continues. This rate decreased by 3.4 percentage points and was realized as 39.1 per cent at the same period.

As stated in the 2003 Pre-Accession Economic Programme, the incomes policy is being implemented in line with the economic programme, which aims at reducing inflation. In this framework, wage and salary increases in the public sector are determined compatible with the inflation targets.

In 2003, net wages in the public sector increased by 26.9 per cent in nominal terms and by 1.3 per cent in real terms. In the same year, the salaries of civil servants increased by 24.2 per cent in nominal terms but decreased by 0.9 per cent in real terms. The minimum net wages were increased by 30 per cent in 2003, representing a real increase of 3.7 per cent.

1.2. Balance of Payments

Current Account Balance

The high rates of growth recorded since 2002 increased the demand for imports considerably and led to a deterioration in the current account balance. As a result, the current account deficit rose from 1.5 billion dollars in 2002 to 7.9 billion dollars in 2003. While the foreign trade deficit was 14 billion dollars, the services balance was in surplus of 10.5 billion dollars in 2003.

The deterioration in the current account balance continued in 2004 and a current account deficit of 10.6 billion dollars was recorded in the period of January to September.

Despite the real appreciation of the Turkish lira in 2003, exports increased at high rates due to low levels of labour costs, the decline in real energy prices and the a rise in productivity. Exports of goods increased by 31 per cent in 2003 and reached 47.3 billion dollars. The fact that export prices rose by an average of 11.9 per cent annual contributed to higher export revenues in this period. The change observed in the composition of Turkish exports since 2002 continued in 2003, as well. In addition to textiles sector, which traditionally has an important share in Turkish exports, the sectors of motor vehicles and electrical machinery and equipment increased their shares in exports.

The upward trend in exports continued during January-September period in 2004. In this period, exports increased by 32.3 per cent compared to the same period of the previous year and reached 44.8 billion dollars. During this period, considerable export increases were achieved in motor vehicles, electrical machinery and equipment, and iron and steel sectors.

Due to the strong domestic demand growth and real appreciation of the Turkish lira, total imports rose by 34.5 per cent in 2003 and reached 69.3 billion dollars. In the January-September period of 2004, imports continued to grow at an accelerated rate, reaching 70.2 billion dollars with an increase of 42.4 per cent compared to the same period of the previous year. The high rates of increases observed in industrial production in 2003 were reflected also in the imports of intermediate goods. Besides, the imports of investment goods and consumption goods also displayed high increases, especially from December 2003 onwards. The increases in industrial production and capacity utilization rates led to an acceleration in the imports of capital goods. Imports of consumption goods, particularly automobiles and consumer durables, were boosted by the fall in real interest rates as well as by the lower cost of consumer credit and the tax allowance for scrap cars.

The volume of trade between the European Union and Turkey indicates a significantly high level of EU-Turkey integration. Exports to the EU-15 countries increased by 32.6 per cent in 2003 and by 31.3 per cent in the January-September period of 2004 compared to the same period of the previous year. Imports from the EU-15 countries increased by 35.9 per cent in 2003 and 40.4 per cent in the January-September period of 2004. The fact that in 2003 the development of the euro/dollar parity in favor of the euro meant an increase in the dollar value of the trade with EU countries. As a result, Turkish exports to and imports from EU countries maintained their respective shares in total, and were realized as 54 and 47 per cent.

Table: 1. 3. Foreign Trade by Countries

(Million Dollars)

	Annual			January-September		
	2002	**2003**	**Percentage Change**	**2003**	**2004**	**Percentage Change**
Merchandise Exports	36,059	47,253	31.0	33,864	44,797	32.3
EU Countries	19,529	25,980	33.0	18,566	24,359	31.2
EU-15 Countries	18,459	24,484	32.6	17,554	23,055	31.3
New Member Countries	1,071	1,496	39.7	1,012	1,305	28.9
Other Countries	15,092	19,777	31.0	13,962	18,631	33.4
Turkish Free Zones	1,438	1,893	31.6	1,337	1,807	35.2
Merchandise Imports*	51,554	69,340	34.5	49,285	70,198	42.4
EU Countries	24,370	33,285	36.6	23,338	33,149	42.0
EU-15 Countries	23,321	31,696	35.9	22,078	30,993	40.4
New Member Countries	1,049	1,589	51.4	1,260	2,157	71.2
Other Countries	26,609	35,469	33.3	25,526	36,448	42.8
Turkish Free Zones	575	586	2.1	422	600	42.3

Source: SIS

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

Tourism revenues being the most important item of the services balance amounted to 13.2 billion dollars in 2003. Tourism revenues declined in the first half of the year during the war in Iraq and began to increase again in the second half of the year as the war came to an end and uncertainties diminished. In January-September period of 2004, tourism revenues increased to 12.6 billion dollars, representing a 20.5 per cent growth which was partly due to the base effect caused by regional uncertainties in the corresponding period of 2003.

The deficit of the income balance, which was 4.6 billion dollars in 2002, was realized as 5.4 billion dollars in 2003. The main determinant of this deficit was the high amount of interest payments. About two thirds of Turkey's long term interest payments, which were 4.3 billion dollars in 2003, were accounted for by interest payments made by the general government and the Central Bank. At the same time, portfolio investment expenditures, consisting of coupon payments related to borrowing instruments such as bonds and bills issued by the Treasury, of dividend payments related to shares purchased by foreigners and of interest on government domestic borrowing instruments, amounted to 2.6 billion dollars in 2003. In January-September period of 2004, the deficit of the income balance fell to 4.1 billion dollars, decreasing by 30 million dollars compared to the same period of 2003.

In 2003, current transfers amounted to 1 billion dollars, of which 729 million dollars were workers' remittances. In January-September period of 2004, current transfers increased by 4.5 per cent compared to the same period of the previous year and amounted to 791 million dollars. Compared to the previous levels, changes in methodology in 2003 and 2004 have been dominant in low realizations in current transfers item.

Capital and Financial Account Balance

Excluding the change in official reserves, the net capital inflow was 6.9 billion dollars in 2003. A significant part of the capital inflow was due to the increase in portfolio investments, short term loans used by banks and deposits held in domestic banks by foreign residents. The general government used a net amount of 1.4 billion dollars of International Monetary Fund (IMF) loans, while the net loan repayments by the Central Bank to the IMF was 1.5 billion dollars. Official reserves increased by 4 billion dollars. On the other hand, net errors and omissions was realized as 5 billion dollars in 2003. The reason behind the high realization of this figure can not be identified. However, conversion of foreign exchange holdings of residents into Turkish lira as a consequence of the reverse currency substitution by residents and factors like statistical errors related to the estimation of the various items of balance of payments are considered as the determinants of high realizations of this item.

Net foreign direct investments amounted to 1.1 billion dollars in 2003. During this year, an inflow of 1.6 billion dollars foreign direct investment was realized and 1 billion dollars of this amount was due to real estate purchases by non-residents. On the other hand, an outflow of 500 million dollars foreign direct investment was recorded.

Portfolio investments were realized as 2.6 billion dollars in 2003. Considering the sub-items, while purchases of securities abroad by domestic residents reached a net amount of 1.4 billion dollars, purchases of securities and government domestic borrowing instruments in Turkey by foreign investors amounted to 2.6 billion dollars in net terms. In 2003, the Treasury bond issued abroad amounted to 5.3 billion dollars and bond repayments were realized as 3.8 billion dollars.

Table: 1. 4. Balance of Payments

(Billion Dollars)

	Annual		January-September	
	2002	2003	2003	2004
Current Account	-1.5	-7.9	-4.5	-10.6
Balance on Goods	-7.3	-14.0	-9.7	-17.5
Exports	40.1	51.2	36.7	47.7
Exports (fob)	36.1	47.3	33.9	44.8
Imports	-47.4	-65.2	-46.4	-65.2
Imports (cif)	-51.6	-69.3	-49.3	-70.2
Balance on Services	7.9	10.5	8.6	10.2
Credit	14.8	19.0	14.6	18.2
Tourism (1)	8.5	13.2	10.5	12.6
Debit	-6.9	-8.5	-6.0	-8.0
Balance on Income	-4.6	-5.4	-4.1	-4.1
Credit	2.5	2.2	1.7	1.9
Debit	-7.0	-7.7	-5.9	-6.0
Interest payments	-4.4	-4.6	-3.4	-3.1
Current Transfers (2)	2.4	1.0	0.8	0.8
Workers' Remittances (1)	1.9	0.7	0.5	0.5
Capital and Financial Account				
Financial Account (inc. Reserves)	1.4	2.9	1.7	8.7
Foreign Direct Investment	0.9	1.1	0.7	1.6
Direct Investment Abroad	-0.2	-0.5	-0.3	-0.7
Direct Investment in Turkey	1.0	1.6	1.0	2.3
Portfolio Investment	-0.6	2.6	2.5	3.5
Assets	-2.1	-1.4	-1.1	-0.6
Liabilities	1.5	4.0	3.5	4.1
Equity Securities	0.0	1.0	0.6	0.7
Debt Securities	1.5	2.9	2.9	3.4
Other Investment	7.3	3.3	4.4	5.1
Assets	-0.8	-1.0	1.1	-4.1
Monetary Authority	0.0	0.0	0.0	0.0
General Government	0.0	0.0	0.0	0.0
Banks and Other Sectors	-0.8	-1.0	1.1	-4.1
Liabilities	8.0	4.3	3.3	9.1
Trade Credits	2.5	2.2	1.2	3.4
Loans	5.1	0.6	0.2	5.2
Monetary Authority	-6.1	-1.5	-0.7	-3.3
General Government	11.8	-0.8	-0.6	0.4
Banks	-1.0	2.0	0.9	3.5
Other Sectors	0.4	0.9	0.6	4.5
Currency and Deposits	0.4	1.4	1.8	0.4
Monetary Authority	1.3	0.5	0.4	-0.0
Banks	-1.0	0.9	1.3	0.5
Other Liabilities	0.0	0.1	0.1	0.2
Official Reserves	-6.2	-4.0	-5.8	-1.5
Net Errors and Omissions	0.1	5.0	2.8	1.8

Source: CBRT

(1) Definition of tourism revenues in the balance of payments account was changed in 2004 in a way to cover the domestic expenditures of Turkish citizens resident in foreign countries, and this change was reflected to 2003 figures as well. As a result of this change, tourism revenues of 2003 are revised upwards and worker remittances of 2003 are revised downwards.

(2) It was identified that a part of the inflows under the import with waiver item was actually provisional imports in the form of financial leasing while another part was actually not imports with waiver. In this framework, the necessary changes under the current account balance were made.

The other investments item in the capital and financial account was 3.3 billion dollars in 2003. The utilization of commercial loans by the non-banking private sector increased in parallel to the rise in the volume of imports in 2003. In this year, the banking sector used a net amount of 2 billion dollars short term loans but was in the position of a net repayer in long term loans. On the other hand, other sectors increased their utilization of long term loans along with the recovery in domestic fixed capital investments.

Despite the reduction in the interest rates of currency deposit accounts with credit letter and super foreign currency accounts of Turkish workers abroad in 2003, the introduction of 1-year time deposit accounts led to an increase in short term deposits at the Central Bank. As a result, despite a decrease of 275 million dollars in long term foreign currency accounts held at the Central Bank, there was a net increase of 772 million dollars in short term deposits. At the same time, deposits held in banks by foreign residents increased in 2003.

Excluding the change in official reserves, there was a total capital inflow of 10.2 billion dollars in the January-September period of 2004. In the same period, there were net inflows of direct investment in Turkey and portfolio investment amounting to 2.3 billion dollars and 3.5 billion dollars, respectively. In this period, trade credits extended abroad for exports led to a capital outflow of 609 million dollars, while short and long term commercial loans used for the financing of imports and investment by private sector amounted to 3.4 billion dollars. The tendency of the banking sector to utilize short term loans and the tendency of other sectors to utilize long term loans continued in this period. As a result of these developments, official reserves increased by 1.5 billion dollars and net errors and omissions was recorded as 1.8 billion dollars.

1.3. Monetary-Exchange Rate Policies and Capital Markets

Monetary Policy

In the framework of the programme introduced in 2001, the Central Bank started to follow a policy which is focused on future inflation and described as implicit inflation targeting, under the floating exchange rate regime. In this context, while the control of the Central Bank on short term interest rates increased, the base money was set as the nominal anchor of the programme to shape the expectations of economic agents. This strategy has been continued throughout 2003 and 2004.

The continuing fiscal discipline, the comprehensive structural reforms introduced and a tight monetary policy focused on price stability, favorably affected the inflationary expectations of economic agents and increased the confidence in the macro policies that were implemented. Significant falls in inflation, interest rates and exchange rates that occurred as a result of these developments necessitated the Central Bank to revise the monetary indicators and targets in certain periods. In this context, in 2003, taking increased money demand into account, the end-year base money targets were revised and the target for 2004 was set. In addition, as a result of the capital inflows and the ongoing reverse currency substitution, the Central Bank held foreign currency purchasing auctions, and consequently the programme target for the end of 2003 with regard to net international reserves was revised upwards and, likewise, new targets concerning net international reserves were set for 2004. In 2004, the performance criterion on net international reserves, indicative targets for net domestic assets, for the end of March and April were achieved while the another performance criterion, for base money was above the target level, as a result of increasing demand for Turkish lira. By the letter of intent dated 15 July 2004, the base money targets for the remaining period of the year were raised.

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

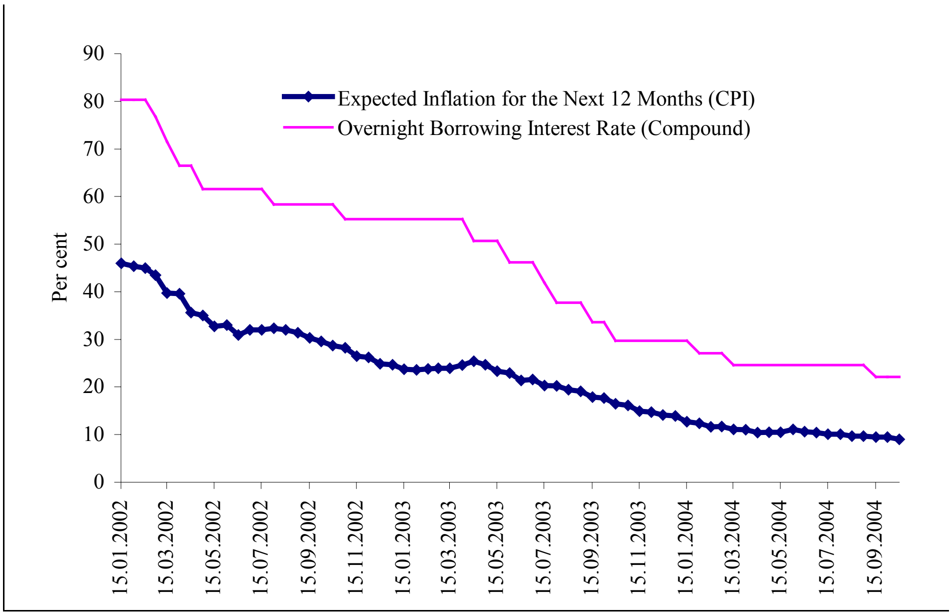
	Upper Limit for Monetary Base(1) (Trillion TL)		Upper Limit for Net Domestic Assets(1) (Trillion TL)		Lower Limit for Net International Reserves (Million Dollars)	
	Target	Realization	Target	Realization	Target	Realization
30 September 2003	14,100(P)	13,877	33,800(I)	22,968	-6,000(P)	1,504
31 December 2003	14,900(p)	14,657	28,400(I)	25,997	-2,000(P)	-536
31 March 2004	16,100(P)	16,948	29,600(I)	27,321	-2,000(P)	748
30 April 2004	17,500(P)	17,508	31,600(I)	26,076	-2,000(P)	1,791
31 August 2004	20,500(P)	19,301	34,600(I)	28,015	-2,000(P)	1,629
31 December 2004	20,900(P)	-	35,000(I)	-	-2,000(P)	-

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

The improvement in inflationary expectations and the ongoing reverse currency substitution caused a rapid growth of the base money during the mentioned periods. This growth of the base money points to a behavioural change in the money demand rather than the recovery in consumption demand. When the design of the implemented monetary programme and its policy instruments are taken into consideration, the expansions that occurred in the base money in excess of foreseen levels are not in contradiction with the implementation of a tight monetary policy. In this context, monetary aggregates are determined endogenously depending on the money demand and through its interest rates policy the Central Bank accompanies developments in the base money in such a way as not to be in conflict with the inflation target. Thus, the effectiveness of short term interest rates, which are the main monetary policy instrument, is also preserved through the strategy in question. Furthermore, real interest rates give important signals about the course of the monetary policy implementation. Although short term interest rates are on a downward trend, the high level of real interest rates indicates that the Central Bank is continuing to implement the tight monetary policies.

The Central Bank makes its interest rate decisions by taking possible developments in future inflation into account, with a view to the main aim of price stability. In this framework, overall supply-demand balance, developments in fiscal policy, public and private sector pricing behaviour, inflationary expectations, exchange rates and factors that may affect them and external shocks are taken into consideration for interest rate decisions. In this context, due to the decline in cost-push inflationary pressures as a result of the appreciation of the Turkish lira and the fall in oil prices following the end of the war in Iraq, the Central Bank decreased short term interest rates starting from the first quarter of 2003. Finally, due to the absence of a remarkable domestic demand pressure, continuing decline in inflationary expectations and confidence that the economic programme would be implemented in a long term perspective without deviating from fiscal discipline and structural reforms, the Central Bank overnight borrowing interest rate, which was 44 per cent in April 2003, was gradually reduced and, as of October 2004, brought down to the level of 20 per cent.

Figure: 1. 1. Short Term Interest Rates and Inflationary Expectations



Source: CBRT

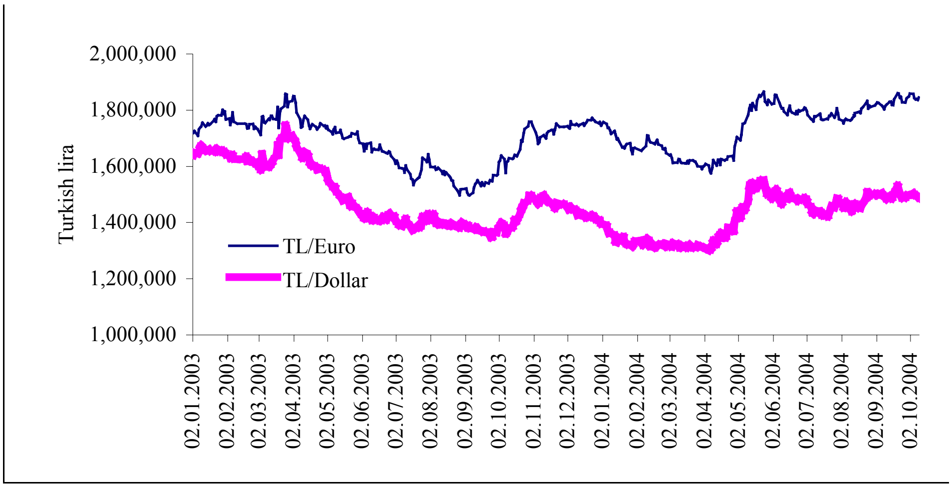
The Central Bank also attached importance to the strengthening of stability in the financial markets to allow effective implementation of policies focusing on price stability. In this direction, it introduced the government domestic debt instruments Lending Transactions Market in early 2003 as a step towards supporting the Primary Dealer System. Thus, while the opportunity to obtain additional return with low risk was created for banks willing to lend government domestic debt instruments, the obligations of the Primary Dealer banks on the borrowing side to give quotations in the secondary market were made easier. In addition, the fluctuations in the market due to the war in Iraq were quickly stabilized by providing liquidity in foreign exchange markets. Similarly, in the aftermath of the terrorist attacks that took place in İstanbul in November 2003, banks were provided with unlimited borrowing, and the lending rates were temporarily reduced to smooth out possible fluctuations in the markets.

Since 2003, no significant change has been made in the operational structure of monetary policy. Excessive liquidity in the market continued to be sterilized through reverse repo operations carried out in the repo and reverse repo market at the İstanbul Stock Exchange (ISE) in the framework of open market operations and Turkish lira deposit buying auctions in the interbank money market.

Exchange Rate Policy

Considering the developments in exchange rates, it is observed that the Turkish lira began to appreciate especially after April 2003 and has followed a relatively stable trend since then. Both the fact that the actual inflation figure for 2003 was lower than the target and the inflation target for 2004 is achievable, contributed significantly to achieve exchange rate stability. However, the uncertainties regarding the US monetary policy, developments concerning Cyprus and Iraq, the discussions during the reviews under the Stand-By agreement with the IMF and expectations regarding the continuity of the economic programme and the developments about Turkey's EU accession led to upward movements in exchange rates at certain times, albeit to a limited extent.

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



Source: CBRT

Under the floating exchange rate regime, exchange rates are determined under the market conditions. Where excessive fluctuations are observed in exchange rates in either direction, the Central Bank could intervene in the foreign exchange market in a limited manner. In addition, it holds foreign exchange buying auctions to build up its foreign exchange reserves in connection with the strong capital inflows and reverse currency substitution developments, but in such a way as not to affect the long term equilibrium of the exchange rate.

In this context, due to the increased supply of foreign exchange as a result of the reverse currency substitution following the end of the war in Iraq, daily foreign exchange buying auctions were launched on 6 May 2003, with a view to strengthening the international reserve position. However, due to the rise in exchange rates that started in late September as the consequence of both a decline in the excess supply of foreign currency and increasing foreign currency demand by some banks to adjust their accounts for the end of the year, foreign exchange buying auctions were suspended as of 23 October 2003. Observing a new increase in the excess supply of foreign currency, the Central Bank resumed its daily buying auctions on 23 January 2004. As the excess supply of foreign currency decreased once again, the buying and option amounts in foreign exchange auctions were reduced from 70 million dollars to 40 million dollars per auction starting from 14 April 2004 and suspended again as of 27 April 2004. As a result of these developments, the Central Bank bought 5.7 billion dollars of foreign currency in 2003 and 3.9 billion dollars in the first four months of 2004 through foreign exchange auctions.

Staying in conformity with the exchange rate policy declared in the programme, the Central Bank made direct foreign exchange buying interventions in 2003, once each in May, June and July and twice in September, with a view to preventing excessive volatility. In 2004, as a result of increased volatility due to positive expectations created by the developments concerning the Cyprus issue, the Central Bank made an intervention in the foreign exchange market for the first time on 16 February, in the form of direct buying. In May, due to the impact of internal and external developments creating anxiety in the markets, particularly expectations about US interest rates, and due to the contraction of foreign currency liquidity caused by the process of reverse currency substitution, sudden fluctuations were observed in foreign exchange markets. In response, the Central Bank made a direct foreign exchange selling intervention, in a very limited amount, on 11 May 2004. As a result of these developments, the Central Bank made direct foreign exchange purchases of 4.8 billion dollars in 2003 and 1.3 billion dollars in the first ten months of 2004.

Capital Markets

Improvements in macroeconomic indicators and especially the decrease in interest rates had a positive effect on the capital markets. The value of ISE National 100 Index in terms of dollar, rose by 131.8 per cent in September 2004 as compared with 2002. The market capitalization for all the companies listed in ISE, which has not been steady over time, went up from 33.8 billion dollars at the end of 2002 to 76.6 billion dollars as of September 2004.

Although government securities maintained their high share in total securities stock, the share of private sector securities in total securities stock, which was 8 per cent at the end of 2002, rose to 8.4 at the end of 2003 and to 9.8 per cent as of September 2004. The ratio of public sector securities stock to GDP was 55.5 per cent at the end of 2003 while the ratio of private sector securities to GDP was 5.1 per cent. Relative improvement in the economy has not affected private sector borrowing instruments yet and no private sector borrowing instrument was issued in 2003. It is expected that if the recovery and stability environment continues, then private sector borrowing instruments could be used to finance companies and they might create a good market for this purpose.

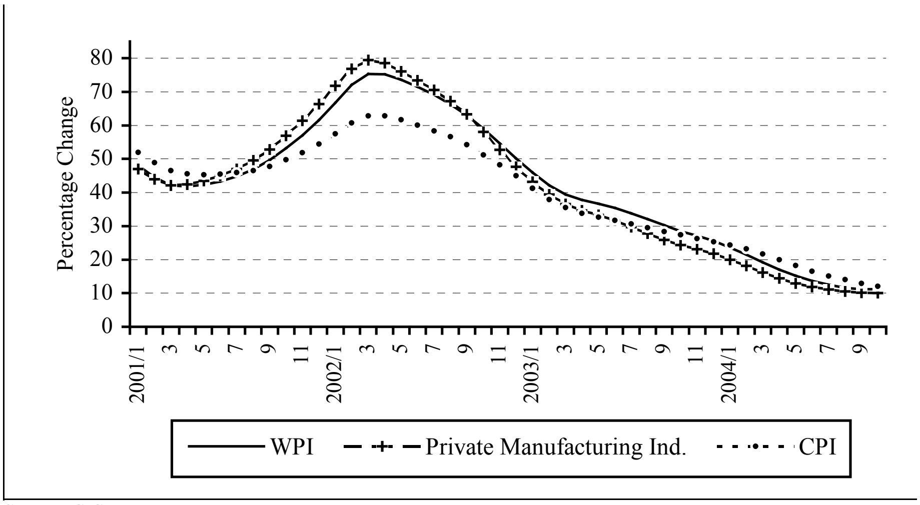
There are 305 joint stock corporations listed in the stock exchange under the registration of Capital Markets Board (CMB) as of September 2004. In addition, there are 33 investment trusts registered to the board for the same period. The number of investors in investment funds, which was 2,204,924 at the end of 2003, reached 2,617,412 as of September 2004 while the total value of net assets increased from 14.3 billion dollars to 16.2 billion dollars for the same period. The number of financial intermediaries in the capital market is 158 as of September 2004.

1.4. Inflation

At the end of 2003, the twelve-monthly inflation rates were 18.4 per cent in the Consumer Price Index (CPI) and 13.9 per cent in the Wholesale Price Index (WPI). Compared with 2002, the fall in inflation was 11.4 percentage points in the CPI and 16.9 percentage points in the WPI. The most important factors that contributed to this fall achieved in inflation are the increased confidence in the economy as a result of the strict monetary and fiscal policies that were implemented and therefore the steady decline in inflationary expectations. The incomes policy implemented under the programme was another factor that contributed to the decline in inflation. Also, the real appreciation of the Turkish lira and the relatively moderate increases in energy prices limited the rise in the cost of production and thus considerably contributed to the reduction in inflation rates. In addition, the decline in food and agricultural prices supported this process.

The downward trend of inflation continued in the first nine months of 2004. The annual rates of price increases dropped to single-digit figures in the WPI in February 2004 for the first time since 1970 and in the CPI in May 2004 for the first time since 1983. According to Central Bank surveys, the inflationary expectations (CPI) dropped for the first time to the level of the year-end inflation target in March and, in the following months, the inflationary expectations fell even below the target. The fall in inflationary expectations, the environment of increased competition and the monetary and fiscal discipline that was pursued limited the pass-through of cost increases to prices. With the floating exchange rate regime, this process also reduced the pass-through exchange rate fluctuations to the prices. In October, however, the WPI monthly rate of increase turned out to be higher than expected as a result of seasonal increases in agricultural product prices as well as the reflection of significant rises in the international commodity prices during the recent months to the public manufacturing industry prices. On the other hand, the fact that prices in the energy sector fell by 1.7 per cent in the first ten months of 2004 is another factor that contributed to the disinflation process. As a result of these developments, the WPI rate of increase was 12.8 per cent in the period of January to October 2004.

Figure: 1. 3. Price Developments (12 Monthly Average Percentage Change)



Source: SIS

The fact that the CPI monthly rates of increase remained below the target path during the first nine months of 2004 was mainly due to the increase in food prices by only 0.7 per cent and the fall in the prices of the clothing sub-sector by 5.7 per cent in the same period. In October, on the other hand, due to the reflection in the transport sector of the rise in oil prices as well as the increases in food and clothing prices, the monthly CPI increased more rapidly, although the overall figure remained within the programme target. However, it is observed that the price rigidity from the backward indexation behavior continued in the sector of services (housing, education, health care) during the period of January-October. As a result of these developments, the CPI rate of increase was realized as 7.2 per cent in January-October period of 2004. It is foreseen that the twelve monthly rate of increase in the CPI will be around 10 per cent at the end of 2004.

1.5. Public Finance

Developments in Consolidated Budget Revenues and Expenditures

The budget of 2003 was prepared in conformity with the main goal of ensuring the sustainability of the public debt stock through achieving a significant primary surplus. Within this scope, measures to increase revenues and to provide discipline on expenditures were continued as well as the structural regulations.

In 2003, Fiscal Reconciliation Law was adopted to liquidate the large number of disputed tax files by means of reduced penalties and interest and to eliminate outstanding problems between taxpayers and the tax administration. In addition, the funds and shares allocated out of excise duty revenues to organizations outside the general budget were reduced to zero; the excise duty on tobacco products and alcoholic beverages was raised; the periods the special transactions and special communications taxes were extended; certain exceptions and exemptions regarding the corporate tax were decreased; and the rate of the provisional corporate tax was increased to the rate of the corporate tax.

To achieve the budget targets of 2003, measures were taken to reduce expenditures as well as to increase revenues. The salary rises were determined in line with the inflation targets, and an upper limit of 35,000 was set for the number of new appointments of personnel by public institutions under the budget.

Table: 1. 6. Consolidated Budget Balance by Years

(Per cent of the GDP)

	2000	2001	2002	2003
Expenditures	37.7	45.5	42.2	39.0
Non-Interest Expenditures	21.3	22.5	23.5	22.7
Current Expenditures	10.9	11.4	11.0	10.7
Personnel	8.0	8.5	8.3	8.4
Other	2.9	2.9	2.7	2.3
Investment	2.2	2.7	3.0	2.0
Transfer	24.6	31.4	28.2	26.3
Non-Interest Transfer	8.2	8.4	9.5	10.0
Interest Payments	16.4	23.0	18.7	16.3
Revenues	26.7	28.8	27.2	27.9
General Budget	26.4	28.4	26.9	27.4
Tax Revenues	21.3	22.3	21.5	23.4
Non-Tax Revenues	2.8	4.2	3.9	2.8
Special Revenues and Funds	2.4	2.0	1.5	1.1
Annexed Budget	0.2	0.3	0.4	0.5
Primary Surplus	5.4	6.3	3.7	5.1
Budget Deficit	-11.0	-16.7	-15.0	-11.2

Source: Ministry of Finance

With a view to improving the financial balances of the social security institutions, the premium rate for the State Pension Fund was raised from 15 per cent to 16 per cent and the rate of premiums payable by persons with optional insurance of the Social Insurance Agency (SSK) was raised from 20 per cent to 30 per cent, but it was later reduced to 25 per cent in July 2004. Furthermore, in the Social Security Organization of the Self-Employed (BAĞ-KUR), a new system was introduced for the medical drug contribution share to be collected from members and to be deducted from the monthly pension. To curb the rapid increase in health expenditures, the average price system was introduced for members of the State Pension Fund and organizations in the scope of the general or annexed budget, whereby an average reference price is determined for every class of drugs and the difference between the actual price of a drug and its average reference price is paid by the pensioner or employee concerned or another drug at the same price range or a cheaper drug is used. However, this practice was ended in 2004 with regard to members of the State Pension Fund. New regulations were introduced for the prescribing of antibiotics, which have an important share in drug expenditures. A negative drug list was prepared to prevent the contribution by the institution concerning certain drugs and vitamins.

Differently from previous years, in 2003, the project amount to be financed by foreign project loans in kind and in cash were included in the initial investment allocations realistically, with the aim of enhancing fiscal discipline and transparency.

As a result of these developments, budget revenues and budget expenditures in 2003 were respectively, 27.9 per cent and 39 per cent of GDP, whereas the budget deficit was 11.2 per cent and the primary surplus was 5.1 per cent of GDP.

In 2004, the new budget classification was introduced in all organizations under the consolidated budget. The new system, called the Analytical Budget Classification, enables functional classification, international comparisons to be made, fiscal transparency to be enhanced, accountability to be improved, and those responsible for programmes to be identified through detailed institutional coding.

A serious of austerity measures were taken in 2004 to increase revenues and decrease expenditures with the aim of reaching the general government primary surplus target[2] under the implemented programme.

Measures to increase revenues:

- The collection of a fund levy at the rate of 10 per cent of the amount of income tax and corporate tax was ended at the beginning of 2004 by Law No.4842 of 9 April 2003 with the aim of reducing the tax burden on taxpayers. To compensate for the resulting loss of revenue, the corporate tax rate was raised to 33 per cent, for only 2004 earnings, by Law No.5035 published in the Official Gazette on 2 January 2004. In addition, certain rates of withholding for income tax were increased by Council of Ministers Decision No. 6577 of 10 December 2003.
- With the regulation introduced by Law No.5035 of 25 December 2003, the special communications tax was made permanent and its scope was extended to include some telecommunications services. Furthermore, the services provided by Turkish Telecom Inc. were also subjected to the special communications tax by Law No.5228 of 16 July 2004, but the transfer of a certain portion of its revenues to the Treasury was terminated.
- The special transactions tax was abolished by Law No.5035, taxation of some of the transactions that were subject to this tax was abandoned while taxation of some others was made permanent by including them within the scope of the stamp duty, the charges and fees, or the newly created tax on games of chance.
- The rates of Special Consumption Tax (SCT) on motor vehicles for transport of goods were increased.
- The SCT system on tobacco and alcoholic beverages was rearranged. In addition to the proportional SCT applicable to alcoholic beverages, the minimum fixed SCT amounts were determined and the requirement that the total duty payable can not be less than the fixed amount was introduced. As regards tobacco products, fixed SCT amounts were determined in addition to the existing proportional duty, and the principle was adopted that these two elements should be jointly applied to assess the total duty payable. As manufacturers set prices in such a way as to cause a loss of tax revenue, the proportional SCT on tobacco products was later reduced and the fixed amounts of SCT were differentiated and increased according to the types of tobacco contained in these products.

[2] The general government primary surplus agreed with the IMF is 5.5 per cent and the primary surplus of the total public sector including the State Economic Enterprises is 6.5 per cent.

- The system of taxation for motor vehicles was rearranged starting from the beginning of 2004. Weight ceased to be a criterion in the taxation of automobiles, minibuses, off-road vehicles and the like, and the principle of capacity was replaced by the principle of gross weight in the taxation of trucks, vans, tractors and similar vehicles.

In addition to these revenue-increasing measures, arrangements were made towards the implementation of tax policies which promote investment and employment, to the extent permitted by budgetary means. In those provinces where income per capita is 1,500 dollars or less, tax and social insurance premium subsidies and energy support were introduced with the aim of promoting employment. Economic double taxation on earnings abroad was lifted and R&D activities were encouraged with the aim of contributing to technological development and economic growth.

Inflation effect on taxation was removed through the introduction of inflation accounting system and financial tables were standardized in line with international norms.

Legal arrangements reducing the tax burden on corporate income from 65 per cent to 45 per cent were made.

Investment allowance system was rearranged and requirement for incentive documents was abolished.

The efforts that were started for the revenue administration to make use of possibilities offered by technological development in taxation are continuing. In this framework, work is under way to extend the automation of tax offices, to receive tax returns through the internet and to achieve automation in tax inspection.

Measures to decrease expenditures:

- The Budget Law of 2004 imposed an upper limit of 40,000 on the recruitment of new staff at governmental agencies included within the general or annexed budget.
- In 2004, the salaries and wages in the public sector were raised by 6 per cent in January and July, in line with the inflation target.
- Being effective from 1 March 2004, the rate of Value Added Tax (VAT) on medical drugs was reduced from 18 per cent to 8 per cent. Likewise, the rate of VAT on blood, blood products and serums was reduced from 18 per cent to 1 per cent. By the decree of 14 April 2004 on drug prices, the fall in exchange rates was reflected in drug prices.
- In addition, the same decree replaced the cost-based system of drug pricing, which was open to abuses, with a system reference price for each drug that takes the cheapest price in the EU countries as the reference and this allowed reductions of 1 per cent to 80 per cent in the prices of about 950 different drugs. This provided further decrease of 20 per cent on average in drug prices. Starting from 2 August, drug prices were increased by 8.7 per cent in parallel to the increase in exchange rate. As a result of these developments was a reduction of 25 to 30 per cent in average drug prices was achieved.
- The Budget Law of 2004 introduced the requirement of a Council of Ministers Decision for general and annexed budget agencies and revolving funds in

acquiring vehicles during the year, and provided that it is an extreme urgency and necessity.

- The connection of associations and funds with the public institutions was removed with the Law No.5072. It was prohibited for public institutions to provide resources to associations and funds in the form of appropriation, aid or in any other way.

Additionally, the gross minimum wage was raised by 38 per cent and increased from 306 million Turkish lira to 423 million Turkish lira in the January-June 2004 period. To reduce the impact of the increased minimum wages on the costs of employers a part of the premium contributions of employers was undertaken by the Treasury, however this implementation was ended in July 2004.

Table: 1. 7. Consolidated Budget Balance in the January-October Period

(Percentage Change)

	January-October		
	2002	**2003**	**2004**
Expenditures	36.6	26.2	7.5
Non-Interest Expenditures	59.7	34.3	14.9
Current Expenditures	56.1	27.6	12.6
Personnel	56.1	33.0	19.5
Other	55.8	5.9	-22.4
Investment	69.9	-7.9	-6.0
Transfer	28.8	28.1	6.2
Non-Interest Transfer	62.1	52.2	20.2
Interest Payments	18.0	17.4	-1.8
Revenues	49.9	30.1	19.5
General Budget	49.6	29.6	19.9
Tax Revenues	51.5	42.6	18.5
Non-Tax Revenues	50.4	-16.0	63.4
Special Revenues and Funds	28.1	-14.0	-55.1
Annexed Budget	72.1	60.5	-3.0
Primary Surplus	26.3	17.4	35.4
Budget Deficit	13.8	17.5	-22.6
Memo item:			
Rate of Increase in CPI (January-October Average)	48.6	26.7	10.8

Source: Ministry of Finance

Moreover, under Law No.5073 which entered into force on 28 January 2004, the social support payments made in 2003 were included in the benefits received from the SSK and the BAĞ-KUR, and these benefits were increased by 10 per cent as from the payment period of January 2004 and by another 10 per cent on the previous month as from the payment period of July 2004.

In order not to deviate from the primary surplus target, a deduction of 13 per cent was made from certain budgetary allocations with the aim of meeting the additional financing need due to the additional expenditures arising from the pension increase above the foreseen level and from the Treasury contribution towards the premium payable by employers.

As a result of these developments, while the expenditures in the period of January to October 2004 were 120.9 quadrillion Turkish lira, the revenues amounted to 96 quadrillion Turkish lira and the budget deficit was realized as 24.8 quadrillion Turkish lira. These figures represent an increase of 7.5 per cent in expenditures and 19.5 per cent in revenues compared with the same period of the previous year. High increases in indirect taxes due to high economic growth where effective in the increase of general budget tax revenues by 18.5 per cent. State bank dividends and interest, receipts played an important role in the increase of non-tax revenues. As a result, the primary surplus reached 24.3 quadrillion Turkish lira in the period of January to October 2004.

Developments in the Revenues and Expenditures of the General Government

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

Table: 1. 8. Revenues and Expenditures of the General Government

(Per cent of the GDP)

	2000	2001	2002	2003
Taxes	25.5	27.1	24.0	25.6
Direct	10.0	10.7	8.1	8.0
Indirect	15.1	16.0	15.5	16.7
Wealth	0.4	0.4	0.5	0.9
Non-Tax Revenues	3.0	2.5	3.3	3.1
Factor Incomes	4.9	6.3	7.4	6.4
Social Funds	6.6	7.4	6.9	7.4
Total	40.0	43.2	41.6	42.6
Privatization Revenue	1.5	0.9	0.2	0.1
Total Revenues	41.6	44.1	41.8	42.7
Current Expenditures	17.3	18.2	18.1	17.9
Investment Expenditures	4.6	4.8	4.6	3.7
Fixed Investment	4.5	4.7	4.6	3.7
Change in Stocks	0.0	0.0	0.0	0.0
Transfer Expenditures	29.5	37.0	32.6	31.1
Current Transfers	27.9	35.8	31.6	30.5
Capital Transfers	1.6	1.2	1.0	0.6
Stock Revaluation Fund	0.0	0.0	0.0	0.0
Non-Interest Expenditure	34.4	36.3	36.1	36.0
Total Expenditures	51.4	60.0	55.3	52.8
Borrowing Requirement Excluding Interest Payment	-7.1	-7.8	-5.7	-6.7
Borrowing Requirement	9.8	15.9	13.6	10.1

Source: SPO
(+) refers to deficit and (-) refers to surplus.

In 2002, the ratio of the total revenues of the general government to GDP was 41.8 per cent. In 2003, despite the fall of 1 percentage point in factor incomes, this ratio increased by 0.9 percentage points and reached 42.7 per cent, especially with the impact of one-off measures that were taken. In the same year, the ratio to GDP of the tax revenues, which represented 60 per cent of the total revenues of the general government, increased by 1.6 percentage points in comparison with 2002 and rose to the level of 25.6 per cent. The increase in indirect taxes and wealth taxes were decisive in this rise. The fall in nominal interest rates and the limited increase of wages were the main causes of the decrease in direct taxes.

The total expenditures of the general government, which were 55.3 per cent of GDP in 2002, dropped to 52.8 per cent in 2003 due to the fall in consolidated budget interest payments. It is observed that the ratio of non-interest expenditures to GDP was realized as 36 per cent in 2003 at the same level of 2002.

As a result, the ratio of the general government borrowing requirement to GDP, which was 13.6 per cent in 2002, declined to 10.1 per cent in 2003. The borrowing requirement excluding interest payments was in a surplus of 5.7 per cent of GDP in 2002 and this ratio increased to 6.7 per cent in 2003.

Box: 1.1. Adjustments in General Government Balances in the Context of Fiscal Notification

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

While preparing the fiscal notification tables,

- The revenues and expenditures of fund and revolving funds which must be covered by the consolidated budget according to the EU definition are included into the consolidated budget,
- Revenues and expenditures (duty losses of the state banks, etc.) which are defined as such in the ESA 95 rules but which were not included in the consolidated budget deficit are added to the budget; and accounts which do not comply with the definition of revenue (privatization, profits of the Central Bank, issues of Treasury coins, etc.) or expenditure (risk account) but which are included in the consolidated budget are eliminated from the budget,
- Revenues and expenditures which are reported in the consolidated budget on a cash basis are changed to the required values on an accrual basis. For example, the assessment and collection periods differs, particularly for taxes on income. The assessment and collection periods for taxes on goods and services and for non-tax revenues do not differ significantly in general. Therefore, an adjustment is made to correct for assessment and collection differences
- Interest expenditures on the public debt stock are calculated on an accrual basis and allocated to the year to which they are belong.

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

(Per cent)

	2000	2001	2002	2003
General Government Borrowing Requirement/GDP	9.8	15.9	13.6	10.1
General Government Borrowing Requirement/GDP (in accordance with the fiscal notification)	6.1	29.8	12.6	8.8

Source: Ministry of Finance, State Planning Organization, The Undersecretariat of Treasury

Public Debt Stock

The additional costs imposed by the increase in the financing requirement of the budget and by the restructuring of the banking system, whose structure had further deteriorated due to the impact of the crises in November 2000 and February 2001, led to considerable increases in the domestic debt stock in 2001. Furthermore, as a result of the shrinkage of the economy and the increase in the foreign currency denominated debt stock, due to the considerable devaluation of the Turkish lira during the crisis, the ratio of the general government gross debt stock to GDP rose from 65.4 per cent in 2000 to 102.6 per cent in 2001.

In the following years, the strict implementation of the economic programme favorably affected the markets. With political stability and fiscal discipline achieved and with the impact of the borrowing strategy implemented, the ratio of the general government gross debt stock to GDP fell by 13.1 percentage points compared to 2001 and realized as 89.5 per cent in 2002 and fell by 9.3 percentage points compared to 2002 and realized as 80.2 per cent in 2003.

Table: 1. 9. General Government Gross Debt Stock

(Per cent of the GDP)

	2000	2001	2002	2003
		General Government		
Domestic Debt	42.0	69.3	54.7	54.8
External Debt	23.4	33.3	34.8	25.4
Total General Government	65.4	102.6	89.5	80.2

Source: SPO

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

The consolidated budget domestic debt stock, which was 149.9 quadrillion Turkish lira at the end of 2002, rose to 194.4 quadrillion Turkish lira at the end of 2003 and to 225.6 quadrillion Turkish lira at the end of October 2004. Thus, the ratio of the domestic debt stock to GDP at the end of 2003 sustained its 2002 year end level around 54 per cent. The domestic debt stock at the end of December 2003, consisted of 67.1 per cent of cash securities and 32.9 per cent non-cash securities, and of 21.9 per cent in foreign currency denominated and foreign currency indexed instruments, 42.8 per cent in floating rate instruments and 35.3 per cent in fixed rate instruments. The composition of domestic borrowing has been changing in favor of fixed rate instruments and the share of the non-cash domestic debt stock in the total debt stock has been gradually falling. This trend continued also during the first ten months of 2004.

Table: 1. 10. Consolidated Budget Domestic Debt Stock Composition by Instruments

	2000	2001	2002	2003	2004 Oct.	2000	2001	2002	2003	2004 Oct.
	At Current Prices Quadrillion Turkish Lira					Percentage Distribution				
Cash	29.6	58.4	89.3	130.5	162.6	81.3	47.8	59.6	67.1	72.1
Fixed Rate	19.4	17.7	37.6	68.6	90.9	53.3	14.5	25.1	35.3	40.3
Floating Rate	9.0	11.4	17.4	29.1	37.2	24.7	9.4	11.6	15.0	16.5
FX Denominated	1.2	7.1	16.5	16.8	25.5	3.3	5.8	11.0	8.7	11.3
FX Indexed		22.1	17.8	16.0	8.9		18.1	11.9	8.2	4.0
CBRT (IMF Credits)		13.8	9.7	8.5	4.9		11.3	6.5	4.4	2.2
Swap		7.7	7.6	7.5	4.0		6.3	5.1	3.8	1.8
Others		0.5	0.5	0.0	0.0		0.4	0.3	0.0	0.0
Non-Cash	6.8	63.8	60.6	63.9	63.0	18.7	52.2	40.4	32.9	27.9
Fixed Rate	1.0	0.0	0.0	0.0	0.0	2.7	0.0	0.0	0.0	0.0
Floating Rate	4.0	49.5	46.7	54.1	53.8	11.0	40.5	31.2	27.8	23.8
FX Denominated	1.8	12.4	11.9	7.9	7.5	4.9	10.2	7.9	4.1	3.3
FX Indexed		1.9	2.0	1.9	1.7		1.6	1.3	1.0	0.8
Total Stock	36.4	122.2	149.9	194.4	225.6	100	100	100	100	100

Source: The Undersecretariat of Treasury

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

The composition of the domestic debt stock by lenders changed substantially and the domestic debts owed to public institutions increased to 66 per cent of the total debt stock at the end of 2001. As a result of the repayment of non-cash securities of state banks through borrowing from the market, the share of the domestic debt owed to public institutions in the total stock fell to 52.8 per cent and 47.7 per cent, at the end of 2002 and 2003 respectively, while the share of debt owed to the market increased. This trend continued also in the first ten months of 2004.

Table: 1. 11. Domestic Debt Stock Composition by Lenders

	2000	2001	2002	2003	2004 Oct.	2000	2001	2002	2003	2004 Oct.
	At Current Prices, Quadrillion Turkish Lira					Percentage Distribution				
Total	36.4	122.2	149.9	194.4	225.6	100	100	100	100	100
Public	12.2	80.6	79.1	92.6	85.5	33.5	66.0	52.8	47.7	37.9
CBRT	1.5	18.8	18.4	18.4	18.4	4.1	15.4	12.3	9.5	8.2
State Banks	2.9	22.7	24.3	27.2	27.5	7.8	18.6	16.2	14.0	12.2
SDIF Banks	3.9	15.1	11.0	15.1	9.1	10.6	12.3	7.4	7.7	4.0
CBRT (IMF Credits)	0.0	13.8	9.7	8.5	4.9	0.0	11.3	6.5	4.4	2.2
Other	4.0	10.2	15.7	23.4	25.6	11.0	8.4	10.5	12.1	11.4
Market*	24.2	41.6	70.8	101.8	140.1	66.5	34.0	47.2	52.3	62.1

Source: The Undersecretariat of Treasury

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

The annual compound interest rate on Turkish lira denominated government domestic borrowing instruments in cash decreased from 95.3 per cent in July 2001 to 72.5 per cent in July 2002. Interest rates, which declined following the optimism observed in the markets due to the decrease in political uncertainty in the aftermath of the early elections held on 3 November 2002, began to rise again due to the impact of the uncertainty concerning Iraq. After the war ended, interest rates resumed their downward trend and went down to 28.5 per cent at the end of 2003 as the resolutely implemented economic programme began to generate its positive results. Interest rates, sustaining their downward trend during the early months of 2004, went up in April and May as a result of the uncertainty on the eve of the referendums held in Cyprus and the US Federal Reserve statement concerning an interest rate increase. In June, interest rates declined to their levels at the beginning of the year as the volatility effects from external markets in particular were reduced, the activities to review the economic programme were completed and the positive expectations regarding the EU accession became stronger.

As of the end of December 2003 and September 2004, the real interest rate of the domestic debt stock, which reflects the weighted average of real returns (including exchange rate fluctuations) calculated separately on cash and non-cash securities making up the domestic debt stock, was calculated as 11.9 per cent and 11.7 per cent , respectively.

The average maturity of Turkish lira cash borrowings, which was 8.5 months in 2002, rose to 10.4 months in 2003. In January-October period of 2004, it increased to 13.2 months on cumulative basis.

Due to the fall in the ratio of long term non-cash bonds in total debt stock, the stock's average period to maturity fell from 32.1 months at the end of 2002, to 25.1 months at the end of 2003 and to 21 months at the end of October 2004.

In 2002, the ratio of medium-long term debt to the total external debt stock increased to 87.4 per cent while the ratio of short term debt decreased to 12.6 per cent. The share of medium-long term debt in the total external debt stock has been decreasing since 2002 and realized as 5 percentage points below the 2002 level as of June 2004. The share of short term debt rose by the same amount.

In 2001, the share of international organizations in the external debt stock increased by about 10 percentage points compared to the previous year, while the share of other organizations and banks decreased. Similar developments continued in 2002 and 2003, though to a lesser extent.

Table: 1. 12. The Structure of Total External Debt Stock

	Million Dollars					Percentage Distribution				
	2000	2001	2002	2003	2004 June	2000	2001	2002	2003	2004 June
Maturity Composition										
Total	118,804	113,899	130,350	145,797	148,213	100	100	100	100	100
Short-Term	28,301	16,403	16,424	23,013	26,097	23.8	14.4	12.6	15.8	17.6
Medium-Long Term	90,503	97,496	113,926	122,784	122,116	76.2	85.6	87.4	84.2	82.4
By Lender										
Total	118,804	113,899	130,350	145,797	148,213	100	100	100	100	100
Multilateral Organizations	11,397	22,062	30,829	33,470	32,126	9.6	19.4	23.7	23.0	21.7
Government Institutions	8,681	8,564	9,288	9,448	8,844	7.3	7.5	7.1	6.5	6.0
Commercial Banks	44,691	35,295	33,717	37,024	39,572	37.6	31.0	25.9	25.4	26.7
Other Private Creditors	54,036	47,978	56,516	65,855	67,671	45.5	42.1	43.4	45.2	45.7
Currency Composition										
Total	118,804	113,899	130,350	145,797	148,213	100	100	100	100	100
USD	64,592	57,536	61,120	66,521	73,140	54.4	50.5	46.9	45.6	49.3
DEM	23,147	826	0	0	0	19.5	0.7	0.0	0.0	0.0
JPY	7,447	5,176	5,312	4,517	3,894	6.3	4.5	4.1	3.1	2.6
EUR	14,832	34,187	39,863	48,603	46,933	12.5	30.0	30.6	33.3	31.7
Other	8,786	16,174	24,055	26,156	24,246	7.4	14.2	18.5	17.9	16.4

Source: The Undersecretariat of Treasury

2. MACROECONOMIC FRAMEWORK

Main Objectives of the Macroeconomic Policy

Increasing welfare of the society will continue to be the main objective of the economic policy during the period of 2004-2007. To this end, along with strengthening macroeconomic stability, further improvement of the current social policy implementations will be possible.

The main perspective in determining economic policy in the process of EU accession, is the further improvement of the economic structure in the context of Copenhagen economic criteria, with an ultimate aim of achieving convergence towards the Maastricht criteria. The basic priorities of Turkey's macroeconomic policies during PEP 2004 period, are to reduce inflation permanently, to bring the ratio of the public deficits and public debt stock to GDP closer to the EU averages and to establish a sustainable growth environment in the economy, as it was the case during the PEP 2003 period.

At the same time, strengthening the market economy and increasing the competitiveness of the economy will continue to be prior targets. In this context, reducing the role of the state in the economy through privatization, transferring the function of market regulation to independent regulatory authorities, strengthening private entrepreneurship, and eliminating legal obstacles and economic uncertainties that have a negative impact on the functioning of the free market, are of special importance. Reducing the development gaps among regions and between Turkey and the EU, minimizing the imbalances in education, health, and social security and improving the quality of labour are the other priority subjects of the ongoing economic policies.

Emphasis will be given to increasing the dialogue with the EU in the process of setting and implementing macroeconomic policies.

Fiscal Policy

The main objectives of the fiscal policy implemented since 2001, have been to secure a permanent reduction in the ratio of the public debt stock to national income and in the public deficits, to achieve a balanced budget structure, to contribute to the establishment of a sustainable growth environment, and to support the fight against inflation. These objectives will continue to shape the framework of the fiscal policy during the period of 2004-2007.

In this context, tight fiscal policies to maintain the fiscal discipline, like achieving significant primary surplus in line with sustainable debt stock at first hand, will be continued during the 2004-2007 period like previous years. Thus, efforts to widen the tax base and reduce the unregistered economy will continue, with the aim of increasing tax revenues. Furthermore, in the context of public expenditure reform, saving and efficiency considerations will be the priorities in the determination of public expenditures.

Monetary and Exchange Rate Policy

The main objective of the Central Bank has been determined as ensuring price stability. In this context, monetary policy is being conducted with a view to reducing inflation to the target levels in the short term and to achieving and maintaining price stability in the medium term.

Important achievements have been obtained in the disinflation process in the recent years. The Law on Central Bank which was put into force in 2001 has played an important role in the disinflation process by making the price stability the primary objective of the Central Bank and securing the independence of the Central Bank in conducting an autonomous monetary policy. To enhance these achievements further it has utmost importance to strengthen the administrative structure of the Central Bank as well as its independence.

A permanent reduction in chronic inflation will bring a considerable progress regarding the convergence towards the EU averages, during the process of EU accession. The continuation of this convergence and thereby, bringing inflation closer to the EU average are targeted during the PEP 2004 period.

The Central Bank has been implementing an implicit inflation targeting regime, in order to achieve these targets. Furthermore, once the necessary pre-conditions are met, the Central Bank will shift to formal (explicit) inflation targeting policy.

In addition, the floating exchange rate regime will continue to be implemented during the period ahead. The exchange rate will be determined by supply and demand conditions in the market, however, the Central Bank may intervene against excessive fluctuations without affecting the long term level of the exchange rate.

Incomes Policy

Incomes policy maintains its importance for the success achieved in the fight against inflation to be permanent and for the continuation of the downward trend in inflation. It becomes more important when the rapid recovery in domestic demand over the last two years is taken into consideration, in particular. In this direction, incomes policy will continue to be determined in line with the inflation targets in order to support the policy of fighting against inflation in the short term. However, the significant productivity increases that have taken place in recent years in the economy stand as another factor that needs to be taken into account. Therefore, incomes policy is targeted to be determined considering the parameters of price stability, productivity and profitability, in the medium term. In the framework of the implemented economic programme, forward indexation policies will be continued in the public sector wage policy. The government will continue to use the Economic and Social Council and similar platforms, to secure consensus among the social partners with the aim of ensuring that the private sector also follows a wage policy in conformity with the inflation target.

Structural Reform Policies

Structural reforms play an important role in reaching the foreseen targets and achieving permanent macroeconomic stability. Through the structural reforms that have been implemented since 2000, considerable progress has been made towards establishing a sustainable growth environment and creating a highly competitive economy based on market rules. The basic goal is to develop this economic structure further through the structural reforms to be implemented during PEP 2004 period.

In this context, it is aimed to strengthen the market mechanism and further increase the role of the private sector in the economy, to develop a financial sector that will effectively provide the necessary resources for the real sector, and to improve the quality of the labour supply. In addition, reforms are being continued in the administrative field, with the aims of making public services more efficient, preventing waste of resources, and withdrawing the public sector from production in certain areas and strengthening its regulatory and supervisory role in the market. Furthermore, structural reforms are in progress to improve productivity and competitiveness in the agricultural sector and to secure efficient use of resources in this sector. Along with the improvements to be achieved in public finances, the share of education, health, R&D and social expenditures will be increased, in order to raise the quality of life in the society, to improve human capital, to fight against poverty, to improve income distribution and to reduce the regional development gaps.

External Factors

The growth rate of the world economy, which remained below its long term rate in 2002, began to accelerate in the second half of 2003. It is foreseen that the growth rate of the world economy will rise above its historical average and realize as 5 per cent, in 2004. This is due to rapid growth in the industrialized countries and in the emerging economies, China in particular. However, the expectations of growth for 2005 are brought down, by the fact that oil prices increased by a high rate in the recent period and growth has begun to lose its momentum particularly in the USA, Japan and China. In this context, it is estimated that world output will grow by 4.3 per cent annually in the period of 2005-2007. In parallel to developments in growth, the world trade volume, which is expected to grow by 8.8 per cent in 2004, is projected to grow by 7.2 per cent in 2005, and by 6.6 per cent in 2006 and 2007.

The assumptions concerning the world economy that are used in the macroeconomic analyses and forecasts of the Pre-Accession Economic Programme are based on the latest forecasts made by organizations such as the European Commission, the IMF and the Organization of Economic Cooperation and Development (OECD).

Within this framework, it is assumed that growth in the EU-15 countries, which account for more than 50 per cent of our exports, will be around 2 per cent in 2004, rise to 2.4 per cent in 2005, and reach the potential level of 2.5 per cent in 2006 and 2007.

The import demand growth rate of developing countries was 11.1 per cent in 2003 and is forecast to be 12.8 per cent and 11.9 per cent, in 2004 and 2005, respectively. It is predicted that the import demand of developing countries will grow by 9.1 per cent during the period of 2006-2007. The growth of world import price index rate that was 8.8 per cent in 2003, is assumed to be 6.4 per cent and 0.7 per cent for 2004 and 2005, respectively and 1 per cent for 2006-2007 period.

Oil prices, which shows an upward trend since the end of 2002 due to the impact of the war in Iraq, were realized as 27 dollars per barrel on average, in 2003. As the upward trend of oil prices is continuing, the barrel price of oil is taken to be 36 and 40 dollars, respectively, for 2004 and 2005. On the other hand, it is assumed that there will be a limited decrease in oil prices in 2006 and 2007.

The euro/dollar parity is estimated as 1.25 for 2004 and 1.24 for 2005 by the EU Commission. Considering also that the euro/dollar parity, which was around 1.23 on average during the first ten months of the year, is close to the estimates of the EU Commission, the euro/dollar parity is taken to be 1.25 for 2004 and 1.24 for the period of 2005-2007.

2.1. Growth and Employment

Following the severe crisis in 2001, the Turkish economy has entered into a process of recovery starting in the first quarter of 2002. Fighting against inflation, improving the public financial balances, and eliminating the structural problems have continued to be the policy priorities in this period. As a result of rigorous implementation of the programme, stability and predictability in the Turkish economy has considerably increased and the targets have been approached significantly.

It is accepted that tight monetary and fiscal policies generally have restrictive effects on growth. However, it is also known that in countries with a high debt stock and high inflation, policies to improve public balances and to reduce inflation, improve future expectations, reduce the risk premium and therefore increase growth. As a matter of fact, the strict monetary and fiscal policies implemented over the last three years have had no restrictive effects on growth in the Turkish economy, on the contrary, they have actually paved the way for growth by raising confidence in economic policy.

For the period of 2005-2007, no significant changes are foreseen in the priorities and framework of economic policy. It is therefore considered that the positive effects of commitment to the same policy framework, will continue during this period. It is foreseen that the ratio of the debt stock to national income will thus continue to fall, that disinflation and economic stability will become permanent, and that the increase of social expenditures and investments as well physical investments will contribute to growth.

In 2004, the Turkish economy has been displaying an exceptionally high growth performance. One of the most important reasons for this performance is the fact that expectations have changed permanently in a positive direction. After the 2001 crisis, inflation has been on a steady downward trend and come close to single-digit levels as of 2004. At the same time, starting from the first quarter of 2002, high growth figures have been achieved without interruption over a period of 10 quarters. There are indications that the Turkish economy has been freed from the structure displayed since the 1990s, which is characterized by boom-bust cycles, and has embarked on a high-growth process based on productivity increases.

Along with increased predictability in the economy, the fact that interest rates have fallen to relatively low levels has made it possible to overcome the psychological obstacles against investment, and considerable increases have been recorded in private sector fixed capital formation. The fall in interest rates has lead to increases in private consumption through consumer loans. In addition, factors such as the scrapped car allowance introduced for new car sales, a real increase in minimum wages, and the interest payments made to employees on forced saving accounts, as well as the appreciation of the Turkish currency in real terms and postponed consumption, have led to significantly high rate of increases in private consumption. In addition to the increase in domestic demand, the continuation of the high export increases since 2001, has raised growth to a considerably high level. As a result of all these developments, it is predicted that the economy will grow by around 10 per cent in 2004.

For the period of 2005-2007, it is foreseen that output will move around its potential level and that GDP growth will be around 5 per cent on average, which is the potential growth rate. The most important sources of growth during this period are expected to be increases in private investment and exports. On the other hand, the continuation of tight fiscal policy and the fact that no considerable increase is foreseen in the real incomes of employees due to the design of incomes policy in accordance with the inflation target, will be factors that restrict consumption in the period of 2005-2007. In addition, the abolishment of the scrapped car allowance, which is now reduced by half, completely at the end of 2004, and the increased excise duty on car sales will slow down the demand for automobiles. The fact that postponed consumption has largely been realized in 2004, will be another factor to slow down consumption in the periods ahead. It is expected therefore that consumption will contribute less to growth during the period of 2005-2007.

It is foreseen that in the period of the 2004 Pre-Accession Economic Programme, fixed capital investments will support export growth by increasing the production capacity and that the high performance of exports will continue. This forecast is supported by the increases of investment observed in the exporting sectors, in 2004. It is expected that the increases of labour productivity achieved in recent years will continue as a result of high renovation investments. Therefore, it is expected that the competitive advantage in exports due to labour productivity will be maintained.

The positive effects of structural reforms on the economy have begun to be observed starting from 2004. Through the arrangements made, factors preventing competition in many sectors have been removed and a more competitive environment has been created. With the continuation of structural reforms in the period of 2005-2007, further progress will be made towards improved economic efficiency.

The performance in the area of fiscal discipline has relatively lessened the pressure of the public sector on the financial markets. One of the most important indicators of this, is the considerable expansion in the real volume of credits, which was one of the factors supporting investment and consumption in 2004. It is expected that during the period of the Pre-Accession Economic Programme, banks will transfer increasingly greater resources to the real sector to finance increasing investments due to the fall in interest rates.

For the period of 2004-2007, in connection with the projected growth and investment increases, it is expected that a substantial number of new jobs will be created and employment will increase by 1.7 million persons. However, as a result of the expected increase in the labour supply, a moderate decline in unemployment rate is projected.

Demand Components of Growth

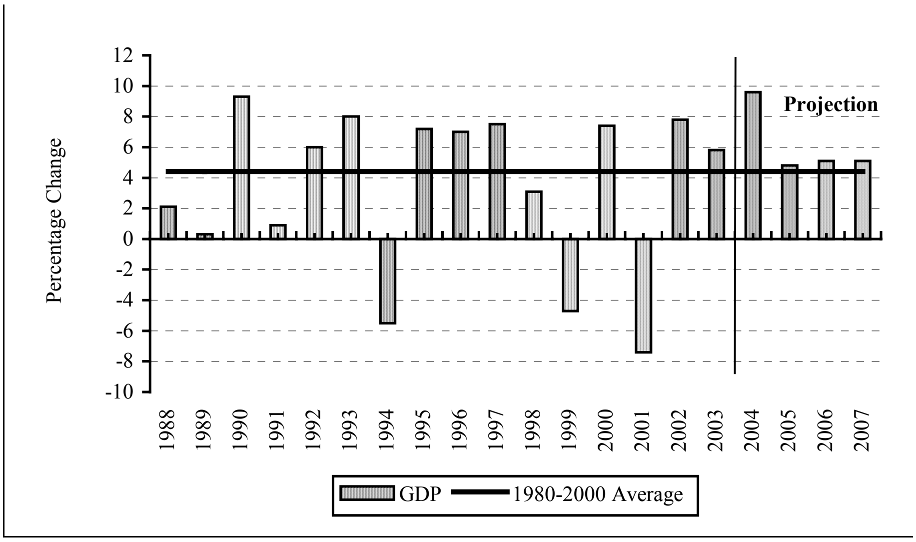
In 2003, GDP was realized above the level predicted in the 2003 Pre-Accession Economic Programme. For 2003, while GDP growth was predicted to be 5.3 per cent, it was actually 5.8 per cent. While both exports and imports increased more than expected, the increase in total investments turned out to be below the expectations. At the same time, the contribution of stock change to growth was significantly positive contrary to expectations. On the other hand, public sector consumption and investments contracted in real terms as a result of the tight fiscal policy that was implemented.

Compared with the 2003 Pre-Accession Economic Programme, no significant change is foreseen in the macroeconomic policy framework for the period of 2004-2007. However, the differences arising from the actual realizations of 2003 and of the first ten months of 2004 are reflected in the forecasts.

It is estimated that in 2004, GDP will grow by 9.6 per cent and GNP by 10 per cent. The main elements that drive growth in 2004 have emerged as private durable consumption, private fixed capital investments, and exports. In particular, postponed consumption has played an important role in the growth of durable consumption. In this framework, it is estimated that private consumption will grow by 8.6 per cent. Public consumption, on the other hand, is expected to grow by a limited rate, at 2.2 per cent, due to the tight fiscal policy. Influential in the growth of fixed capital investments are the facts that investment rates in the Turkish economy were rather low for many years, the need to support export increases through investments as a result of high capacity utilization rates reached, and the decline in the investment cost as a result of falling interest rates and of real appreciation of the Turkish lira. In this framework, private fixed capital investments are expected to grow by 41.5 per cent. It is estimated that public fixed capital investments will increase at a limited rate, by 3.1 per cent. Thus, final domestic demand is expected to grow by 10.7 per cent.

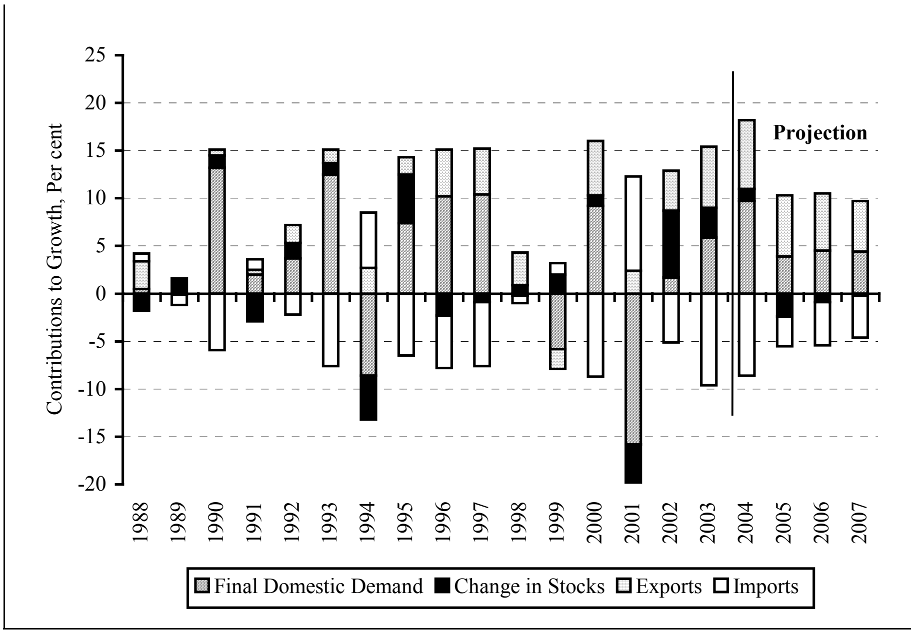
Exports have been one of the main driving forces of growth in 2004 as it was the case in 2003. The high export performance is expected to continue in the period ahead. It is estimated that exports of goods and services will grow by 16.6 per cent in 2004. On the other hand, imports have also increased considerably as a result of the recovery of domestic demand. An important source of this increase is the large increases in the imports of investment and consumption goods (See Box 2.5). As a result of these developments, it is estimated that imports of goods and services will grow by 20.5 per cent in 2004.

Figure: 2. 1. GDP Growth Rate



In the period of 2005-2007, GNP and GDP are expected to grow by an annual average of 5 per cent. As it was in the PEP 2003 forecasts, it is considered that growth will be driven mainly by increases in investment and exports, in the 2004 forecasts. During this period, total fixed capital investments are expected to grow by 8.9 per cent on average, where private investments and public investments expected to grow by 9 per cent and by 8.3 per cent, respectively. It is foreseen that in the same period, exports and imports of goods and services will increase by 12 per cent and 8.5 per cent annually on average, respectively. Also, it is foreseen that while private consumption will increase by 3.3 per cent annually on average, the increase in public consumption spending is targeted to be 1.3 per cent.

Figure: 2. 2. Contributions to GDP Growth



Savings-Investment Balance

As a result of the tight fiscal policy implemented successfully since 2002, a continuous improvement has been achieved in public finances. Thereby, the ratio of the public borrowing requirement to GDP has steadily decreased and the share of interest payments in public expenditures has stayed considerably below the initial allocations, particularly in 2004. As a result, the pressure of the public sector on the financial markets has reduced and, in parallel to this, there has been an increase in resources available for private investments. As a consequence of these developments, significant real increases have been recorded in private investments, starting from 2003. The ratio of private investments to GDP was realized as 11.3 per cent in 2002 and maintained this level in 2003. This ratio is expected to reach 13.7 per cent in 2004 and 16.6 per cent by the end of 2007, through considerable increases in private investments.

The ratio of public investments to GDP, which was around 5-6 per cent during the 1990s, fell as far as to 4 per cent in 2003 as a result of the implemented tight fiscal policy. It is estimated that this ratio will be 4 per cent in 2004. However, in connection with the expected rise in infrastructure investments in 2005, public investments are expected to grow considerably in real terms and, in consequence, their share in GDP to move around 4-5 per cent in the 2005-2007 period.

It is thereby expected that the ratio of fixed capital formation to GDP, which dropped to around 15 per cent in 2003, will be 17.7 per cent in 2004 and reach 21.2 per cent in 2007.

For the PEP 2004 period, it is estimated that the ratio of interest expenditures to GDP will decrease and public disposable income will increase as a result of falling interest rates due to macroeconomic stability, effective public debt management and improvement in confidence, as was foreseen in the previous PEP. In this context, public savings-investments gap is expected to narrow down in comparison with the previous periods as a result of the increase in public disposable income and the slowdown in the growth of public consumption. As a consequence, it is predicted that there will be a fall in the share of private disposable income and therefore of private savings in GDP.

Table: 2. 1. Total Savings-Investment Balance

(Per cent of the GDP)

	Average		Realization			Forecast			
	90-94	95-99	2001	2002	2003	2004	2005	2006	2007
Total Investment	23.1	23.2	15.9	21.3	22.8	25.9	24.8	24.7	25.0
Fixed Capital Formation	24.2	22.9	17.2	16.6	15.5	17.7	19.2	20.5	21.2
Public	6.3	5.5	5.3	5.3	4.2	4.0	4.5	4.7	4.6
Private	17.9	17.4	11.9	11.3	11.3	13.7	14.7	15.8	16.6
Change in Stocks	-1.2	0.3	-1.3	4.7	7.3	8.2	5.6	4.2	3.8
Total Savings	23.1	23.2	15.9	21.3	22.8	25.9	24.8	24.7	25.0
Domestic Savings	21.3	19.2	18.2	19.8	19.5	21.3	22.1	22.3	22.7
Foreign Savings	1.8	4.1	-2.3	1.5	3.3	4.6	2.7	2.4	2.3

Note: The savings-investment balance is based on the SIS figures of the GDP by expenditures. Public investments in the table include the investments of the SEEs in addition to those of the general government.

Considering the savings–investment balance as a whole, the first point to be noted is that total domestic savings will be in an upward trend over the entire period and this increase will have a counterpart in investments. The large increases of domestic demand that were observed in 2003 and 2004 have increased the economy's need for foreign savings. It is expected that foreign savings, which was 3.3 per cent of GDP in 2003, will increase and reach 4.6 per cent in 2004. However, in consequence of a more limited growth of domestic demand envisaged for the 2005-2007 period, it is foreseen that the savings gap will narrow down and the ratio of foreign savings to GDP will fall to 2.3 per cent in 2007.

Sources of Growth

Although a high growth rate was achieved in 2003 as in 2002, there was a decline in employment. As a result of this decline, labour productivity increased by 6.8 per cent. Therefore, while the contribution of employment to growth was negative due to the decline in employment, the contribution of capital stock and total factor productivity (TFP) to growth increased considerably and were realized as 52.2 per cent and 58.5 per cent, respectively.

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

(Per cent)

Period	GDP	Capital Stock	Employment	TFP
1990-2000	4.1	7.6	1.5	0.3
2001-2003	1.8	4.3	-0.7	0.7
2003	5.8	4.0	-1.0	4.9
2004	9.6	4.9	2.4	6.0
2005	4.8	5.3	2.5	1.3
2006	5.1	5.5	2.5	1.4
2007	5.1	5.6	2.5	1.4
2004-2007	6.1	5.3	2.5	2.5

It is expected that the growth rates foreseen for the PEP 2004 period will be supported by increases in the production factors as well as in productivity. Due to the expectation of a high rate of investment, it is predicted that a capital accumulation rate of 5.3 per cent can be achieved. Parallel to the increase in the capital stock, labour demand is also expected to increase. In this context, employment is predicted to grow by 2.5 per cent annually on average. Moreover, total factor productivity is expected to increase considerably during the period.

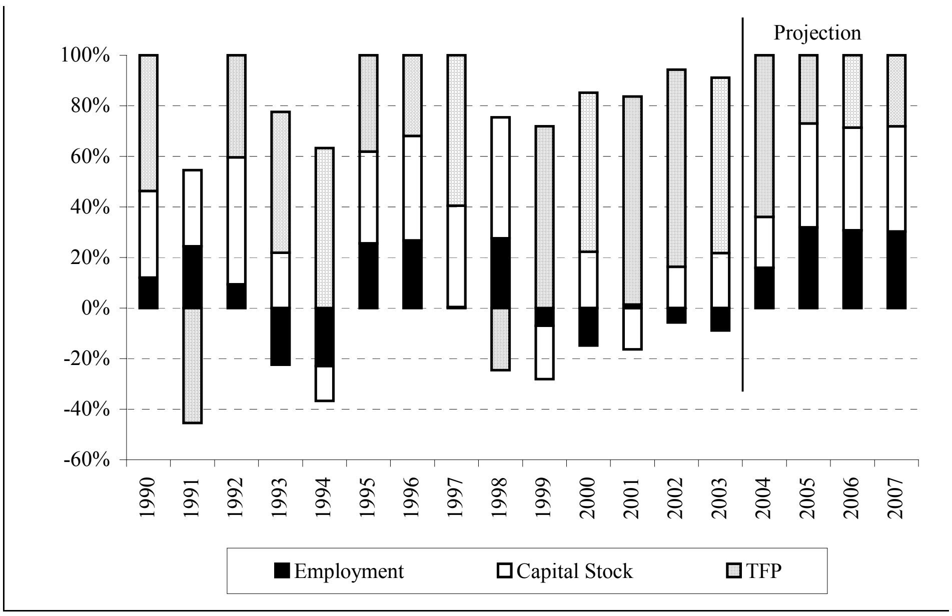
Table: 2. 3. Contribution to Growth by Factors of Production

(Per cent)

Period	Capital Accumulation	Employment Increase	TFP Increase
1990-2000	73.2	23.5	3.3
2001-2003	87.3	-23.0	35.6
2003	52.2	-10.7	58.5
2004	28.7	15.9	55.4
2005	25.2	31.9	42.9
2006	33.4	30.8	35.8
2007	38.8	30.3	30.9
2004-2007	31.1	25.2	43.7

As a result of these developments expected regarding the factors of production, the contributions to growth by the capital stock, employment and TFP during the period of the Pre-Accession Economic Programme are estimated to be 31.1 per cent, 25.2 per cent and 43.7 per cent, respectively.

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



Box: 2.1. Growth and Structural Reforms in the Process of Convergence to the EU

Turkish economy has displayed a higher growth performance than the average of the EU member countries (2.4 per cent for the EU-15) by growing an average of 4 per cent annually over the period of 1970 to 2003. However, despite the high growth rates, Turkey's per capita national income according to purchasing power parity has remained rather low compared with the EU countries due to the factors such as economic instability, fluctuations in growth and the fast population growth. In 2003, per capita national income in Turkey in terms of purchasing power parity is about 25 per cent of the EU-15 average. To converge towards the average of the EU countries in the process of accession to the EU, the Turkish economy have to achieve a high and sustainable growth performance.

In this context, structural reforms which are being implemented on a very broad range involve a number of changes for improving the macroeconomic environment and thus establishing high and sustainable growth. The aim of these changes is to solve the problems that created instability in the economy during the 1990s and caused fluctuations in growth and considerable fall in the average growth rate. In addition, these reforms, which will ensure Turkey's alignment with the EU countries and strengthen the functioning of the free market economy, will also enable potential growth to increase steadily.

The contribution of structural reforms to growth in the medium and long term can be evaluated in the framework of the Cobb-Douglass production function under the assumption of constant returns to scale. In this context, the direct and indirect effects of the reforms on production (Y) are expected to materialize through increases to be achieved in the capital stock (K), in employment (L) and in total factor productivity (TFP).

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

Y: Production L: Labour demand (employment)

K: Capital stock TFP: Total factor productivity

Structural reform implementations, detailed in Chapter 4, are expected to have both general and sectoral effects on economic growth. In this framework, it is foreseen that Turkey's process of convergence towards the EU will accelerate with the impact of the positive contributions of structural reforms to growth.

In general, with structural reforms, fiscal discipline will be secured, a strong banking system capable of performing its function of transferring resources from the financial sector to the real sector will be created, the role of the public sector in the economy will be reduced, a more efficient and transparent public administration will be created, inflation will fall to single-digit figures, regional dynamics will be set in motion, more efficient structures will be created in sectors such as education, health, energy, transportation and agriculture, the institutional and legal infrastructure will be raised to international norms, and a better environment will be created for domestic and foreign investments. It is considered that as a result of the targeted structural transformation, the existing economic system will converge towards a system conforming to the EU economic criteria and functioning more effectively. For these reasons, structural reforms are expected to result in productivity increases in the economy.

In addition to the positive effects of structural reforms on the economy in general, it is expected that each reform will create specific effects in the sector concerned and that these effects will be reflected in economic growth both through capital stock and employment increases and through productivity increases.

The contribution to growth by reforms in the area of strengthening the market economy and entrepreneurship (See Section 4.1) can be evaluated from three different points of view. Firstly, withdrawing the public sector through privatization from areas where it operates as a monopoly and ensuring that the private sector operates in those areas under free market conditions will invigorate the market and make a positive contribution to growth. This contribution will be in the form of increases both in physical production and in total factor productivity as a result of increased competition in these sectors. Secondly, reforms carried out in the area of improving the competition environment (See Section 4.1.2) will enable a more efficient allocation of resources and an increase of production throughout the economy in monopolistic fields, particularly in energy, telecommunication, tobacco and sugar markets. Thirdly, efforts to remove administrative obstacles, to reduce bureaucratic formalities, and to implement policies promoting investment and production, in the context of improving the investment environment (See Section 4.1.3) will lead to an increase of domestic and foreign investments and clear the way for the targeted sustainable growth. In addition, foreign investments in particular will increase total factor productivity by accelerating technology transfer.

Structural reforms implemented in the financial sector (See Section 4.2) are aimed at creating an effective and competitive structure in the financial markets. Reducing both the weight of the public in the banking sector and the borrowing requirement of the public sector in the financial markets has priority with regard to this aim. Thus, the necessary resources to ensure an environment of stable growth can be effectively channeled to investments. Consequently, optimal financing policies can be put into practice and a contribution will be made to accelerating capital accumulation which is one of the main factors of production. Taking into account the contributions to be made by increased capital accumulation to technological development and employment growth, the importance of continuing the structural reforms in the financial sector rigorously and on a wider scale is obvious.

The structural reforms concerning the labour market (See Section 4.3) are aimed at increasing employment and creating a more effective labour market. Compared with EU countries, the most salient feature of the Turkish labour market is the fact that the labour force participation rate and employment rate are rather low. While these rates are near the EU averages for men, they are much lower in the case of women. However, it is observed that the labour force participation rate is significantly higher among educated women. Therefore, the labour force participation rates are expected to increase as the education level of the labour force in general increases. Developing the quality of the labour force is also important with regard to creating a labour supply with the skills and capacities needed by the economy. Programmes which are implemented to this end will contribute positively to growth by raising the efficiency of labour and reducing the rate of structural unemployment.

Developments in the area of education (See Section 4.3) are very important for growth performance as they directly affect the quality of the labour force. Considering the demographic structure of Turkey, it is observed that the ratio of young population to total population is higher than the EU countries. However, when indicators related to education are analyzed, it is noted that both the schooling rates and the quality of education are behind those of the EU countries. Full implementation of education reform in Turkey will, in the long term, provide effects such as an increased schooling rate, an improvement in the quality of vocational education in relevant fields and a development of the opportunities and quality of higher education. Thanks to these reforms to be carried out in the area of education, Turkey's human capital will develop and both the quality and the productivity of the labour force will increase. The improved human capital stock will develop the country's innovation capacity, enhance technological development and ensure that the capital stock becomes more productive. All these developments will create an increase in growth potential.

The structural reforms implemented and planned in the administrative field (See Section 4.4) are expected to contribute to economic growth through more effective provision of public services, through preventing waste of resources and through the public sector withdrawing from production in certain areas and strengthening its regulatory and supervisory role in the market. Important steps have been taken and legislative measures have been adopted in the public sector towards eliminating non-budgetary activities, widening the scope of the budget with a definition of the general government that conforms to international norms, enhancing budgetary discipline and transparency and forming a performance-based strategic budget. As a result, it will be possible to increase effectiveness and savings in the public sector and thus to transfer more resources to the infrastructure investments that will support economic development. In addition, the reform concerning public employees will achieve a more efficient organization of the workforce in the public sector and improve the efficiency of public employees, who have an important share in the total labor force. Strengthening the institutional structures of the regulatory and supervisory authorities established to improve the functioning of the market economy will make the implementation of free market rules more effective. The Local Government Reform, which is being prepared to restructure local authorities in accordance with the principles introduced by the European Local Government Charter, will ensure a more effective and efficient use of public resources through delegation of financial and administrative powers to local governments. All these effects will contribute positively to growth by increasing both physical investments and total factor productivity.

The structural reforms implemented in the agricultural sector (See Section 4.5) since 2000 are aimed at improving efficiency and competitiveness and achieving effective utilization of resources. In Turkey, agriculture is a relatively inefficient sector. Although approximately 33 per cent of total employment is in agriculture, this sector accounts for only 11 per cent of total value added. Furthermore, agricultural supports have had an important share in the budget for many years but it has not been possible to achieve effectiveness in these supports. As a result of the reforms that are being implemented, an agricultural sector with increased efficiency and competitiveness is expected to make a greater contribution to economic growth.

The new plans and programmes introduced in the area of regional development (See Section 4.6.1) and the Regional Development Agencies which are planned to be founded are aimed at reducing the development gaps between regions, improving the economic and social conditions of people who live in relatively underdeveloped regions, raising their level of welfare, creating new employment opportunities and thus giving an added dynamism to economic growth. The contributions to the economy are expected to come from the increase in the capital stock through new investments, from an improvement in the quality of the labour force through better training and from increased productivity through more efficient utilization of resources. However, it is expected that the growth, income and employment effects of the regional programmes and projects implemented will initially remain limited both in the regions and across the country as a whole. It is foreseen that the growth effects will arise more clearly in the medium and long term as the project development and implementation capacity at regional and central levels increases over time with effective utilization of EU pre-accession funds in the regions.

The social security reform and the health transformation programme (See Section 4.6.2) are aimed at including the entire population within the coverage of both retirement and health insurance and making the current system financially more effective. Through these reforms, a contribution can be made to creating a financial structure that enables more effective utilization of public resources. In addition, the increased quality and coverage of health services will increase labour productivity and working time by improving the quality of life and raising life expectancy. These factors will contribute positively to growth potential.

Through the legislative measures adopted in the area of information and communications technologies (ICT) (See Section 4.6.3), the legal infrastructure of the sector has been put in place in the framework of transformation to the knowledge-based economy. The effect of the ICT sector on economic growth, which is one of the important subjects of discussion in the literature during recent years, occurs in three different ways. The first effect is the increase of production and productivity in sectors that generate ICT as these sectors are inclined to generate new technology. The second is the capital increase effect that occurs because other sectors which use the technology generated in the ICT sector as an input undertake new investments for adaptation to this technological development. The third effect is the increase in total factor productivity that is achieved through reorganization in sectors which use ICT as an intermediate input.

In the sector of transportation (See Section 4.6.4), increasing the quality of service, opening the sectors which remain monopolistic (such as railways and airways) to further competition, and attracting more private sector investment to these areas, will contribute positively to economic growth as this sector is an important area of infrastructure. It is also important that developments in this sector will have an incentive effect on foreign direct investments.

The energy sector (See Section 4.6.5) is a sector that provides an intermediate input to other sectors. In this framework, the structural arrangements made in the energy sector will both make resource allocation in this sector more efficient and positively affect the production performance of other sectors which use energy as an input. The structural reforms under way are aimed at creating a more competitive environment in the energy sector and having energy prices set under more competitive conditions. In this context, there will be a decrease in the production costs of sectors that use energy as an intermediate input. Falling production costs will also enhance the international competitiveness of firms. In addition, as uncertainties will be reduced in the energy sector through the implementation of structural reforms, it will also be possible to achieve increased effectiveness in production planning in the economy. However, the structural arrangements made in the energy sector should be expected to have a positive effect on the long term, rather than the short term, growth performance of the Turkish economy.

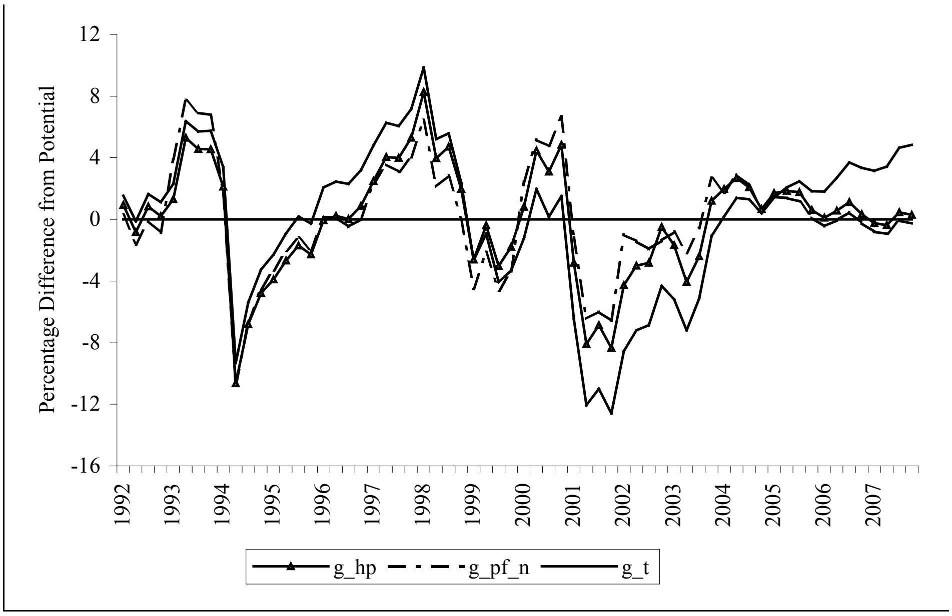
Potential Output

Growth is expected to stabilize around potential growth as permanent economic stability is ensured and the cycles of growth and contraction are left behind. Figure 2.4 shows the output gap series calculated by three different methods: the linear method, the Hodrick-Prescott method and the production function method. In the figure, it is observed that the output gap calculated by the linear method is diminishing as of 2004 and a warming-up tendency becomes evident in the period of 2005-2007. This is mainly due to the fact that the low growth performance in the past has pulled down the trend growth rate.

On the other hand, the output gap values calculated by the production function and Hodrick-Prescott methods do not point out a warming-up in the economy. The production function is much better in reflecting the economic developments and the increase in the production potential. In periods when there are important changes in growth rates, the production function method is a more reliable indicator. In the Pre-Accession Economic Programme period, a considerable increase in investments and a more rapid capital accumulation are foreseen. With the increase both in capital accumulation and in the level of employment, it is predicted that the production potential will rise and the rapid growth will have no inflationary effect.

Moreover, it is thought that the tight fiscal and monetary policies envisaged to be implemented during the Pre-Accession Economic Programme period will make it possible to control inflation.

Figure: 2. 4. Output Gap



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

GDP Growth by Sectors

In the Turkish economy, which is undergoing a rapid process of economic development, the shares of industry and services are increasing while the share of agriculture is falling. The share of industry in GDP was 22.3 per cent in 1980 and 26.7 per cent in 1990 and increased to 29.3 per cent in 2003. The share of the services sector has displayed developments parallel to industry. Thus, the share of services sector in GDP was 52.6 per cent in 1980 and rose to 56.4 per cent in 1990 and to 58.3 per cent in 2003. The share of agriculture in GDP, on the other hand, was 25.1 per cent in 1980 and decreased to 17 per cent in 1990 and to 12.4 per cent in 2003.

Table: 2. 4. Value Added by Sectors

(At 1987 Prices, Per cent)

	Realization			Forecast			
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
				Growth Rates			
Agriculture	-6.5	6.9	-2.5	3.1	-1.7	2.4	2.0
Industry	-7.5	9.4	7.8	10.8	6.5	5.9	5.8
Services	-7.7	7.5	6.7	10.3	5.3	5.2	5.3
GDP	-7.5	7.9	5.8	9.6	4.8	5.1	5.1
				Shares in the GDP			
Agriculture	13.6	13.4	12.4	11.7	10.9	10.7	10.3
Industry	28.4	28.8	29.3	29.7	30.1	30.4	30.6
Services	58.0	57.8	58.3	58.7	58.9	59.0	59.1
GDP	100	100	100	100	100	100	100

It is expected that the GDP growth rate in the period of 2005-2007 will be 5 per cent annually average. It is predicted that the sectors of industry and services will grow more rapidly than GDP on average and thus their shares in GDP will reach 30.6 per cent and 59.1 per cent, respectively, in 2007. It is expected that the share of agriculture in GDP will continue to decrease in this period and with the agricultural value-added growing by an average annual rate of 1 per cent, this share is expected to decrease to 10.3 per cent in 2007.

Developments in the Labour Market

As in 2002, there was a decline in the level of employment also in 2003, despite a high growth rate. This decline was due to the fact that the decreases of employment in the agriculture and industry sectors were not fully absorbed by the increase of employment in the services sector (See Box 2.2). For 2003, it is noteworthy that employment in industry sector decreased although a growth rate of 7.8 per cent was achieved in this sector. This development in two consecutive years has led to emergence of debates about jobless growth in Turkey.

However, the results of the Household Labour Force Survey for the second quarter of 2004 indicate that employment has started to increase. Although the growyh elasticity of employment was behind its long term value also in this quarter, it is expected to increase in the forthcoming period. As a result, employment increases are expected to be more parallel to growth. In this context, it is predicted that the level of employment will increase by an average annual rate of 2.5 per cent in the period of 2005-2007. Therefore, it is estimated that about 1,650,000 new jobs will be created over the next three years but there will be a limited fall in unemployment due to the rapid increase in the working age population.

During the Pre-Accession Economic Programme period no significant change is foreseen in incomes policy. Wage increases will be decided in line with the inflation targets, and priority will be given to employment increase.

Table: 2. 5. Developments in the Labour Market

	Realization	Forecast			
	2003	2004	2005	2006	2007
Civilian Labour Force (Thousand Persons)	48,912	49,810	50,730	51,648	52,573
Labour Force Participation Rate (Per cent)	48.3	48.3	48.5	48.7	48.9
Employment (Thousand Persons)	21,147	21,649	22,182	22,741	23,304
Employment (Percentage Change)	-1.0	2.4	2.5	2.5	2.5
Unemployment Rate (Per cent)	10.5	10.0	9.8	9.6	9.3

Box: 2.2 Developments in Employment

Although the employment creation capacity of the Turkish economy was not very high in earlier periods, either, due to the lack of employment creation despite economic growth in the recent period, claims that the economy has entered into a process of jobless growth have been more frequently pronounced on. Employment has been steadily declining since 1999. However, the period since 1999 is characterized by important structural transformations place, two major crises and instabilities. For example, from 1998 to the end of 2003, the Turkish economy grew only by 3.2 per cent cumulatively, with 1999 and 2001 being years of serious contraction. Therefore, in a long term perspective, it is actually not quite surprising that it has not been possible to create employment in recent years.

When the picture is examined in more detail, it does not seem possible to argue that the Turkish economy as a whole can not create employment. Although total employment declined by 901,000 persons from 1999 until the end of 2003, 790,000 new jobs were created in the non-agricultural sector. However, the employment contraction of 1,691,000 persons that was observed in agriculture in the same period resulted in a decrease in employment across the country. Therefore, one of the reasons for the failure of employment to increase in parallel to growth is the fact that in the non-agricultural sectors it was not possible to create sufficient jobs to absorb the population that had left agricultural sector. Considering the non-agricultural sectors, the developments in the sectors of construction and industry in particular are noteworthy.

In the 1990-2000 period, the construction sector created employment for 350,000 persons. However, there was an employment loss of about 400,000 persons in the sector in 2001 and 2002. Consequently, the lack of employment creation in this sector was also influential in the emergence of recent debates on jobless growth. Starting from 2003, on the other hand, employment increases began to be observed in the construction sector.

In industry, an employment increase parallel to the high growth rates has not been observed in recent years. Significant inefficiencies accumulated in firms which were operating in an environment of high inflation and macroeconomic imbalances before 2000. The 2001 crisis created a pressure on firms to eliminate these inefficiencies and resulted in considerable employment losses in industry. In the following period of recovery, the decline in inflation and the achievement of macroeconomic stability compelled firms to compete through productivity gains, and during that period productivity gains came to the fore. Considering that the process of elimination of those inefficiencies is largely completed, one may expect an employment increase more conformable to growth in the period ahead.

As a matter of fact, the results of the 2004 second quarter Household Labour Force Survey are encouraging in this regard. In this period, an upward trend in employment began to be observed. Total employment increased by 2.3 per cent compared to the corresponding period of the previous year and the unemployment rate declined from 10 per cent to 9.3 per cent. It is observed that the decline in the unemployment rate was also reflected in the unemployment rate among young population, which was 19.6 per cent in the second quarter of last year and now dropped to 16.9 per cent. In the same period, no significant change was observed in the labour force participation rate.

The point to be welcomed concerning the increase of employment is the fact that this increase was mainly due to an increase in urban employment and the creation of new jobs in the private sector. Sectorally, employment increased in industry by 4.3 per cent and in the construction sector by 6.7 per cent compared to the corresponding period of the previous year. Construction is traditionally the first sector that absorbs labor force leaving agriculture. Considering that the downward trend of rural population will continue, employment in the construction sector is quite important.

Despite the increase in employment, it is noted that the growth elasticity of employment was below its long term level also in this period. It is predicted that as economic stability is maintained and reforms are implemented with determination, the employment elasticity of growth will reach its long term average and the employment creation capacity of the economy will increase. It is considered that the active employment policies implemented by the Turkish Employment Agency will partially contribute to the solution of employment problem in the short term. In addition, it is thought that the investment incentives made available for those provinces with a per capita income of 1,500 dollars or less will also support the increase of employment.

2.2. Inflation

One of the main objectives of the Pre-Accession Economic Programme is to converge inflation to the level of EU countries by reducing inflation permanently. In this framework, in 2005, as in the period of 2002-2004, monetary policy will focus on the primary goal of price stability, and short term interest rates, which are the main policy instrument, will continue to be set taking into consideration the expected future movements of the variables that affect inflation. Maintaining monetary and fiscal discipline, conducting the public sector incomes policy in line with the inflation targets, continuing to take lasting steps in structural reforms, supporting production increase with productivity increases, and no major shocks in external factors such as crude oil prices are of critical importance in order to achieve the inflation targets. Through the implementation of the policies, in the period of 2005-2007 converging the inflation rate towards the Maastricht criterion is targeted. The target is to reduce the annual rate of increase in the CPI to 8 per cent in 2005, to 5 per cent in 2006 and to 4 per cent in 2007. In this framework, the projections for the period of 2005-2007 concerning the year-end CPI and the annual average rate of increase in the GDP deflator are presented in the table below. As of 2005, the SIS will renew the baskets of goods and services according to the results of the 2003 Household Consumption Survey and start to publish the Producer Price Index (PPI) as well as the CPI. For this reason, in the table the Wholesale Price Index (WPI) projections which were given in the previous PEPs are not presented.

Table: 2. 6. Price Targets and Projections

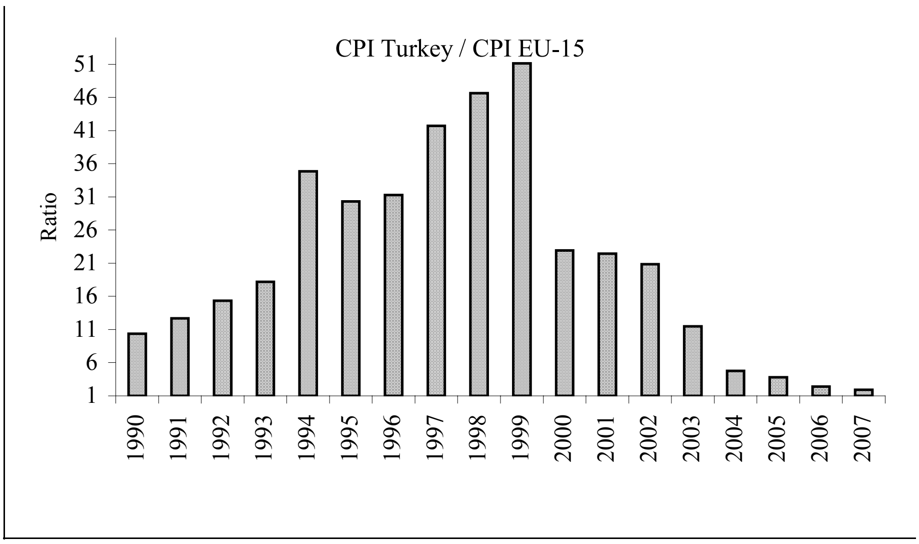
(12 Monthly Percentage Change)

	2004	2005	2006	2007
CPI (1)	10.0	8.0	5.0	4.0
GDP Deflator (2)	8.2	7.9	6.4	4.4

(1) Although the end year target is 12 per cent, realization projection is 10 per cent. Figure given for 2005 is year-end target and figures given for other years are the year-end projections.
(2) Projections for average annual increase rate.

The increasingly higher inflation rates in the post-1990 period caused Turkey to move further away from the inflation averages of the EU until 2000. In that year and afterwards, this structure was reversed by the anti-inflation policies that were implemented. In particular, due to the considerable success of the latest programme, which is being carried on with determination, the process of convergence towards the inflation averages of the EU has significantly accelerated since 2003. The main goal is to continue this process in the PEP 2004 period. Figure 2.5 shows the process of convergence towards the EU averages in light of the inflation projections given above.

Figure: 2. 5. The Ratio of Turkish Inflation to EU-15 Inflation



In addition to monetary policy, the tight fiscal policies implemented are also important for being able to reduce inflation permanently. In particular, the continuity of fiscal discipline is of great importance for the increase in effectiveness of monetary policy. It is planned that the policy of implementing a high primary surplus and the improvement achieved in budget performance will continue in the PEP 2004 period. In this context, the continuation of the decline in the budget deficit and downward trend in the ratio of the debt stock to national income remains important as it confirms the commitment to the economic programme and has a positive effect on expectations.

Likewise, structural reforms, which are planned to be continued and further extended, are important due to their effects of improving the competition environment and regulation of the markets. These reforms, which will further develop the effectiveness of the economy, are essential for the fall in inflation to be permanent.

Box: 2.3. Exchange Rate Pass-Through: Changing Trends

In the past decade many emerging economies shifted to flexibility in their foreign exchange markets and floating exchange rate regime was adopted by many countries in parallel to this trend. One of the important debates in this context, is how monetary and fiscal policies could be used by countries in order to eliminate the fundamental shortcomings in their economies while developing their own floating exchange rate regime. One of the ideas, which came to the fore in this context, is that an independent central bank taking price stability as its main objective with high priority, could control inflationary expectations and thereby reduce pass-through from exchange rates to domestic pries.[1] One of the ways to control inflationary expectations is the inflation targeting policy. A clear statement by the Central Bank that it has adopted an inflation targeting policy after providing the necessary infrastructure and particularly its achievement of declared targets could help stabilizing inflation and thus reduce pass-through from exchange rate to prices.

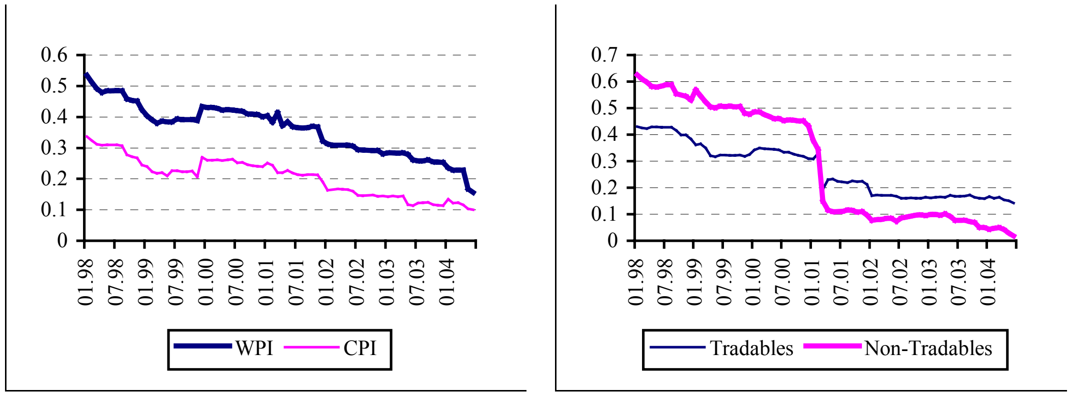
There are strong parallels between this trend and the transformation witnessed in economic policies in Turkey after 2001. There was a shift to floating exchange rate regime during the period following the crisis in February 2001, and price stability was declared as the primary goal of the Central Bank.[2] The determination of the Central Bank independence as the main priority and amendments to the CBRT Law strengthening its independence in April 2001 indicates a transformation in the historical structure.

Inflation pursuing a trend in line with the targets set in the last three years imply that there has been a change in the dynamics of the Turkish economy that prevailed in the last three decades. As a result of this transformation, there has been changes in the pass-through effect from exchange rates to prices.

Analyzing this process using time varying parameter models, it is observed that the pass-through effect from exchange rates to prices has decreased and backward indexation behavior has weakened in the period after 2001.[3] Panel (a) of the following figure shows the coefficients of the pass-through effect from exchange rate to prices for consumer price index and wholesale price index. Considering the trend of these coefficients over time, the coefficient for wholesale price index fell from average of 0.55 to 0.15 and the coefficient for consumer price index fell from an average of 0.3 to around 0.1 in 2004. Panel (b) of the figure indicates that the pass-through effect from exchange rates to prices for non-tradable goods under consumer price index declined to a third of its historical path after May 2001. More importantly, while this coefficient was higher than the coefficient of the pass-through effect from exchange rates to prices for tradable goods historically (high indexation), it fell below the latter after 2001. As a consequence, there has been a weakening in the indexation behavior.

Figure: Pass-Through Effect of Exchange Rates to Domestic Prices

a. Consumer Prices and Wholesale Prices **b. Tradable / Non-Tradable Goods (CPI)**



In the light of those facts, one could assume that the monetary policy strategy pursued after 2001 has been successful in weakening the pass-through effect from exchange rate to prices. Even more interestingly, the pass-through effect from exchange rate to prices for non-tradable goods, which was historically high, has declined. This downward trend in indexation behavior, in a sense, demonstrates the performance of the current monetary policy in managing inflationary expectations.

However, it should be also noted that these pass-through measures refer to the short term, not the long term. Only three years of data under the floating exchange rate regime is not enough to identify the change in long term pass-through. On the other hand, it is not expected that the long run pass-through to decline drastically since Turkey is an open economy with a sizeable fraction of imported intermediate goods.

Notes:

[1] Similarly, strong prudential regulations can moderate the balance sheet mismatches of the financial sector and companies (Rogoff, K., A. Husain, A. Mody, R. Brooks, and N. Oomes, 2004, Evolution and Performance of Exchange Rate Regimes, IMF Occasional Paper No. 229).

[2] In addition, structural reforms aimed at stabilizing financial markets are regarded as a secondary goal. As regards fiscal policies, tight policies are being implemented with determination and reforms, which lay emphasis on quality of fiscal adjustment in addition to the goal of primary surplus, are being carried out.

[3] In the model including time varying parameter models, which is referred to above, seasonally adjusted monthly inflation rate is explained by using its own lags and the monthly depreciation rate of Turkish lira. In each observation in the sample of model, a coefficient is estimated for each explanatory variable. The state-space of these coefficients is based on the assumption of random walk.

2.3. Monetary and Exchange Rate Policies

Turkey's monetary policy is called implicit inflation targeting and focuses on future inflation since the beginning of 2002. In this context, the Central Bank uses short term interest rates as the main policy tool to achieve price stability. In addition, performance criterion and indicative targets have been imposed on some items in the Central Bank's balance sheet within the framework of the IMF Stand-By agreement for 2002-2004. Although base money continues to be an additional nominal anchor under the framework of implicit inflation targeting regime, priority will be given to the deviations of the forecasted inflation from the targeted level. In addition, the Central Bank gives high priority to stability in the financial markets in order to ensure that policies aimed at achieving price stability are implemented efficiently under the floating exchange rate regime.

Meanwhile, crucial steps are being taken in order to provide the necessary conditions for shifting to explicit inflation targeting. In this context, achieving permanent discipline in public finance is of vital importance. Continuation of structural reforms aiming at increasing efficiency in the public sector and the quality of primary budget surplus, by positively affecting the debt dynamics and reducing risk premium, will increase the efficiency of short term interest rate, which is the most important tool for monetary policy. Secondly, broadening the scope of the financial sector reform and making the financial system more functional will increase predictability of monetary transmission mechanism and thus render inflation targeting more effective.

The Central Bank has completed its preparations to shift to explicit (formal) inflation targeting both institutionally and technically. In this context, CBRT has acquired an institutional structure in terms of its duties and responsibilities, which is more convenient in terms of inflation targeting, as a result of the latest amendments to the law. Short and medium-term inflation forecasting models have been built, surveys were developed to measure the expectations of economic agents about inflation and macroeconomic developments, studies analyzing the inflationary developments in detail were carried out and the results were made public.

Finally, a new monetary policy report mainly focusing on inflation and monetary policy has being issued regularly since October 2003. Unlike the previous reports, it analyzes variables shaping the monetary policy and possible developments in the overall situation and the reasons behind monetary policy decisions are openly shared with the public. In addition, although a specific number is not declared for the inflation forecast, general outlook about the future trend of inflation is provided verbally.

Effects of the economic program implemented in the past three years on inflation have been extremely encouraging. Confidence in the economic program and political stability are gradually increasing. As an indicator of the success achieved in curbing inflation and rising confidence in the Turkish lira, the Turkish Parliament approved the Law, in January 2004, on the new currency (which will eliminate six zeros), which will be put into circulation in 2005 (See Box 2.4). Exchange rates have remained stable in the recent period, the ratio of the public debt stock to GDP continues to fall and the relationship between the Central Bank's short term interest rates and long term is being gradually strengthened. In conclusion, considerable progress has been achieved in the process of shifting to inflation targeting.

Fulfillment of all the preconditions for shifting to formal inflation targeting is of paramount importance for the regime functions efficiently. In this context, Central Bank will take new steps in the near future concerning the process of monetary policy decisions and sharing information with the public. Firstly, efforts are under way to ensure that the Central Bank's decisions about interest rates are rendered more transparent and predictable. In other words, decisions about interest rates will be regular on pre-specified dates and the underlying reasons will be shared with the public. Secondly, inflation forecast figures will be announced in advance. However, a relatively high public debt with a short maturity compared to EU averages, causes risk premium to remain high and volatile. Although it is pursuing a downward trend, the high pass-through from exchange rates to prices and high share of the public sector in consumer prices make price projections vulnerable especially to developments in public finance. In addition, consumer price index is still 1994 based and the State Institute of Statistics is working on an updated index. Thus, it would be appropriate to delay announcement of quantitative forecasts in order to avoid uncertainties that could be caused by possible deviations.

Box: 2.4. Currency Reform: The New Turkish Lira (YTL)

Elimination of Zeros In Currencies: Country Experiences

High inflation, which has reduced the real value of the Turkish lira, damaged the reputation of the currency and had an adverse effect on its monetary functions as a medium of exchange and a store of value. The increase in the number of zeros in the currency has created problems in cashier transactions, accounting and statistical records, data processing programs and payment systems in terms of recording and expressing monetary values. Similar proposals were made in the past in order to eliminate zeros from the Turkish lira. However, they were not implemented due to the lack of appropriate economic conditions.

Around the world, 49 countries have eliminated zeros in their currencies so far. When the experiences of some countries that eliminated zeros from their currencies are analyzed, it is observed that a new currency was generally introduced in the framework of a stability program and the number of zeros were eliminated under different inflation rates. Israel, which is one of the countries where stability program was implemented successfully carried out the currency reform shortly before the program was launched while Poland, Bolivia, Bulgaria, and Mexico implemented the reforms after their stability programs had positive effects on inflation. Further currency reforms became necessary in some countries, such as Argentina and Brazil, where stability programs had failed. In our country, it was decided to eliminate six zeros from the Turkish lira in the beginning of 2005 on account of the declining inflation under the stability program favorable expectations that price stability will be achieved in the near future.

The New Turkish Lira and the New Kuruş

The Law on the Currency Unit of the Republic of Turkey related to elimination of zeros from the Turkish lira was put into effect after it was published in the Official Gazette on January 2004. According to the Law, the Turkish Republic's new currency will be the new Turkish lira and the new kuruş will be its sub-unit. One new Turkish lira (YTL) will be equal to one hundred new kuruş (YKr). The conversion rate to be used in adapting the values in Turkish lira into the new Turkish lira will be as follows: one million Turkish liras (1,000,000 TL) equal to one new Turkish lira (1 YTL). After a couple of years from the introduction of new Turkish lira the term new will be removed and Turkish lira will be used again.

The Process of Shifting to the YTL

Given the possibility that prices could be rounded up during the first months after elimination of zeros from the currency, there could be an insignificant increase in the inflation rate. Possible impact of the currency reform on inflation, which could arise from retailers' inclination to pass transition costs on to consumers or to round up prices in order to take advantage of monetary illusion arising from use of kuruş, will not be long lasting. Furthermore, the practice of rounding up prices is a phenomenon usually witnessed when banknotes and coins with a low value are withdrawn from circulation in the high inflationary environment. Bringing inflation to single digits, acquiring the habit of using coins, and introducing 1 YKr corresponding to 10,000 TL, which is not currently in circulation could be expected to prevent the inclination to round up prices. In addition, the YTL and the TL will remain in circulation together and prices both in terms of the TL and the YTL will be displayed together on labels until end of 2005 in order to prevent consumers from making mistakes in calculation of prices.

Moreover, the currency reform, which will be carried out at a time when uncertainties in the Turkish economy are reduced and inflation is brought down, could weaken backward indexation in the pricing behavior.

Elimination of zeros from the Turkish lira is regarded as a sign of determination to maintain the gains achieved in economic stability. The currency reform to be carried out in this context is expected to serve as a factor enhancing confidence in the currency.

The Central Bank plans to maintain the floating exchange rate regime in the following periods. In this context, there could be limited direct interventions in the foreign exchange market in the event of sharp fluctuations in exchange rates in both directions in line with the current policy. Besides, transparent purchases of foreign exchange will be carried out through auctions to strengthen foreign exchange reserves without affecting long term equilibrium rate of exchange rates.

2.4. Balance of Payments

Current Account

Export revenues were realized as 47.3 billion dollars in 2003, which was above the projected level of 43.5 billion dollars. Despite the real appreciation of the Turkish lira, export performance was better than expected mainly as a result of diversification of exporting sectors and the decline in unit labor cost due to increase in labor productivity. Meanwhile, imports including gold, which was projected as 63.4 billion dollars according to the 2003 Pre-Accession Economic Programme, reached 69.3 billion dollars as a result of the economic recovery above expectations and the real appreciation of the Turkish lira. Tourism revenues also surpassed expectations. As a result of these developments, the actual current account deficit, which was estimated as 7.4 billion dollars in the 2003 Pre-Accession Economic Programme, was 7.9 billion dollars.

In spite of the real appreciation of Turkish lira, the upward trend in exports due to increase in labor productivity in 2003 is expected to continue in the medium term. It is foreseen that substantial increases in exports, which continued in the first half of 2004, will be maintained during the period of Pre-Accession Economic Programme as well. No adverse effects that could result from real appreciation of the Turkish lira are expected in this period. In this context, it is estimated that export revenues, which are expected to be 62 billion dollars in 2004, will reach 88.9 billion dollars in 2007.

Imports, which are expected to reach 95.5 billion dollars in 2004 due to increasing domestic demand, are anticipated to slow down in the following years and to realize as 125.2 billion dollars in 2007 (See Box 2.5).

Tourism revenues were recorded as 13.2 billion dollars in 2003. This resulted from good performance of tourism and the change in the methodology used in the calculation of tourism revenues. This performance is expected to continue during the forthcoming period. However, in the 2004 Pre-Accession Economic Programme, conservative assumptions have been made about tourism revenues and tourism revenues are expected to reach 20.6 billion dollars in 2007.

In this context, current account deficit, which is estimated to be 14.6 billion dollars in 2004, is expected to improve during the Pre-Accession Economic Programme period and realized around 10-11 billion dollars. The ratio of current account deficit to GDP, which is foreseen as 4.9 per cent in 2004, is expected to be 3 per cent in 2007.

Box: 2.5. Developments in Imports

In parallel to high growth rates since 2002, the recovery in domestic demand was also reflected in imports. The increase in imports in the January-September period of 2004 was realized as 42.4 per cent compared to the same period of 2003. Considering the composition of imports in the same period, increases in imports of capital goods, intermediary goods and consumer goods were realized as 68.5 per cent, 29.4 per cent and 101.8 per cent, respectively.

A sub-item of imported capital goods containing transportation vehicles incidental to industry and equipment, which stood at 0.8 billion dollar in January-September 2003, rose to 3.1 billion dollars in the same period of 2004, which represented a 284.5 per cent increase. Meanwhile, imports of capital goods other than transportation vehicles and incidental to industry which was 6.6 billion dollars in January-September period of 2003, increased by 42.3 per cent and rose to 9.4 billion dollars in the same period of 2004.

Furthermore, the rise in imports of intermediate goods were in parallel with the increase in exports. In addition, reduced cost of imported inputs as a result of real appreciation of the Turkish lira triggered procurement of inputs from other countries. While imports of intermediate goods in January-September period of 2003 were 36.5 billion dollars, it reached 47.3 billion dollars in the same period of 2004. The highest increase in imports of intermediate goods was recorded in parts of transportation vehicles, which went up 79.7 per cent in January-September period of 2004 and reached 4.7 billion dollars, up from 2.6 billion dollars in the same period of 2003. Thus, the increase in imports of capital goods and intermediate goods partly resulted from the rise in imports of transportation vehicles and their parts accessories.

Table: Imports by Classification of Broad Economic Categories (BEC)

(Million Dollars)

BEC Description	2001	2002	2003	2003 J-Sep	2004 J-Sep	Percentage Change (1)
Total	41,399	51,554	69,340	49,285	70,198	42.4
Capital Goods	6,964	8,492	11,326	7,412	12,487	68.5
Transportation Vehicles Incidental to Industry	1,058	828	1,503	801	3,079	284.5
Other Capital Goods	5,906	7,664	9,823	6,611	9,408	42.3
Intermediate Goods	29,971	37,443	50,012	36,540	47,267	29.4
Parts of Transportation Vehicles	2,416	2,632	3,942	2,635	4,734	79.7
Consumer Goods	4,084	5,008	7,536	5,002	10,093	101.8
Automobiles	588	814	2,220	1,180	3,144	166.5
Durable Consumer Goods	708	739	917	636	1,057	66.2
Semi-durable Consumer Goods	827	920	1,265	895	1,387	55.1
Non-durable Consumer Goods	1,447	1,899	2,355	1,711	2,352	37.4

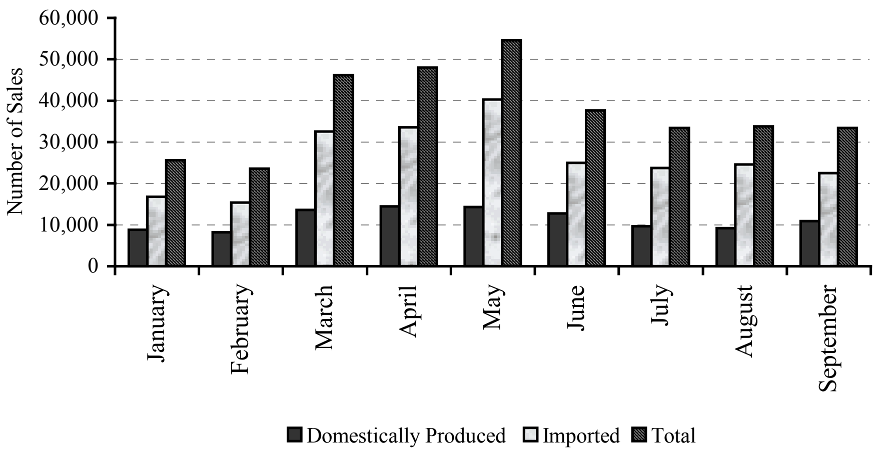
Source: SIS

(1) Percentage change in the January-September period of 2004 as compared to the same period of 2003.

The movement of exchange rates in favor of increase in import demand and the realization of postponed demand in this period increase the share of imports of consumer goods in total imports from 10.1 per cent in January-September period of 2003 to 14.4 per cent in the same period of 2004. Thus, the rise in imports of consumer goods was a major contributor to the increase in total imports.

The main reason of the increase in the imports of consumer goods is regarded as the rising domestic consumption demand. The increase in private consumption was recorded as 13.5 per cent in the first half of 2004. On the other hand, the increase in the private durable consumption goods was realized as 55.3 per cent.

Figure: Monthly Automobile Sales in 2004



Source: Automotive Manufacturers Association

The composition of private durable consumption indicates that automobiles was one of the major items in private durable consumption in the first quarter of 2004. Figures indicate that car sales, which stood at 63,751 in the first half of 2003, went up to 235,675 in the same period of 2004, which represented a 270 per cent rise. Sale of imported automobiles increased by 290 per cent in this period. In parallel to this trend, imports of automobile increased by 236 per cent.

Some measures were, however, taken in the second half of 2004 in order to control factors that led to an increase in automobile sales in the first half. Tax concession applied to scrapped cars, which was implemented after August 2003, was cut by 50 per cent in May 2004 and it will be totally abolished at the end of 2004. Consumer loans, which rose sharply after the second half of 2003, started to fall following the rise in interest rates on consumer loans in May 2004. The Resource Utilization Support Fund levy was increased from 10 per cent to 15 per cent, which served as a deterrent factor in loan utilization. In addition, Special Consumption Tax imposed on automobiles was raised in the range of 7 to 9 percentage points. In addition to these measures, realization of postponed consumption to a large extend and 15 per cent nominal depreciation of the Turkish lira after May, are expected to lead to a slowdown in private consumption, durable consumption in particular, in the second half of the year and thus lead to a decline in consumer goods imports. Additionally, given that imports of transportation vehicles was the main contributor of the rise in imports of capital goods and intermediate goods, with the undertaken measures, not only imports of consumer goods, but also total imports are expected to pursue a downward trend. Thus, imports of automobiles, which was 476 million dollars in May 2004, dwindled to 297 million dollars in September. Those figures signal that there will be a decline in the second half of 2004 as compared with the first six months.

Table: Imports of Motor Vehicles, Parts and Accessories by Sub-Chapters in 2004

(Million Dollars)

	Jan.	Feb.	March	April	May	June	July	Aug.	Sept.
Tractors	41	23	52	41	47	51	54	46	48
Buses, etc.	9	3	3	11	13	8	4	2	1
Automobiles	175	248	438	415	476	454	342	298	297
Spare Parts	196	202	289	304	312	346	338	238	284
Other Vehicles	71	88	189	159	194	210	164	142	152
Total	492	564	971	930	1,042	1,069	902	726	782

Source: SIS

Furthermore, the increase in oil prices is one of the factors that contributes to the increase in imports in 2004. Crude oil imports, which was 3.6 billion dollars in the January-September period of 2003, rose by 22.7 per cent and reached 4.4 billion dollars in the same period of 2004.

Capital and Finance Account

Despite a high current account deficit in 2004, it is anticipated that capital flows will finance this deficit and reserves will increase by an amount of 1.3 billion dollars in 2004. It is, however, estimated that capital outflows resulting from repayment of approximately 20 billion dollars to the IMF during the period of 2005-2007, and from the current account deficits, will lead to a 5.6, 4.7 and 1.7 billion dollars decline in the official reserves in 2005, 2006 and 2007, respectively.

Important steps were taken in the past two years in order to increase foreign direct investment in Turkey. In this context, arrangements were made in areas like, removal of administrative obstacles, reduction of bureaucratic formalities, and taxes and incentives. Efforts are also underway to improve the investment climate and to encourage foreign investment. Detailed information about this issue is given in Section 4.1.3.

Results of the reforms concerning foreign investments started to be observed in 2004. In this context, foreign direct investment in Turkey, which was 1.6 billion dollars in 2003 went up to 2.3 billion dollars in the first nine months of 2004. Foreign direct investment in Turkey, which is expected to be around 2.9 billion dollars in 2004, is expected to reach substantial levels in the coming periods and exceed 4 billion dollars starting from 2005 onward.

Table: 2. 7. Balance of Payments Forecasts

(Billion Dollars)

	Realization			Forecast			
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Current Account	3.4	-1.5	-7.9	-14.6	-11.1	-10.8	-10.5
Balance on Goods	-3.7	-7.3	-14.0	-22.6	-21.2	-22.3	-23.6
Exports	34.4	40.1	51.2	66.2	76.0	84.7	93.9
Exports (fob)	31.3	36.1	47.3	62.0	71.0	79.7	88.9
Imports	-38.1	-47.4	-65.2	-88.8	-97.2	-107.0	-117.5
Imports (cif)	-41.4	-51.6	-69.3	-95.5	-104.0	-114.2	-125.2
Balance on Services	9.1	7.9	10.5	12.7	14.9	16.0	17.1
Credit	16.0	14.8	19.0	23.0	25.8	27.5	29.3
Tourism (1)	8.1	8.5	13.2	16.0	18.0	19.3	20.6
Debit	-6.9	-6.9	-8.5	-10.4	-10.9	-11.5	-12.1
Balance on Income	-5.0	-4.5	-5.4	-5.7	-5.9	-6.0	-6.0
Credit	2.8	2.5	2.2	2.4	2.5	3.5	3.6
Debit	-7.8	-7.0	-7.7	-8.2	-8.4	-9.5	-9.6
Current Transfers (2)	3.0	2.4	1.0	1.2	1.2	1.5	1.9
Workers' Remittances (1)	2.8	1.9	0.7	0.9	0.9	0.9	1.1
Capital and Financial Account							
Financial Account (inc. Reserves)	-1.7	1.4	2.9	12.7	11.1	10.8	10.5
Foreign Direct Investment	2.8	0.9	1.1	2.0	3.7	3.8	3.9
Direct Investment Abroad	-0.5	-0.2	-0.5	-0.9	-0.9	-1.0	-1.1
Direct Investment in Turkey	3.3	1.0	1.6	2.9	4.6	4.8	5.0
Portfolio Investment	-4.5	-0.6	2.6	5.6	2.6	3.3	2.7
Assets	-0.8	-2.1	-1.4	-0.3	-1.1	-1.1	-1.1
Liabilities	-3.7	1.5	4.0	5.9	3.6	4.4	3.8
Equity Securities	-0.1	0.0	1.0	0.9	1.0	1.0	1.2
Debt Securities	-3.6	1.5	2.9	5.0	2.7	3.4	2.6
Other Investment	-2.7	7.3	3.3	6.5	-0.8	-1.1	2.2
Assets	-0.6	-0.8	-1.0	-4.5	-0.6	-0.8	-1.1
Monetary Authority	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General Government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Banks and Other Sectors	-0.6	-0.8	-1.0	-4.5	-0.6	-0.8	-1.1
Liabilities	-2.1	8.0	4.3	11.1	-0.2	-0.3	3.2
Monetary Authority (3)	11.0	-4.8	-1.0	-4.4	-2.8	0.0	0.0
General Government (3)	-2.0	11.8	-0.8	0.4	-5.0	-8.7	-6.0
Banks and Other Sectors	-11.1	1.0	6.0	15.1	7.6	8.4	9.2
Official Reserves (3)	2.7	-6.2	-4.0	-1.3	5.6	4.7	1.7
Net Errors and Omissions	-1.7	0.1	5.0	1.8	0.0	0.0	0.0

(1) Definition of tourism revenues in the balance of payments account was changed in 2004 in a way to cover the domestic expenditures of Turkish citizens resident in foreign countries, and this change was reflected to 2003 figures as well. As a result of this change, tourism revenues of 2003 are revised upwards and workers' remittances of 2003 are revised downwards.

(2) It was identified that a part of the inflows under the import with waiver item was actually provisional imports in the form of financial leasing while another part was actually not imports with waiver. In this framework, the necessary changes under the current account balance were made.

(3) Due to the fact that new Stand-By negotiations with the IMF was continuing during the preparation process of the Pre-Accession Economic Programme, the credit amount that can be utilized in the context of this agreement was not included in the balance of payments figures. However, the fall in official reserves will decrease depending on the credit utilization from the IMF.

Portfolio investments are expected to reach 5.6 billion dollars in 2004. Portfolio investments are expected to decline to 2.6 billion dollars in 2005, but increase to around 3 billion dollars in 2006 and 2007. Treasury bond issues abroad is expected to be around 5 billion dollars during the period of 2005-2007.

The general government's net contribution to capital flows is expected to be around 2.4 billion dollars in 2004. However, it is expected to be -3, -6.3, and -4.4 billion dollars in 2005, 2006, and 2007, respectively, due to high repayments to the IMF during this period.

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

Any change in the set of assumptions of the baseline scenario of the macroeconomic framework foreseen for 2004-2007, might cause deviations from the macroeconomic framework. In this section, firstly, the case of exports performing below projections due to a decline in external demand, is analyzed. Secondly, risks associated with monetary policy and inflation in the forthcoming period are analyzed.

A Slowdown in Export Performance

This scenario analyzes how macroeconomic balances could be affected by a possible decline in export performance due to a lower external demand of Turkey's trade partners. The macroeconomic indicators that could be directly affected by such an outcome are presented below. The analysis given in this section has been conducted by applying a shock to the macroeconomic model used in development of the baseline scenario. In this context, if actual export revenues realize lower by an amount of 1 per cent of GDP compared to the baseline scenario for 2005-2007 period, it is estimated that GDP will increase 1.8 and 0.1 percentage points less compared to the baseline scenario in 2005 and 2006, respectively and no growth effect is observed for 2007. This projection implies that a possible slowdown in exports could have a serious impact on growth especially in the first year of the shock.

In addition, the effects on current account balance will be limited in parallel to a decline in imports. This results from the high growth elasticity of imports. In fact, when preceding periods are considered, there were sharp increases in imports during periods of high economic growth, as in 2004.

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

	The Baseline Scenario			Difference from the Baseline Scenario		
	2005	2006	2007	2005	2006	2007
GDP Growth (Per cent)	4.8	5.1	5.1	-1.8	-0.1	-0.0
Exports (fob, Billion Dollars)	71.0	79.7	88.9	-3.0	-3.1	-3.3
Imports (cif, Billion Dollars)	104.0	114.2	125.2	-2.4	-3.0	-3.5
Current Account Balance / GDP (Per cent)	-3.7	-3.4	-3.0	-0.3	-0.1	0.0

Risks Associated with Monetary Policy and Inflation

Significant gains were achieved towards providing economic stability, in particular curbing inflation, during the process of moving to explicit inflation targeting. High growth rates achieved in the national income together with sharp falls recorded in inflation for three consecutive years, were possible, as a result of the implementation of the current economic programme without any major concessions. It is imperative that the Central Bank, acting as an independent body focusing on inflation, use monetary policy tools effectively, in order to maintain these gains and to provide permanent price stability by taking these gains further over the medium term. For this reason, the biggest risk that could be confronted with in the near future concerning inflation would be developments that could reduce the effectiveness of the monetary policy.

One of the main factors that determine the effectiveness of the monetary policy is fiscal policy implementation. Maintaining the fiscal discipline and continuing to achieve primary surplus in this context, prevent high volatility in risk premium by reducing the fragility of debt dynamics in the public sector, and increase the effectiveness of short term interest rates, which is the Central Bank's basic policy tool. In addition, steps towards strengthening the fundamentals of the public sector balances have a positive effect on expectations, thereby contribute to the weakening of inertia in inflation and support the downward trend in inflation.

Concessions from fiscal discipline, therefore, constitute one of the major risks that could interrupt the decline in inflation. Given the recovery of domestic demand, which started in mid-2003 and expected to continue in the coming periods, the importance of maintaining fiscal discipline, incomes policy compatible with targeted inflation and the continuation structural reforms, become even more obvious.

Meanwhile, another risk for price stability over the medium-long term is the possibility of failing to ensure continuity of structural reforms. Laying emphasis on structural arrangements aimed at removing obstacles to investment and production and at creating a competitive environment, is of crucial importance, in order to ensure that the productivity increases, which made significant contribution to the decline in inflation over the past three years, continue over the medium-long term. In addition, uninterrupted implementation of structural reforms aimed at increasing efficiency in the public sector, will play a key role in keeping price increases in the public sector in line with the targeted inflation rate, by contributing to quality of fiscal discipline.

Beside all these factors, developments in exchange rate, which could occur as a result of differentiations in global liquidity trends, still maintain their importance in terms of determining inflation dynamics, although a relative decline has been observed in exchange rate pass-through on prices. Exchange rates and whether the decrease in pass-through on prices is structural, are being monitored closely. Exchange rates are expected to be influenced mainly by external factors in the coming periods. Main risks originating from external factors include the rapid increase in global oil prices, political instability and military conflicts in Turkey's region, and interest rate policies in developed countries such as the United States and the European Union. Developments related to Turkey's process of accession to the European Union and continuation of relations with the IMF will also affect exchange rates, as they are being closely monitored by market players. Meanwhile, it should also be taken into consideration that credibility and political stability achieved by the economic program implemented in the past three years has reduced vulnerability to external shocks.

Finally, growth in global economy indicate that prices of imported raw materials will remain high for a while. If this trend continues for a long period, inflationary expectations may increase again. The Central Bank, however, will continue to follow these developments closely and respond by adapting a proper monetary policy, should oil shocks create long term inflationary expectations.

3. PUBLIC FINANCE

3.1. Objectives of Fiscal Policy

Fiscal Policy

Since the beginning of 2000, the basic objectives of the fiscal policy are, to contribute to the establishment of a sustainable growth environment, to support the efforts toward disinflation, and to achieve a substantial level of public sector primary surplus in order to reduce the debt stock to a sustainable level. These fundamental objectives constitute the framework of the fiscal policy, which is going to be implemented till the end of 2007. Public revenue, expenditure, and borrowing policies will be implemented efficiently and consistently with these fundamental objectives.

Public Revenues Policy

Public revenues policy will be implemented under the context of the following objectives, which are;

- implementation of a tax policy which is compatible with the targeted primary surplus,
- strengthening the implementation, monitoring and auditing functions of the tax administration, and rationalizing the tax system in order to control the unregistered economy,
- efficient implementation of tax policies in a way to increase investment and employment,
- simplification of tax legislation by revising the provisions about the exemptions, allowances and tax reductions in the tax laws, in the context of economic and social policies.

In line with those objectives, arrangements have been made in order to eliminate the structural problems in the tax system, to generate efficiency in the tax management, to meet requirements of taxpayers, to improve the investment climate in order to achieve a sustainable growth and an increase employment, and to ensure that opportunities created by economic and technological development are used in the taxation process.

A draft law on restructuring the revenue administration functionally so that it can manage the tax system efficiently, has been prepared, and is expected to be enacted soon. This regulation is intended to;

- Restructure the General Directorate of Revenues as a sub-department of the Ministry of Finance, and to ensure that it has a functional structure,
- Reorganize the provincial organizations, and transfer the responsibilities of the local revenue offices to the General Directorate of Revenues,
- Create a more taxpayer oriented organization,
- Improve the quality and increase the number of the personnel employed by the revenue administration.

The second phase of the Tax Office Full Automation Project, which is an information technologies project aimed at increasing efficiency and effectiveness of tax administration as well as tax collection, was launched late in April, 2004. The project intends to extend the automation of tax offices, to receive tax statements via the internet, to provide automation in tax audit, and to bring unregistered economic activities into the scope of registered economy, by creating a data base. In addition, tax laws and regulations will be amended in order to revise tax exemptions and exceptions and to reduce types of taxes as part of the efforts to simplify and rationalize the tax system.

Public Expenditures Policy

The main objective of the expenditure policy is to achieve expenditure discipline by increasing efficiency in public services, and to avoid creating pressure on public borrowing requirements through expenditures.

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

The following policies concerning expenditures are going to be pursued in the medium term:

- A comprehensive personnel policy reform and reorganization of the public personnel system are foreseen.
- The policy of reduction of overemployment in the public sector will continue.
- Wages and salaries in the public sector will be determined in line with the inflation target and in a way so as to maintain the fiscal balances and a fair distribution of wages.
- The health expenditures of social security institutions will be brought under control. Implementation of the measures concerning pharmaceuticals, health care services and premium collection will be continued, in order to reduce transfers from the budget to social security institutions.
- Regulations will be made in order to redefine the distribution of duties and authority among the central government and local administrations, and to reorganize local administrations to increase their authority and responsibilities, so as to bring expenditures under control and ensure efficient allocation and utilization of resources according to strategic priorities.
- Efforts to rationalize the public investment programme will continue by taking into consideration the sectoral priorities and available resources.
- To increase efficient utilization of resources in the public sector and to meet the demands of society through an outcome effective approach, the necessary capacity to implement strategic planning in governmental institutions will be developed in line with the national policy framework. Pilot organizations guided by the SPO will draw up their strategic plans and prepare their budgetary proposals for 2006 in accordance with these plans.

Public Finance Projections (2004-2007)

The general government fiscal balance is achieved by the consolidation of revenues and expenditures of consolidated budget, local administrations, funds, social security institutions and revolving funds. In addition to the general assumptions related to growth, inflation, interest rates, balance of payments, and nominal wage increases for the period of 2004-2007, the following assumptions were taken into consideration during the projection process of the general government accounts.

Assumptions related to the revenues:

- Effect of reductions in corporate and income tax that can be initiated during the period of 2005-2007 on revenues is assumed to be neutral. In other words, revenue losses are assumed to be compensated by other measures.
- Corporate income tax rate, which was 33 per cent in 2004, is foreseen to be 30 per cent in the period of 2005-2007.
- The effect of inflation accounting, which was launched in 2004, was taken into consideration in the projections.
- Due to privatization, it was assumed that the amount to be transferred to the budget from the revenues and dividends of the SEEs will be reduced, starting from 2004.
- In the period of 2004-2007, a total of 6 billion dollars is targeted to be accumulated in the privatization fund.
- Income and expenditure projections concerning special revenues and special allocations will be included into the initial budget appropriations and projections of budget revenues as from 2005.

According to the projections taking these assumptions into consideration, total general government revenues, which are expected to be 43.4 per cent of GDP in 2004, are projected to increase to 43.7 per cent of GDP in 2007.

Assumptions related to expenditures:

- It was assumed that the policy of limiting the number of sector personnel will continue.
- Efforts aimed at rationalizing the public investment program will be maintained in the forthcoming period and supported by additional measures to improve the programming process.
- The financial impact of the General Health Insurance that is expected to be launched in 2005, was not reflected to the fiscal balance. It is expected that the overall cost of General Health Insurance will be neutralized due to the measures taken. The share of funds transferred from the budget to the social security institutions in the national income will be reduced, through implementation of measures regarding expenditures on medication and medical treatment as well as the measures to increase premium collection.
- The transfer expenditures which constitute an important portion of general government expenditures have been in a significant downward trend, since 2003. In the 2004-2007 period, a decrease in transfer expenditures is foreseen due to the implemented saving measures and declining interest payments in budget based on the assumption that Treasury will have opportunity for long-term and low-cost borrowing.
- It is assumed that direct income support system and payment of premium for some agricultural products will continue.
- By decreasing the quantity of crop purchases, stocks will be reduced and implementation of alternative crops project will continue.

According to the projections based on these assumptions, it is estimated that the share of general government expenditures in GDP, which was 49.7 per cent in 2004, will steadily declined to 44.2 per cent in 2007. Non-interest expenditures, which accounted for 35.6 per cent of GDP in 2004, is expected to reach 36.7 per cent in 2007. Thus, the key factor in the anticipated decline in general government expenditures is the significant decline in consolidated budget interest payments.

Table: 3. 1. General Government Revenues and Expenditures

(Per cent of the GDP)

	2004	2005	2006	2007
Taxes	25.9	27.0	27.1	27.2
Direct	7.4	6.9	6.7	6.6
Indirect	17.8	19.4	19.7	19.9
Wealth	0.7	0.7	0.7	0.7
Non-Tax Revenues	2.9	2.7	2.5	2.4
Factor Incomes	6.4	6.4	5.8	5.5
Social Funds	7.9	8.1	8.0	8.0
Total	43.0	44.1	43.5	43.1
Privatization Revenues and Asset Sales	0.4	0.3	0.6	0.6
Total Revenues	43.4	44.5	44.1	43.7
Current Expenditures	17.7	17.5	17.4	17.3
Investments	3.4	3.9	3.9	3.9
Fixed Investment	3.4	3.9	3.9	3.9
Change in Stocks	0.0	0.0	0.0	0.0
Transfers	28.5	27.5	25.0	23.1
Current Transfers (net)	27.8	26.9	24.3	22.4
Capital Transfers	0.7	0.6	0.7	0.7
Stock Revaluation Fund	0.0	0.0	0.0	0.0
Non-interest Expenditure	35.6	36.9	36.9	36.7
Total Expenditures	49.7	48.9	46.2	44.2
Borrowing Requirement Excluding Interest Payments (1)	-7.8	-7.5	-7.2	-7.0
Borrowing Requirement	6.3	4.4	2.1	0.5

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

(1) Borrowing Requirement Excluding Interest Payments given in the table is calculated by subtracting total non-interest expenditures of the general government from total revenues of the general government. For this reason, these figures are different from the total public and consolidated budget figures in the IMF Stand-By Program. However, these differences emerge completely from definitional differences.

General government fixed capital formation, which is foreseen as 3.4 per cent of GDP in 2004, is expected to rise by 0.5 percentage point and reach 3.9 per cent in 2005-2007 period. Thus, the partial compensation of substantial reductions in investment expenditures due to measures regarding primary surplus targets over the last years, is intended.

General Government Borrowing Requirement

General government borrowing requirement, which was 10.1 per cent of GDP in 2003, is anticipated to decline substantially after 2004 and fall to 0.5 per cent in 2007. The most important factor in this development is the considerable decline expected in consolidated budget interest payments. In addition, the increases foreseen in privatization revenues and bringing the deficits of social security agencies under control will also contribute to the reduction of the borrowing requirement.

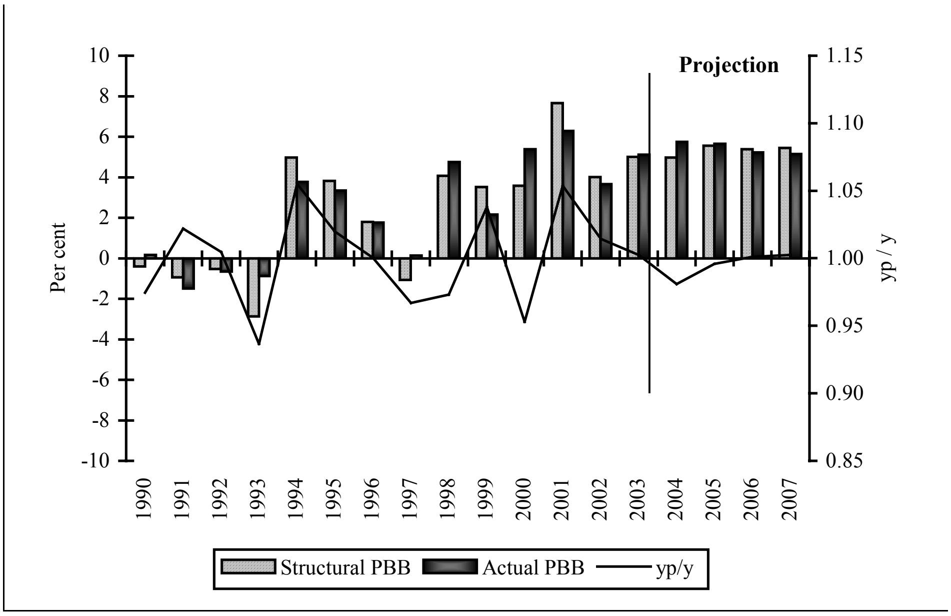
General government primary budget surplus, which is expected to be 7.8 per cent of GDP in 2004, is anticipated to decrease to 7 per cent in 2007.

The Pre-Accession Economic Programme for 2003 predicted that the borrowing requirement would reduce considerably and fall to 2.5 per cent of GDP in 2006. In this year's program, it is assumed that the annual decline in the borrowing requirement would be more significant due to the increased market confidence. The main factor behind that decline is the rapid fall in consolidated budget interest payments as a result of public debt management supported by a tight fiscal policy.

Structural and Cyclical Consolidated Budget Balance

The structural and cyclical budget for the Turkish economy was analyzed within the framework of the methodology which was presented in the Pre-Accession Economic Program in 2003 in details and used by the European Commission and the OECD.

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

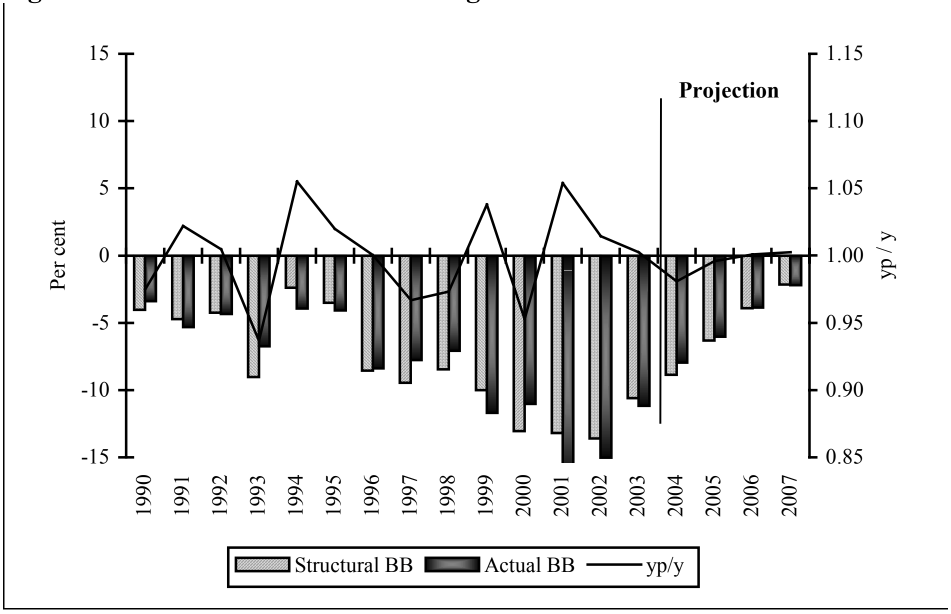


PBB: Primary Budget Balance yp/y: Potential Output / Actual Output

The ratio of the structural primary budget balance to GDP, which is shown in Figure 3.1, rose considerably with the Stand-By program put into effect in 2000 and increased to 4 per cent in 2002 and 5 per cent in 2003. The ratio of non structural primary balance is expected to maintain its high levels for the period of 2004-2007.

Figure 3.2 shows that the structural budget balance starts to a downward trend as a result of the fall in interest rates and high primary budget surplus. It is estimated that this trend will continue in the period of 2004-2007.

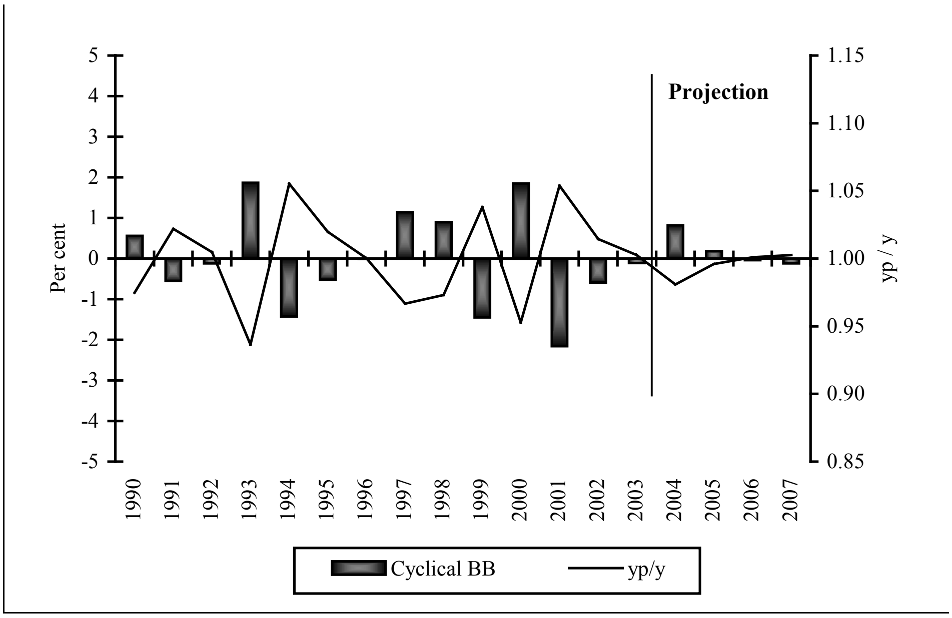
Figure: 3. 2. Actual and Structural Budget Balances



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

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

Figure: 3. 3. Cyclical Budget Balance



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

3.2. Public Debt Management

Institutional Responsibilities For Debt Management and Borrowing Limits

Debt management is handled in accordance with the borrowing limit determined by Article 5 of the Law No.4749 on Regulating Public Finance and Debt Management, which was enacted on April 9, 2002.

According to the Law, the fundamental principles of public debt and risk management are as follows:

- Following a sustainable, transparent, and accountable borrowing policy in harmony with monetary and fiscal policies while taking the macroeconomic balances into account,
- Meeting funding requirements at the lowest possible cost over the medium and long term subject to the specified risk level, which is determined according to the conditions in the domestic and international markets as well as the cost factors.

Borrowing limit is defined as the difference between the total initial appropriations and the estimated revenues specified in the budget law of the fiscal year. Net borrowing limit may be raised up to 5 per cent by the decision of Council of Ministers, depending on the requirements and development of debt management in accordance with the same article of the Law.

Debt Management Strategy

In order to enhance transparency in public debt management and to assure effective borrowing based on performance with minimum cost and at a reasonable level of risk, a strategic benchmark, which is determined according to cost and risk calculations, was established starting from 2004. In this context,

- using Turkish lira denominated instruments as the major source of total borrowing,
- using fixed rate Turkish lira denominated instruments as the main source of cash domestic borrowing,
- lengthening the average maturity of cash domestic borrowing including FX denominated and indexed ones in line with the market conditions,
- keeping a certain level of cash reserves throughout the year in order to reduce the liquidity risk associated with cash and debt management,

were foreseen.

Public confidence and positive expectations in domestic and international markets, which will be maintained through structural reforms to be carried out in 2004-2007 period are predicted to reduce borrowing costs. Thus, it is expected that the ratio of the public debt stock to GDP will continue to decline.

Meanwhile, high primary surplus, which is anticipated to be achieved in the framework of implemented economic program, will maintain confidence in the markets and lead to a decline in public debt stock.

Contingent Liabilities

These are the liabilities that are not public debt but become public debt in the case of undertaking by the government. The obligations which are established by a contract or law are stated as explicit contingent liabilities, whereas the others are called as implicit contingent liabilities.

The risks like default of government agencies and local administrations in repayment of their debts that are not guaranteed by the Treasury constitute implicit contingent liabilities, which should be taken into account in Turkey's case.

In addition to that, third party limited guarantee granted to the civil aviation industry and saving deposit insurance which is limited with 50 billion Turkish liras per customer in the banking sector are the important explicit contingent liabilities that should be taken into account.

The Undersecretariat of Treasury grants repayment guarantees to public agencies which are not included in the general or annexed budgets in order to minimize their investment financing costs, to ensure the sustainability of growth, and to meet funding requirements related to multi year investments. Besides, Treasury investment guarantees are granted to public agencies which are not included in the general or annexed budgets and have take-or-pay agreements with build-operate-transfer or build-operate companies in connection with funding of projects based on build-operate-transfer or built-operate models.

The possibility of the undertaking of guaranteed debt repayments and liabilities arising from the take-or-pay contracts of institutions which are in bad financial condition by the Treasury constitutes an important part of the explicit fiscal risks.

Repayment Guarantee

Treasury guarantees were tracked outside of the consolidated budget accounts before 2002, as they did not create a direct burden on the budget and cause any cash transaction. In addition, this method was intensively used over years in order to reduce investment costs and to complete public sector investments quickly. State Economic Enterprises (SEEs) and local administrations, respectively, have used 60 per cent and 26 per cent of the total 9.3 billion dollars of Treasury guaranteed loans during the period of 1996-2002.

In this context, the shares of SEEs and local administrations in the total guaranteed debt stock increased over years.

However, starting from 1992, the Treasury has undertaken the Treasury guaranteed external debt of local administrations, initially, and then of other public agencies in the course of time as a result of their financial troubles. An amount of 8 billion dollars repayment has been made for guaranteed loans of the agencies between 1992 and 2002. Local administrations had the highest share in those payments, which were followed by SEEs.

Cash requirements arising from those obligations, which had not been included in the budget, had an adverse effect on debt and cash management of Treasury while leading to a considerable increase in the receivables stock of Treasury.

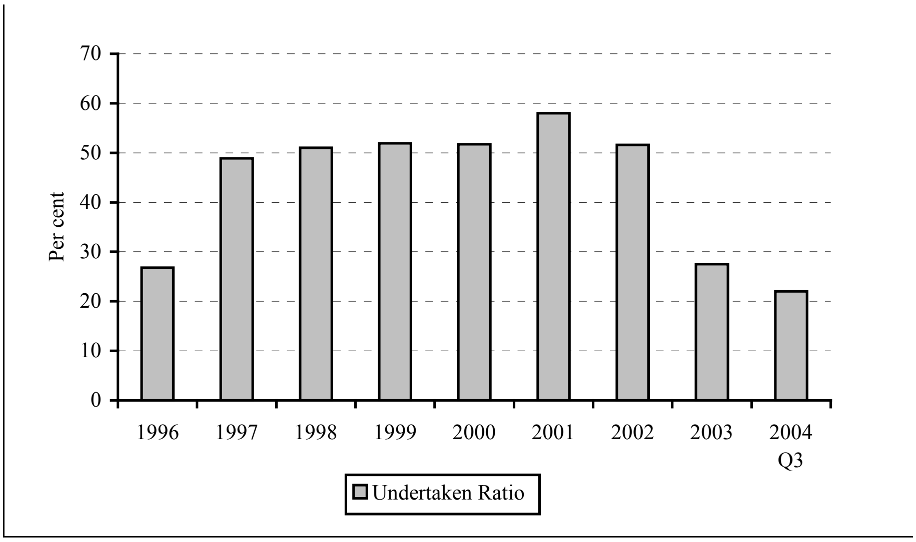
In order to minimize fiscal risks arising from explicit contingent liabilities, various legal measures have been taken since 1998, including imposing limits on guarantees.

With the Law on Regulating Public Finance and Debt Management, which was enacted in 2002, a more comprehensive and efficient infrastructure was created in order to ensure that transactions, which create obligations on the central government, are carried out by a single authority. Thus, easiness in tracking the financial transactions that are executed in line with public fiscal management and an active risk management strategy in terms of and contingent liabilities were established. A risk account was established in order to meet obligations arising from guarantees.

The effects of arrangements in the Borrowing Law became observable since the beginning of the 2002, increase in collections and decrease in undertaking rates were recorded.

While Treasury guaranteed debt stock, which was 6.3 billion dollars in 2002, decreased to 5.5 billion dollars by the end of June 2004, the undertaking rate fell from 52 per cent to 22 per cent during the first three quarters of 2004.

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



Considering the payment projection of Treasury guaranteed external debt in the medium term, it is observed that payment amounts enter into a falling trend.

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

(Million Dollars)

	Principal	Interest	Total
2004 Q3-Q4	668	106	774
2005	921	183	1,105
2006	741	151	892
2007	609	122	731
2008-2014 +	2,895	390	3,285

Note: Projections are based on commitments.

Investment Guarantees

Aside from repayment guarantees, investment guarantees granted to 15 power plants which were constructed by build-operate-transfer and build-operate models and a SEE engaged in the energy sector which has take-or-pay agreement constitute a major explicit contingent liability. If this SEE fails to discharge its obligations to the build-operate-transfer/build-operate companies, then the Treasury would have to undertake these obligations. These financial risks are taken into consideration in calculation of burdens that could arise from contingent liabilities, although there has been no payment obligation arising from these guarantees so far.

In addition, an investment guarantee was granted to a municipality in 1995 for its liability of water bill payment in the context of build-operate-transfer project. Total commitment undertaken for this investment guarantee was 1.1 billion dollars from 1999 to end of September 2004.

Treasury Receivables

In the analysis of the fiscal risks carried by the consolidated budget, risks arising from the Treasury's receivables stock should also be taken into account in addition to contingent liabilities. The Undersecretariat of Treasury has a total receivable stock of 40.1 billion dollars from other public institutions; as of end of September 2004, arising from undertaking of guaranteed debt and repayment of onlent loans . The receivable stock is formed of domestic debt as 64 per cent, external loans onlent to public agencies as 16 per cent, undertaken guaranteed debt as 15 per cent and undertaken built-operate-transfer project as 6 per cent. The high share of domestic debt in the receivables stock resulted from the domestic borrowing notes issued in order to provide funds for the Saving Deposit Insurance Fund in connection with the restructuring of the banking industry since 2000.

2004-2007 General Government Gross Debt Stock Projections

During the Pre-Accession Economic Programme period, an important improvement is anticipated in the ratio of the general government gross debt stock to GDP in a stable economic environment enhanced by the application of a tight fiscal policy and effective public debt management. This ratio, which reached 80.2 per cent in 2003 is expected to fall to 68.3 per cent in 2007.

Estimations for the debt stock to GDP ratio in PEP 2004 differs from PEP 2003 in three ways. Firstly, the definition of gross debt stock was harmonized with general government debt by deducting public debt excluding general government from the total debt stock. Secondly, the growth rate in 2004 is expected to exceed the predictions made in 2003 considerably. Thus, estimations about the ratio of gross debt stock to GDP remain below those given in the PEP 2003. Finally, real appreciation of the Turkish lira in 2004 decreased the ratio of debt stock to GDP, by reducing the Turkish lira equivalent of external debts.

In this context, data for the ratio of general government gross debt stock to GDP, which is estimated for 2004-2007, are presented in Table 3.3.

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

(Per cent of the GDP)

	Realization	Estimation			
	2003	2004	2005	2006	2007
Domestic Debt Stock	54.8	54.3	52.7	52.1	50.0
External Debt Sock	25.4	24.0	22.7	20.1	18.3
Total Debt Stock	80.2	78.4	75.3	72.2	68.3
Decrease in Total Debt Stock	-	1.8	3.1	3.1	3.9

3.3. Risks Associated with Public Finance

In the 2004-2007 period, tight fiscal policy aiming at a high rate of primary surplus has to be maintained in order to bring down the debt stock to GDP ratio, which is an indicator of the sustainability of the debt stock. The risk that may arise in achieving this aim are listed as follows:

- The domestic debt stock consists mainly of foreign exchange denominated/indexed and floating rate bonds. Therefore, unexpected increases that can be seen in exchange rates and interest rates create risks in terms of debt stock.

- Any developments negatively affecting the collection of premiums in the social security institutions and the insufficiency in controlling health expenditures may increase the transfers from the budget to social security institutions.
- The product purchases and input guarantees extended to the build-operate-transfer projects and credits under Treasure guarantee constitute a risk on the budget.
- If the foreseen targets of privatization revenue are not realized, this may create a negative impact on the budget and economic efficiency.

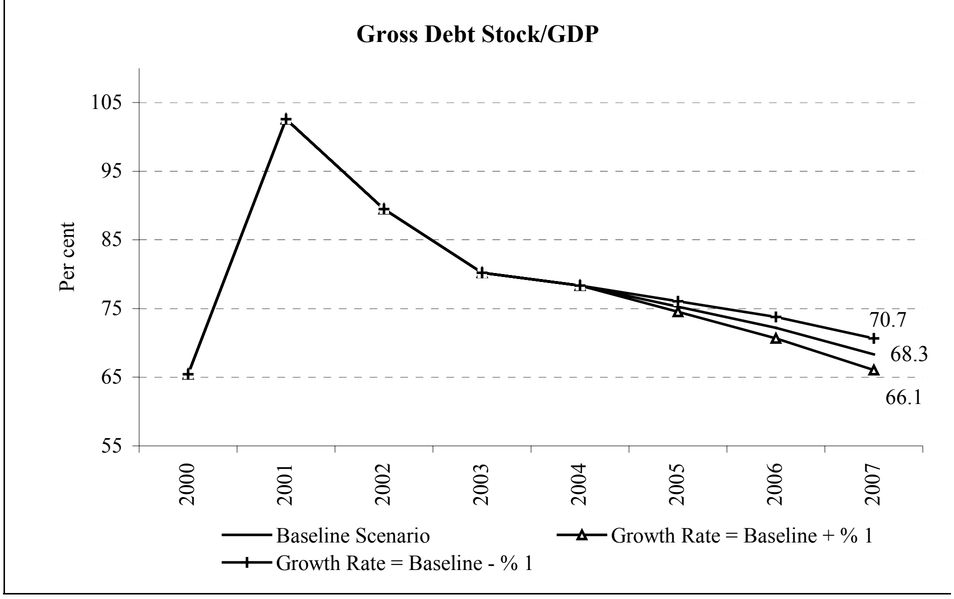
3.4. Sensitivity Analyses

Analyses of Accounting Approach

In this section, the sensitivity of general government gross debt stock to growth, real interest rates, primary budget surplus and real exchange rate were analyzed by using accounting approach[3]. In this context, general government gross debt stock was classified as Turkish lira denominated and foreign exchange denominated. The ratio of general government gross debt stock to GDP which is estimated as 78.4 for the end of 2004, is expected to fall to 68.3 by 2007 under the assumptions of the baseline scenario.

In the context of the analyses of sensitivity of debt stock to growth, two different scenarios were built based on the assumption that GDP growth rate would be 1 percentage point higher or lower than the baseline scenario annually beginning from 2005. The results are presented in Figure 3.5. According to these results, gross debt stock to GDP ratio will be 2.4 percentage points higher than the baseline scenario in 2007 when the growth rate is one percentage point lower than the baseline scenario. If, however, actual growth rate is one percentage point higher than the baseline scenario, then gross debt stock to GDP ratio will be 2.2 percentage points lower than the baseline scenario in 2007.

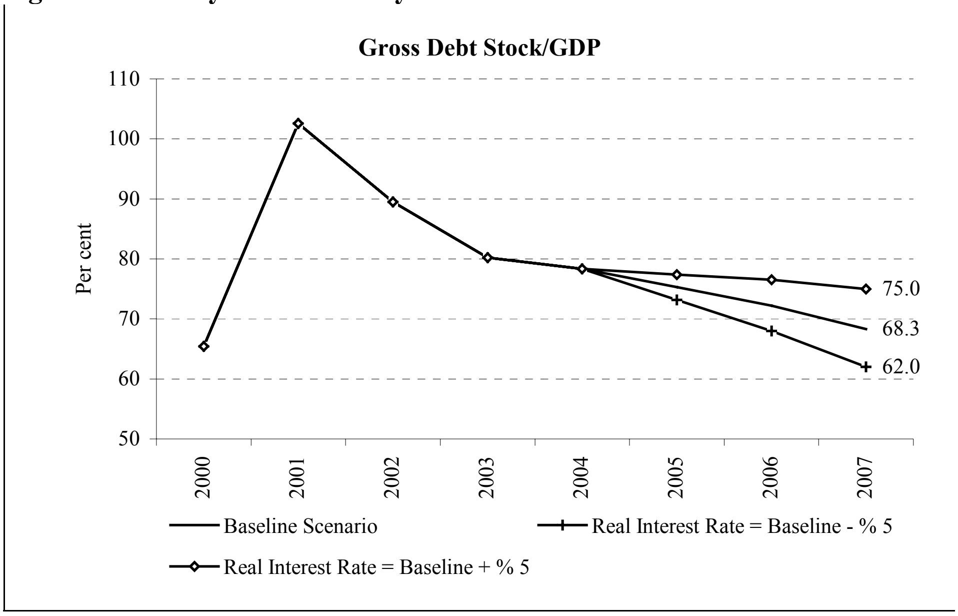
Figure: 3. 5. Analysis of Sensitivity to Growth Rate



[3] Detailed information about the accounting method is given in Public Finance section in the PEP 2003.

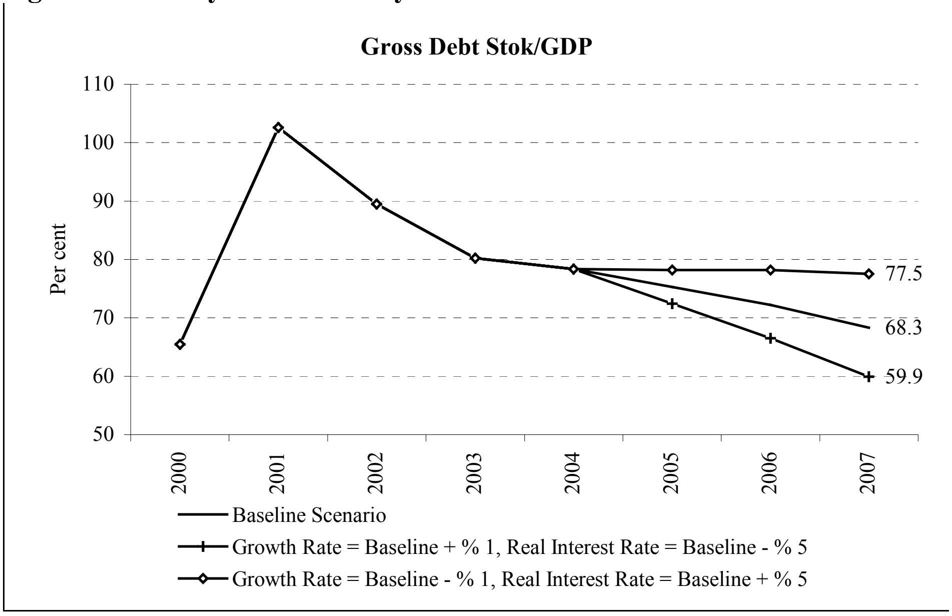
To analyze the effect of a change in real interest rates on Turkish lira denominated debt to the ratio of total debt stock to GDP, two different scenarios were built based on the assumption that real interest rates will be 5 percentage points higher or lower than the baseline scenario annually beginning from 2005. The results are presented in Figure 3.6. According to these results, the gross debt stock to GDP ratio will be 6.7 percentage points higher than the baseline scenario in 2007 if real interest rates remain 5 percentage points higher than the baseline scenario. On the other hand, if real interest rates are 5 percentage points lower than the baseline scenario, the gross debt stock to GDP ratio will be 6.3 percentage points lower than the baseline scenario in 2007.

Figure: 3. 6. Analysis of Sensitivity to the Real Interest Rate on Turkish Lira Denominated Debt



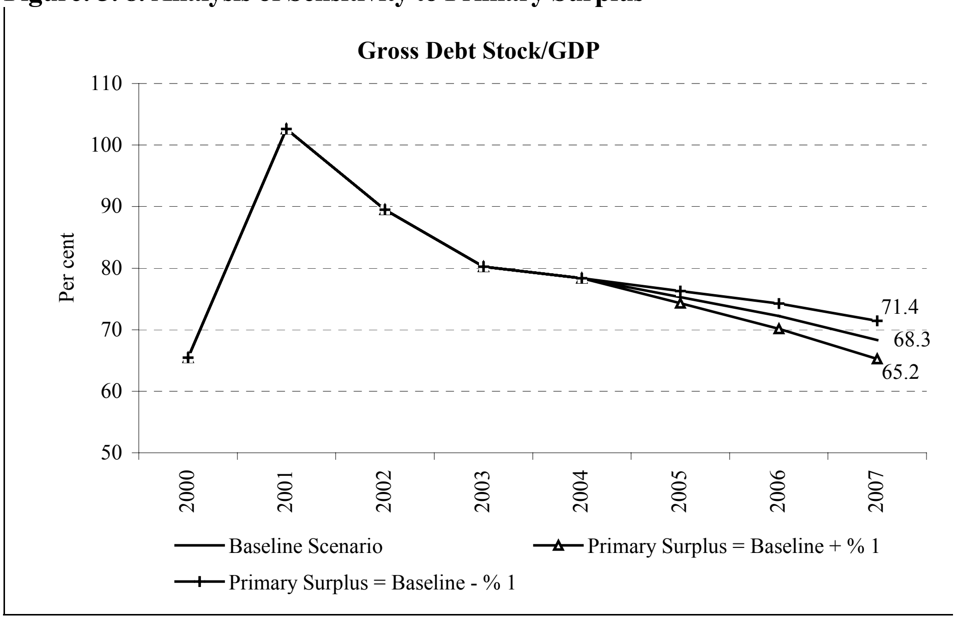
Two scenarios are built in order to analyze the effects of simultaneous changes in growth and real interest rates. In the optimistic scenario, it is assumed that the real interest rates on Turkish lira denominated debt will remain 5 percentage points lower while growth rate will be 1 percentage point higher than the baseline scenario annually beginning from 2005. On the other hand, in the pessimistic scenario it is assumed that real interest rates on Turkish lira denominated debt will remain 5 percentage points higher while the growth rate will be 1 percentage point lower than the baseline scenario annually beginning from 2005. The results of the analysis are presented in Figure 3.7. According to these results compared to the baseline scenario, the gross debt stock to GDP ratio will be 8.4 percentage points lower in the optimistic case while it will be 9.2 per cent higher in the pessimistic case in 2007.

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



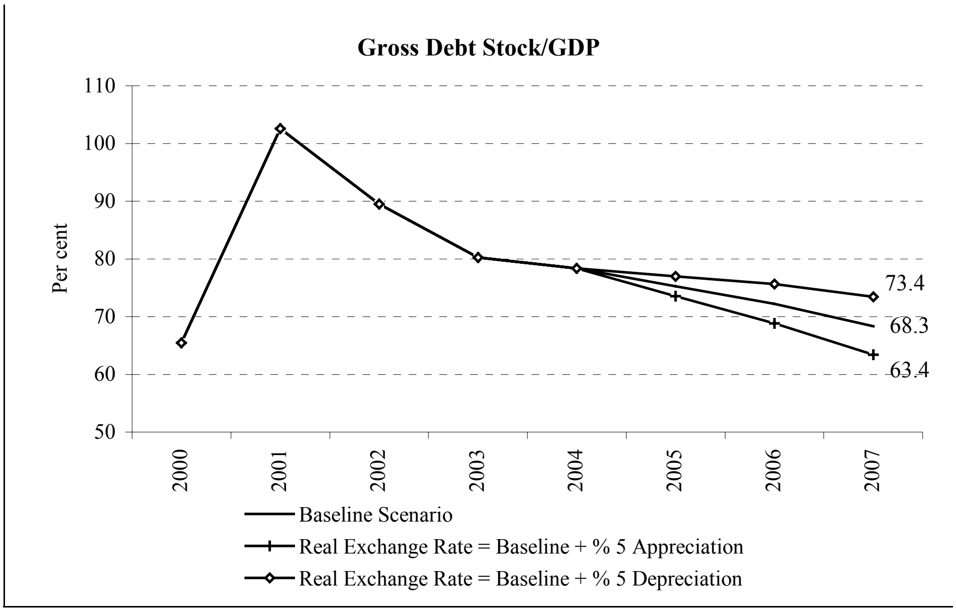
Within the analysis of sensitivity to primary surplus, under the assumption of realization of the primary budget surplus 1 percentage point lower or higher than the baseline scenario annually beginning from 2005, the gross debt stock to GDP ratio will be 3.1 percentage points higher or lower than the baseline scenario respectively in 2007.

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



Finally in the context of analysis of sensitivity of debt stock ratio to real exchange rate, two different scenarios are built based on the assumption that real exchange rate depreciates or appreciates by 5 percentage points more annually beginning from 2005 compared with the baseline scenario. The results are given in Figure 3.9. According to this, the gross debt stock to GDP ratio will be 5.1 percentage points higher than the baseline scenario in the case of real depreciation and it will be 4.9 percentage points lower in the case of real appreciation, in 2007.

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



The results of the analyses of accounting approach can be summarized as, in 2007 compared to the baseline scenario general government gross debt stock to GDP ratio will be higher than the baseline scenario by,

- 2.4 percentage points when the growth rate is 1 percentage point lower than the baseline scenario,
- 6.7 percentage points when the real interest rates is 5 percentage points higher than the baseline scenario,
- 9.2 percentage points when the growth rate is 1 percentage point lower and real interest rates is 5 percentage points higher than the baseline scenario,
- 3.1 percentage points when the primary budget surplus to GDP ratio is 1 percentage point lower than the baseline scenario and
- 5.1 percentage points when the real exchange rate depreciates 5 percentage points compared to the baseline scenario.

4. STRUCTURAL REFORMS

With the structural reforms that started in 2000, significant achievements have been realized towards maintaining a sustainable growth environment in Turkish economy and creating a highly competitive economical structure based on market conditions. Further development of this economical structure is the main target of the structural reforms to be implemented in PEP 2004 period.

In this context, the strengthening of the market mechanism and enhancing the role of the private sector in economy are targeted. There are on-going initiatives for developing a financial sector, which will be more effective in meeting the requirements of the real sector and for improving the qualifications of the labor supply. In addition, reforms in the administrative field have been progressing for running the public services more effectively, avoiding waste of resources and withdrawing the state from production in certain areas to strengthen its regulatory and supervisory role in the market. Moreover, structural reforms are undertaken at the agricultural sector to improve efficiency and competitiveness and to ensure effective resource utilization. It is foreseen that, with the improvement in public finance, the share of education, health, R&D and social expenses will be increased, the life quality of the society will be improved, the qualifications of the human capital will be developed, income distribution will be improved, the development gap among the regions will be narrowed and the fight with poverty will be continued.

4.1. Strengthening the Market Economy and Entrepreneurship

4.1.1. Privatization

Privatization has been an important item of the agenda in Turkey for the last twenty years and is one of the fundamental components of the current economic program. In line with the targets of integration to the world markets and accession to the European Union, bringing the productivity and cost structure of the economy to competitive levels and establishing the conditions of market economy is targeted with privatization. Moreover, it is targeted to establish international norms in the economy, to ensure that state quits from goods and services production and focuses on its core duties and to limit the economical activities of the state to supervising and regulation.

At present, there are 39 SEEs, of which 19 are included in the privatization program. Besides achieving general objectives of privatization, with the privatization of the SEEs, promotion of wider share ownership and technological renovation is expected to be ensured. Furthermore, the proceeds of privatization will contribute to eliminate public deficits and public debt stock.

As of September 2004, the state has withdrawn completely from certain sectors such as animal feed, dairy products, airport ground handling services, oil distribution, alcoholic beverages and cement industry (excluding those transferred to the portfolio of Savings Deposit Insurance Fund, SDIF); and transferred its dominant role in the textile, tourism, meat and fish products, marine transportation, forestry products/paper and cellulose industry, fertilizer and mining (silver and copper) sectors to the private sector. Iron-steel, natural gas distribution and port/marina administration sectors are the main operation fields, from which the state has withdrawn partially. On the other hand, efforts were made to privatize the state banks, and significant steps were taken to decrease the weight of the public on the financial sector. Within this framework, State banks Restructuring and Privatization Strategy was announced on July 2004 for privatization of the state banks. Based on this strategy, it is planned to privatize Ziraat Bank and Halkbank through public offering.

Table: 4. 1. Privatization Transactions, 1985-2004

Covered under the scope of Privatization *	Privatized	Current Situation	
		Under the Scope of Privatization	Under the Program of Privatizations
Public share in 241 companies, 22 incomplete plants 6 real estate holdings 4 power generation plants	176 companies have been privatized through either share or asset sales.	1 company 6 highways 2 bridges 26 electricity generation plants	34 companies 1 electricity generation plant 1 drinking water plant (Manavgat) Motor Vehicles Inspection Stations
The public still has less than 50 per cent share in 17 companies			

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

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

Revenues			Expenditures
Privatization Proceeds	Dividends and Other Revenues	Total	
8.9 billion dollars	3.9 billion dollars	12.8 billion dollars	12 billion dollars

In 2003, a total amount of 171.6 million dollars was obtained by the completion of privatization through sale/transfer. In 1 January-1 September 2004 period, the total amount of the privatization implementations, whose sale/transfer approvals were given and reached contracting stage, was 1.1 billion dollars. In addition, 1.3 billion dollars is the total amount of the privatization practices, completed in the same period, but of which legal procedures are continuing.

Sale/transfer process of Eti Gümüş (silver mines), Eti Bakır (copper mines), DİV-HAN and KBI Samsun Bakır (copper mines) has been completed. While the sale processes of Eti Elektrometalurji (metallurgy company) is completed, Eti Krom (chromium mines), Çayeli Bakır (copper mines), Samsun and Kütahya Gübre (fertilizers), Kütahya and Amasya Şeker (sugar) and some assets belonging to Sümer Holding are on the stage of signing the sale/transfer contracts. Also, a tender was issued in September for privatization of the motor vehicles inspection stations.

For the privatization of Türk Telekom, the limitations on share-sales to foreigners were abolished with the Law No.5189 on 16 June 2004. With the same Law, the coverage of golden share has been narrowed, satellite administration has been separated from Türk Telekom and a regulation has been brought in for the collection of Türk Telekom's all receivables in arrangement with the debtors. On the other hand, before the tender for block sale of Türk Telekom, an Information Process was completed in order to inform the potential investors on legal, operational and financial situation of Türk Telekom and the privatization process itself and to get opinions of the investors. For assisting Türk Telekom tender and valuation commissions, legal and financial consultancy firms have been assigned. As a consequence of these tasks, the tender for the block-sale of 55 per cent of Türk Telekom shares was declared on 25 November 2004.

Within the framework of the Electrical Energy Sector Reform and Privatization Strategy Document, TEDAŞ (Turkish Electricity Distribution Company) has been taken into the privatization programme and portfolio the on 2 April 2004. It is aimed to start tender process for the distribution companies and/or regions until 31 March 2005 and complete until the end of 2006. On the other hand, it is planned to start the privatization process for the generation plants on July 2006.

For privatization of T. Şeker Fabrikaları A.Ş. (sugar company), portfolio groups were formed from the plants of the company, and the tender announcement will be made in the shortest possible time for the first group.

The company, which will serve as consultant in public offering of Türk Hava Yolları A.O. (Turkish Airlines) and Petrochemical Corporation (PETKİM) was selected in August 2004. To start the privatization process concerning the conjuncture in global and national capital markets is planned. In this scope, the required applications were filed at the Capital Market Board for public offering of 20 per cent of Turkish Airlines shares, and the public offering process has been started. It is planned to complete this process in December. The studies for public offering of PETKİM are still continuing.

The proposal of law relating to the privatization of Milli Piyango (National Lottery) was submitted to the TGNA and the consultancy company was selected in August 2004. The tender will start after completion of the preparation works.

Alkollü İçkiler Sanayi ve Ticaret A.Ş. (Alcoholic Beverages Company), one of the subsidiaries of TEKEL, was privatized at the end of 2003, and a new privatization strategy is being developed for privatization of another subsidiary; Sigara Sanayii İşletmeleri ve Ticareti A.Ş. (Tobacco Company). Talks are continuing with the international tobacco companies, which participated in the previous tender, as well as other prospective companies. The tender process is expected to start in the last quarter of 2004, whereas the sale/transfer procedures are expected to be completed in 2005.

Almost all the assets of SEKA and Turkish Maritime Transportation Company (TDİ) were transferred to the private sector. The tender process for the remaining assets is still continuing.

4.1.2. Competition Law and Policies

Certain amendments were made to improve effectiveness in enforcement of the Law on the Protection of Competition. First of all, the powers, which may be used during on-site investigation were clarified, and it was made possible to make the investigation with a court decision, in order to avoid prevention of on-site examination by the competition experts, of the documents and information of the undertakings subject to investigation. Secondly, the provision, which allowed transfer of fines given by the Authority to the Authority budget, was annulled, since it could lead the Authority to a conflict of interest and damage its neutrality in its decision. Thirdly, in order to eliminate the uncertainties with respect to timing of the public announcement of the Board decisions, it was made possible to publish justified decisions of the Board in the Official Gazette without waiting for the outcome of the judicial review. Finally, in order to make strengthen the effectiveness of the fines given by the Board, it was regulated that the fines should not be collected at the end of the judicial review process, which could last longer, but instead after the final decision of the Board is notified to the relevant party.

The Directive on Group Exemption with respect to Research and Development Agreements, which was one of the objectives of PEP 2003 came into force. The agreements, which enable joint use of R&D results by more than one undertakings, mostly increase dissemination speed of the technical information among the parties, prevent duplicate R&D efforts and lead to new developments through exchange of complementary technical information. Within this framework, the Directive aims to protect the competition effectively on one hand and grant group exemption to undertakings, cooperating in certain subjects at R&D stage on the other.

Bilateral and multilateral protocols are being drafted to determine the restrictions and conditions with respect to distribution of the duties, powers and responsibilities among the independent organizations regulating the sector and with respect to their relations with the Competition Authority. As such, in the telecommunication sector, where voice and infrastructure monopoly was removed as of 1 January 2004, a protocol was signed between the Competition Authority and Telecommunication Authority in order to develop the cooperation and coordination at the sector and improve effectiveness in regulation and supervision of the sector. Negotiations are still continuing between the Competition Authority and the Energy Market Regulation Authority for executing a similar protocol at the energy sector.

Within the framework of the Draft Law on Monitoring and Controlling State Aids, it is foreseen to create a State Aids Monitoring and Controlling Board and also a unit within SPO will be established to act as secretary to the Board in order to avoid damage of competition through state aids.

4.1.3. Improvement of the Investment Environment

The Reform Program for Improvement of Investment Environment in Turkey was accepted in December 2001 with the principle decision of the Council of Ministers. In the context of this decision, an Investment Environment Improvement Coordination Board was appointed among representatives of various public and private sector organizations.

The purpose of the Reform Program is to increase domestic and foreign investments, by improving the investment environment. Thus, it is intended to prevent administrative obstacles faced by investors, to reduce or eliminate some unnecessary and repetitive bureaucratic transactions and thereby to complete the procedures rapidly.

The arrangements in the context of this reform will contribute to the areas of easing the entrance to market, elimination of obstacles and improvement of the infrastructure of intellectual property rights in line with Copenhagen Criteria.

In order to solve the above problems, Technical Committees on Company Registration, Employment, Sectoral Licensing, Investment Location, Tax and Incentives, Customs and Standards, Intellectual Property Rights, Direct Foreign Investment Legislation, Investment Promotion and SME were established and they continue to work within the framework of the reform program.

Within the scope of the studies of the Technical Committee on Company Association, the Law on Amendments on Turkish Commercial Code No.4884, Tax Procedural Law, Stamp Tax Law, Labor Law and Social Securities Law came into force on 17 June 2003. This law enabled association of a company in one day, by granting authority to Trade Registries and company association processes was reduced to 3 procedures from 19. The efforts are still continuing to eliminate the problems in company dissolutions and to allow association of companies in electronic environment.

In the context of the studies of the Technical Committee on Employment, the Law No.4817 on Work Permits of Foreigners was enacted on 6 March 2003. With this Law, by removing the disorganization and distributed power in the legislation of the employment of foreigners, working permits of foreigners are provided by single authority, Ministry of Labour And Social Security and thereby the prevention of unrecorded employment was aimed by eliminating the bureaucratic obstacles and lack of auditing. This Law annulled the Law No.2007 on Arts and Services Allocated to Turkish Citizens in Turkey. In this context, it is not necessary to be a Turkish citizen for working in the jobs like interpretation, tourism guide, photographer, driver, waiter. In addition, with the Regulation on employment of foreign employees in foreign direct investments, which came into force on 29 August 2003, a concept of foreign key personnel to be employed foreign direct investment is introduced, thus, it is aimed to develop a shorter and more flexible work permit process for short term key personnel, which will be different from the standard work permit procedures. The Draft Law on National Professional Standards Authority, issued by the commission with the participation of relevant public agencies and professional organizations, will be submitted to the relevant ministries.

Within the scope of the studies of the Technical Committee on Sectoral Licenses, studies on mining, food, pharmaceutics, chemicals and tourism sectors to simplify the legislation and bureaucratic procedures in the area of sectoral licenses were initiated. Thus, the Environmental Impact Assessment (EIA) process was shortened; the preliminary emission authorization was also cancelled for most of the investments upon issue of Regulation on Controlling Industrial Air Pollution. By the Law No.5178, enacted on May 2004, amended the Pastures Law, transactions on the amendment of the purpose of pastures allocation are transferred to provincial organization and revenue offices. Moreover, with the Regulation, issued on 2003 the procedures for changing the allocation purpose of agricultural lands are transferred to provincial organization. With the Law No.5177 Amending Mining Law and Certain Laws, came into force in June 2004 arrangements providing the unification of the legislation of the mining sector and securitization of mining licenses, removed preliminary operating license period and removing certain obstacles and restrictions of other legislations on the mining operations, also the Ministry of Energy and Natural Resources was authorized as for many permissions and certifications the single authority. Again in the Law No.5177 in order to prevent different practices with respect to municipal water basins, it is decided that the Water Basin Regulations issued by the municipalities to be united under a common and single regulation, which will be issued by the Ministry of Energy and Natural Resources. With the Law No.5179 on May 2004, the permissions granted by the Ministry of Health to the food enterprises were transferred to the Ministry of Agriculture and Rural Affairs by amending the Food Law. Moreover, the arrangements about the introduction of One-Stop Office System in relation to sectoral permissions at investment and post-investment stages are included in the Draft Law on Regional Development Agencies. With these arrangements, the provincial units of the Regional Development Agencies will be the single authority, where the applications will be made, followed and coordinated.

Within the scope of the studies of the Technical Committee on Investment Location, the Law No.4916, which provides acceleration, easing and allowance to investor at low price of sale of immovable property of Treasury, amending Various

Laws came into force in July 2003. The Regulation related to allocation of parcels in Organized Industry Zones in the priority investment areas to the investors free of charge, came into force in July 2004. The Ministry of Public Works and Settlement issued a directive in April 2004 for realization of correct practices with respect to land arrangement shares regulated under Article 18 of the Development Law No.3194.

Studies on the revision of the Reconstruction Law No.3194 with respect to shortening the preparation and approval process of Reconstruction Plan, the inventory studies for land utilization, harmonization of lower and upper scale plans, the determination of the standards on planning of industrial areas, acceleration of the planning process and sharing of the planning data by public agencies free of charge, preparation of investment area maps, preparation of Organized Industry Zone inventories, and investigation of the reasons of any unoccupancy in such zones are going on.

Within the scope of the studies of the Technical Committee on Tax and Incentives, in order to initiate inflation accounting for eliminating the adverse affects of inflation on the financial statements, the Law No.5024 amending Tax Procedural Law, Income Tax Law and Corporate Tax Law came into force in January 2003. Inflation accounting implementation has started on January 1, 2004. The Law No.4842 collected existing tax exceptions and exemptions under main Tax Law of Amendment of Certain Laws came into force in April 2003. This Law enabled automatic application of investment discount as 40 per cent.

In the context of the studies of the Technical Committee on Customs and Standards, the Anti-Smuggling Law No.4926 came into force in July 2003. The purpose of this Law is to identify the acts which constitute smuggling offence and punishments for them, the procedures and principles for preventing, monitoring, investigating and adjudicating smuggling as well as the provisions to be applied to smuggled goods. On the other hand, the automation project of the Undersecretariat of Customs was completed and the customs procedures, which were carried out manually before, are now carried out automatically with computer system. As a result of settlement criteria on company basis, while the number of the customs controls is reduced, their effectiveness was increased and the time to complete the customs transactions is shortened. A data and application base was created to enable regular evaluation and finalization of Internal Processing Authorization Certificate in a short time.

Data and application base, which will provide the evaluation and finalization of applications for inward processing license in a short time and regularly, is constructed. Data related to the documents given by the Undersecretariat of Foreign Trade are distributed to automated customs in electronic environment and also all declaration information about these documents are sent back to the Undersecretariat of Foreign Trade every night.

Within the scope of the studies of the Technical Committee on Intellectual and Industrial Property Rights, the Law No.5000 amending the Decree on Organization and Duties of Turkish Patent Institute came into force in November 2003. The purpose of the Law is improving the institutional capacity of Turkish Patent Institute and revising its duties and organizational structure. The Law No.5101 amending Certain Laws, which came into force in March 2004, with the aims to strengthening intellectual property system, to preventing piracy considering international commitments and sector requests and solving the problems between the producer sectors and users in terms of using products subject to intellectual property are targeted. The Law No.5147 on

Protection of the Integrated Circuit Topography, which aims at protecting the Integrated Circuit Topography at international standards, came into force in April 2004. In addition, both the Law No.5118 on Trademark Convention, which aims to harmonize trademark procedures with world procedures and simplify administrative procedures and the Law No.5117 on The Hague Convention on International Registration of Industrial Design, which aims to increase the tendency towards better designs in terms of all methods used in mass production, came into force in April 2004. Furthermore, the Law No.5194 Amending Certain Decrees, which is drafted to enable technological development by encouraging creativity and thus to protect industrial rights and amends industrial rights legislation, came into force in June 2004.

In the context of the studies of the Technical Committee on Promoting Investments, it is decided to strengthen capacity of the General Directorate of Foreign Investments of the Undersecretariat of Treasury and to implement a one-year action plan and to make a review at the end of this period about the establishment of Turkish Investment Promoting Agency.

Within the scope of the studies of the Technical Committee on Foreign Direct Investments Legislation, the Law No.4875 on Foreign Direct Investments, which removes the minimum capital requirement and preliminary authorization for foreign direct investments in Turkey and defined certain concepts such as foreign direct investment and investor at international standards, came into force in June 2003. In addition, this Law ensured continuation of certain principles included in the removed Law No.6224 on Promoting Foreign Investments, such as national action, freedom to transfer profit and dividends, transfer of capital share to abroad in case of dissolution or sale of the company and employment of foreign technical employees. Moreover, this Law confirms the arrangements in the Constitution and other laws relevant to real estate acquisition by the foreign investors, international arbitration and protection against nationalization. The Implementation Regulations of this Law came into force in August 2003.

In the context of the studies of the Technical Committee on SME, a Draft Law granting power to the Council of Ministers with respect to definition of SMEs was submitted to Turkish Parliamentary. Thus, a single SME definition will be made in harmony with EU legislation and this definition shall apply to the legislation and program of all the institutions and organizations, of which name include SME, medium size enterprise, small size enterprise or micro enterprise terms.

The SME Strategy and Action Plan, which defines a roadmap to implementation of national policies for SMEs and increasing competitiveness of SMEs in the EU harmonization process, was approved in November 2003 by the High Planning Council. The basic strategy areas of this Plan for the Small Size Enterprises are constructed considering the priority areas included in European Charter as well as the priorities of Turkey. The activities to be carried out in the framework of these strategy areas will address the finance and technology problems as well as other problems considered within the scope of competitiveness. The projects aiming to achieve the objectives of this plan will be financed by the general budget and EU resources. Furthermore, a web-site, which will collect all the required information and enable dissemination of information rapidly and effectively, is being developed in order to increase the communication between SMEs and the organizations which offer service to SMEs.

Investment Advisory Council (IAC), where limited number of multinational company top level executives will participate as members, was established and the

Council held its first meeting on 15 March 2004 in İstanbul. The top level executives of 20 companies from 10 sectors and 11 countries participated at the meeting. In this context, in line with the primary objective to improve the investment environment in Turkey and make it an attractive investment location, it is aimed to develop a platform, where the CEOs and top level executives of multinational companies deciding the locations of significant investments will advise Turkey.

During the first meeting of the Council, the participants drew attention that the most important factors in selecting a country for investment, were economical and political stability, predictability, sustainability, trust and transparency, and also noted that Turkey had the potential to become a strong attraction center for foreign direct capital investments. In this framework, it was also pointed out that geographical location, the size of the domestic market, rich natural resources, dynamic local industry and high-quality and efficient labor plated a significant role in making Turkey a very attractive place for investments. Besides these points, in this meeting, a report was issued including the priorities, which are considered as obstacles in front of Turkey and should be addressed until the next meeting of the Council. The activities carried out under the Reform Program gained momentum, as the subjects listed in the report corresponded to the activity area of the 10 technical committees appointed within the framework of Reform Program on Improvement of Investment Environment. While the studies on the agreed priorities are continuing, a progress report is being drafted.

In general, these arrangements do not impose an additional cost to the budget and the private sector. However, as a result of amendment on this legislation and rearrangement of the authorizations and procedures related with the investors, some new units will be required in the public (Turkey Pharmaceutical Authority, General Directorate of Food, etc). These units may impose a small burden to the budget. However, these arrangements simplify and accelerate many bureaucratic procedures and create harmony with international practices, thus facilitate investment procedures of the local and foreign investors, saving time and money. Since the number of the responsible public agencies as well as number of the procedures is reduced, a saving is also made for the budget. In total, saving is expected on public side.

As a result of the implementation of these amendments, this reform program will contribute to the economy by increasing investment over time. The contribution of the legal arrangements made in the last two years to the development of foreign capital investments is already visible. While total foreign capital inflow was 1.6 billion dollars in 2003 and increased to 2.3 billion dollars in only the first 9 months of 2004.

The Reform Program primarily addresses the above-mentioned issues. Additionally, when any additional issue arises based on the applications and developments, the Technical Committees will address and try to solve issues. Thus, the Reform Program does not have a limited period, instead, it is an ongoing these program.

4.2. Financial Sector

4.2.1. Banking Sector

The Banking Sector Restructuring Program, initiated after the crises in November 2000 and February 2001, is composed of four main components. These components are defined as restructuring of the state banks -the ultimate goal is privatization- resolution of the banks transferred to SDIF by methods like merger, sale and liquidation, strengthening the private banks and developing the legal and institutional framework, which will increase supervision and audit in the sector and make the sector more effective and competitive. Implementation of this restructuring programme imposed substantial burden on the economy and public finance, as experienced in other countries. The cost of the banking sector restructuring program, detailed in PEP 2003, reached 44 billion dollars. This cost reaches 47 billion dollars with the capital support provided to banks[4].

After the implementation of the banking sector restructuring program, the consolidation both in SDIF and in the private sector continued in 2004. The number of the banks, which was 54 in 2002, decreased to 49 in June 2004. In addition, significant developments occurred in most of the balance sheet items in the banking sector, especially in asset size. The total assets of the sector, which was 130.1 billion dollars at the end of 2002, increased to 184.9 billion dollars as of June 2004. On the other hand, the profitability performance of the banking sector also improved. In fact, the banking sector produced 4 billion dollars profit in 2003, especially with the impact of the decrease in nominal interest rates, and 1.6 billion dollars profit in the first six months of 2004.

Significant progress has been recorded in operational and financial restructuring activities at the state banks initiated after 2001 February crisis. Thus, the number of state bank branches decreased to 1,662 as of June 2004 from 2,494 as of December 2000, whereas the number of employees decreased to 29,977 from 61,601 in the same period. The financial and operational restructuring of the state banks had a positive impact on the profitability performance of these banks. The state banks obtained 1.1 billion dollars profit as of the end of 2003, and 0.6 billion dollar profit as of June 2004. The adverse affects of the state banks on the system were minimized by disposing their duty losses and short term liabilities, giving capital support and reducing their number of branches and employees to rational levels.

Table: 4. 3. Overview of the Banking Sector

	2001	2002	2003	2004 June
Main Aggregates				
Assets (Billion Dollars)	117.7	130.1	178.9	184.9
Loans (Billion Dollars)	23.4	30.0	47.4	58.9
Deposits (Billion Dollars)	76.6	84.4	111.3	115.1
Number of banks	61	54	50	49
Number of Employees (Thousand)	139.0	124.0	123.9	126.3
Performance				
Net Profit (Billion Dollars)	-8.2	1.8	4.0	1.6
Return on Assets (Per cent)	-7.0	1.4	2.2	0.9
Loans / Deposits Rate (Per cent)	30.5	35.5	42.6	51.2
Risks				
Capital Adequacy Ratio (Per cent)	20.8	26.1	30.9	25.4
FX Position (Billion Dollars)	-1.6	- 0.6	-0.0	-1.1
Non-Performing Loans / Gross Loans (Per cent)	29.3	17.6	11.5	6.3
Securities Portfolio / Assets (Per cent)	35.0	40.5	42.8	41.5

Source: BRSA

[4] The burden emerged as a result of the financial fraudulency at İmar Bank is not included in the restructuring activities.

Besides, the strategy efforts to determine the roadmap for the privatization of state banks in the forthcoming period were announced to public in July 2004. The evaluations made at this stage and current market conditions indicate that selling Halkbank and Ziraat Bank stocks in the next period to the individual and institutional investors through public offering will be the appropriate way. A coordination committee and project implementation teams will be formed in Halkbank and Ziraat Bank in order to monitor and coordinate the implementation of the transformation plan, developed within the framework of the determined strategy.

It was also decided to merge Pamukbank, which is for sale by SDIF, with Halkbank in order to minimize its cost to the public sector, to protect the assets of the bank and to create new assets. In this context, the Law No.5230, which regulates the transfer of Pamukbank, came into force in July 2004 and the transfer was completed in November 2004.

On 3 July 2003, the license of İmar Bank to carry out banking transactions and collect deposits were cancelled and management and control of the bank was transferred to SDIF since it failed to fulfill its obligations on time, did not take the necessary actions and continuation of its banking activities posed risk to the interests of the deposit holders. As a result of examinations carried out in İmar Bank, it was discovered that the actual deposit amount was 10 times more than the official deposit figures. The shareholders' rights, excluding the dividends on Adabank, of the former shareholders of the bank were also transferred to SDIF.

Both public and private sector undertook substantial burden during the settlement of the banks within SDIF. Including the cost of İmar Bank, the amount of resources transferred to SDIF banks reached 27.8 billion dollars. In order to reduce this cost, various regulations were put into effect by the Law No.5020 in December 2003 to accelerate the collection of claims from the banks, of which banking license has been cancelled and management and control has been transferred to SDIF. As a reflection of these regulations, SDIF collections increased. During the period between the transfer dates of the banks and July 2004, at 2004 values, a total of 2.2 billion dollars has been collected by SDIF from receivables under follow-up, receivables under the repayment plan and sale of subsidiaries and real estates of the banks. 6.2 billion dollars of collection is expected from liquidation of the assets of the banks transferred to SDIF.

In addition to the improvement in the economy, the progress in risk management capacity and strengthening of market discipline because of the restructuring program, have been effective in limiting the risks in the banking system. As a result of domestic debt swap, floating exchange rate policy and improvement of supervision, auditing and risk management processes, the foreign exchange open position of the sector is at a limited level.

Furthermore, as a result of the improvements at the sector in terms of both risk management and transparency of the financial statements, the loan portfolio was revised and the non-performing loans were classified in compliance with international standards, and necessary provisions were allocated. Significant progress has been achieved with İstanbul Approach, which is a voluntary debt restructuring mechanism of the banks, developed to accelerate settlement of bad loans. As of September 2004, an agreement was reached with 295 of 327 companies covered under İstanbul Approach, and 5.7 billion dollars of debt was restructured, which allowed these companies to continue their economical activities. With the recovery in the economy and results obtained from the İstanbul Approach, the ratio of non-performing loans to the gross loans decreased to 6.3 per cent in June 2004 from 29.3 per cent in 2001. As a result of these developments, the banking sector gained a robust structure and the reinforced market discipline led the sector to work more effectively.

Another regulation made to provide a more effective and competitive structure in the banking sector is transition to limited deposit guarantee system. In this framework, the amount of the deposits subject to deposit insurance is limited to 50 billion Turkish liras and this limited deposit guarantee implementation is put into effect on 5 July 2004.

In order to make the transformation process of the savings into investments more effective, determine the public burdens on financial intermediary and draft the necessary action plan, the project, which was started in March 2003, is finalized. Based on the findings of the project, various regulations are made to reduce intermediary costs. Thus, the basic rate of the quarterly premium paid by the banks to saving deposit accounts, was decreased from 25 in ten thousandth to 12.5 in ten thousandth as of January 2003 and additions in various rates, according to the risk levels of the banks, to this basic rate are applied. As of 26 November 2004, this basic ratio has been increased to 15 in ten thousandth and the premium is only paid for deposits subject to insurance. Moreover, while the stamp tax collected over the loans at 75 in ten thousandth and 1 million Turkish lira private transaction tax collected over each time deposit and participation account was cancelled, the resource utilization support fund deduction collected at 3 per cent over commercial loan interests was reduced to zero.

The Savings Deposit Insurance Fund was separated from Banking Regulation and Supervision Agency by the Law No.5020, which came into force in December 2003, and is now managed and represented by an independent Board. This Law aims to enable BRSA to specialize in supervision and auditing and SDIF in deposit insurance activity, asset management and collection in order to make these processes more effective.

It is intended to establish micro finance organizations to include the low income individuals or groups, who are left out from the potential customer group of the banks, and who do not access financial services, to the financial system, to increase the income level of these groups and to contribute to the deepening of the financial markets. BRSA prepared a Draft Law on Micro Finance Organizations in order to develop the legal infrastructure of these organizations and this Draft Law is ready to be submitted to the Council of Ministers.

In order to strengthen the auditing of Special Finance Institutions within the financial system and to promote their role within the financial system, changes were made in fund collection and utilization methods of these institutions within the framework of Regulations on Establishment and Activities of Special Finance Institutions. These institutions were decided to implement Accounting Practices Regulations in compliance with international accounting standards as of January 2005 to make them operate under same conditions with the banks via increasing the auditing in the sector.

In February 2003, under the leadership of BRSA, a coordination committee was formed with representatives of Banks Association of Turkey, to ensure rapid implementation of New Capital Adequacy Agreement, which is called Basel-II, and capital adequacy arrangements, which are called CAD-3 under European Union legislation. With participation of 23 banks, representing 95 per cent of the sector, a quantified impact analysis (QIS-TR) was performed and an action plan will be drafted based on the evaluation of the findings of this analysis.

The Draft Law on Bank Cards and Credit Cards, identifying the establishment principles of the card issuer institutions, was drafted in compliance with the EU Commission Recommendation as well as with the opinions of the relevant agencies dated November 1988, regulating the relations between cardholders and card issuers. Draft Law is expected to be enacted in 2005.

The Draft Law on Credit Institutions was prepared to make regulation and supervision framework more effective in the light of the international practices and past experiences and by considering the opinions of the relevant agencies. This Law is planned to come into force in January 2005. This Draft Law aims at making financial markets more competitive, minimizing the risks and creating an effective and transparent financial system. The Draft Law intends BRSA to regulate and supervise activities of the deposit banks, special finance institutions, development and investment banks, leasing, factoring, consumer finance companies and financial holding organizations included in the financial system. In essence, this regulation aims at surpassing to risk oriented audit, consolidating regulation and supervision processes parallel to consolidation trend in the financial sector and improving the corporate governance of the financial companies and supervision and audit authority.

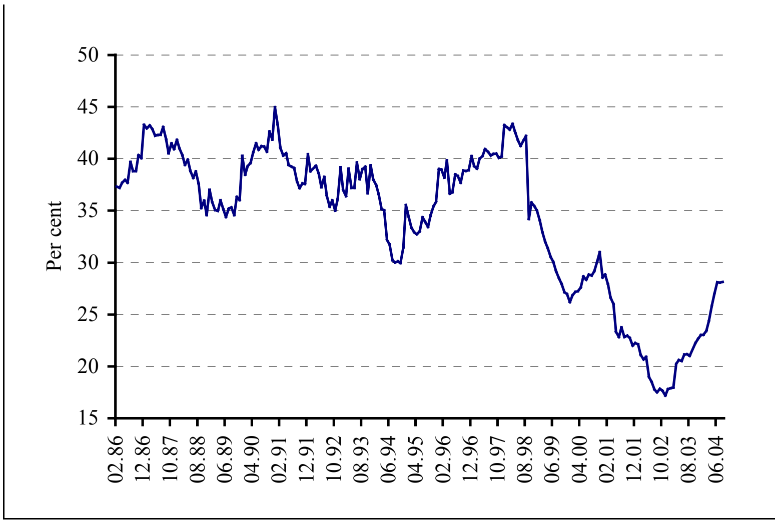
Box: 4.1. Banking Sector and Structural Reforms

A developed financial sector ensures an efficient flow of funds in the economy, contributes to increase in saving and investment ratios, and provides that the savings are channeled to productive areas and thereby improves distribution of resources in the economy. With these critical functions, the financial sector has a positive effect on capital accumulation and efficiency increase, which are the most important factors of economic growth and thus constitutes a main component of economic growth.

Efficiency of the banking sector will play a key role in the finance sector's contribution to economic growth. The banking sector's contribution to the Turkish economy's growth performance remained very limited in the past because of the general instability in the economy. The undesirable structure which is one of the reasons of November 200 and February 2001 crises, has required a series of structural reforms also taking the accordance with EU into consideration. The Banking Sector Restructuring Program, which was put into effect in 2001, intended to strengthen the sector and to make the sector to contribute more on financing the growth.

With the help of economic recovery, the restructuring program brought about significant improvements in various fields, including the asset size of the sector, capital adequacy ratio, volume and quality of loans, etc. There has been a considerable improvement especially in capital adequacy ratio. In fact, this ratio increased to 25.4 per cent in June 2004 from 20.8 per cent in 2001. Similarly, the share of loans of deposit banks in assets, which was at its historically lowest level with 17 per cent in 2002, reached 28 per cent in August 2004. Risk management capacity of the sector improved as a result of legal regulations and the share of non-performing loans in total loans, which was 17.6 per cent in 2002, declined to 6.3 per cent in June 2004. Further improvements are expected in the volume of loans when permanent economic stability is achieved. As a result, a decline in real interest rates will enable the banking sector to channel more funds to the real sector, especially small and medium enterprises (SMEs).

Figure: Share of Deposit Bank Loans in Total Assets



Source: CBRT

Meanwhile, in some of structural indicators of the sector, the expected effects of the reforms has not been appeared completely, yet. There was significant improvement in the banking sector's profitability in 2003. However, the high share of the public borrowing instruments in total assets, seriously affected the sector's profitability, especially those of state banks. A considerable increase was observed in the share of the securities portfolio, which mostly consists of public borrowing instruments, in total assets over the last period due to high real interest rates. The share of securities portfolio in total assets for deposit banks, which remained between 10 and 20 per cent in the 1990s, rapidly increased after the crises and went up to 42 per cent in June 2004. This ratio, however, started to fall in 2004 in parallel with the decrease in real interest rates as compared to 2003. Funds to be channeled by the sector to the real sector with the shift to lower inflation and reduced risk premiums will become a main determinant of profitability performance.

Table: Concentration Ratio and the Ratio of Securities Portfolio to Assets

(Per cent)

	2001	**2002**	**2003**	**2004 June**
Concentration Ratio*	57.7	62.2	63.0	60.0
Securities Portfolio / Assets	35.0	40.5	42.8	41.5

Source: BRSA
* The share of 5 biggest banks in total assets.

The public banks were subjected to a comprehensive reform process as part of the restructuring program in line with the objective of privatization. Despite considerable achievements made in strengthening those banks' financial conditions, serious progress could not be made in the privatization process. The share of the public banks in the banking sector still remain high in terms of assets and deposits. Meanwhile, the share of the private banks in the banking sector has not increased as expected due to the effects of the economic crises. The fact that there has not been any significant change in the shares of domestic and foreign banks in the banking sector, supports the result that the effects of restructuring reforms have not been observed completely, yet. Foreign investors' interest in the banking sector, as in the real sector, remained limited due to economic instability in the near past although there was no regulation imposing restrictions on foreign banks in the sector. The sector share of the foreign banks in total assets, loans and deposits increased slightly during the restructuring process. Foreign investors are expected to take keener interest in the banking industry when permanent stability is achieved in economic and political environment.

The concentration rate, which is close to EU average, rose from 57.7 per cent in 2001 to 60 per cent in June 2004. Privatization of the public banks, increased interest of foreign capital in the sector and economic stability will have a positive effect on competition in the banking sector.

Table: Distribution of Assets, Loans and Deposits by Public-Private Banks and Domestic-Foreign Banks

(Per cent)

		2001	2002	2003	June 2004
Assets	Public	31.6	31.9	33.3	32.7
	Private	57.3	56.2	57.0	57.4
	Other	11.1	11.9	9.7	9.9
	Domestic	97.0	96.9	97.2	96.8
	Foreign	3.0	3.1	2.8	3.2
Loans	Public	19.3	15.5	18.3	19.8
	Private	68.6	69.4	69.1	69.1
	Other	12.1	15.1	12.6	11.1
	Domestic	96.9	95.6	95.9	95.4
	Foreign	3.1	4.4	4.1	4.6
Deposits	Public	33.8	35.1	38.5	39.6
	Private	60.1	58.4	56.8	55.8
	Other	6.1	6.5	4.7	4.6
	Domestic	98.0	97.8	98.0	97.7
	Foreign	2.0	2.2	2.0	2.3

Source: BRSA

In conclusion, despite some noteworthy achievements resulting from the Banking Sector Restructuring Program, which was put into effect in order to establish an effective and competitive environment in the banking sector, the expected improvements have not appeared in some structural indicators, yet. Besides the improvement in the macroeconomic environment became permanent due to the continuation of the reform process in a more comprehensive way, positive developments seem possible in the future. In this context, banking sector is expected to have a stronger structure because of the increase in the share of foreign and private banks in the sector through privatization and consolidation and real banking activities which will accelerate in the low inflation environment. Together with these developments, while improvement will be achieved in the banking sector's effectiveness and competitiveness, progress will be provided in the growth and convergence to EU through the increased contribution of the financial sector to real economy.

4.2.2. Capital Markets

In the period 2003-2004, the following actions were taken in order to protect investors in the capital market and to ensure creation of a stable and efficient market while taking EU directives into account:

- With the Communiqué of July 2003, principles regarding the public disclosure of special events revised in line with EU regulations, proposals of the International Organization of Securities Commissions (IOSCO) and corporate governance principles.
- In line with the objectives of the Turkey's National Programme For the Adoption of the Acquis and to ensure full conformity to EU Acquis, Communiqué on Principles Regarding Exemption Requirements for Issuers and Removal From the Board's Register, Communiqué on Principles Regarding Registration of Corporate Bonds with the Board, Communiqué on Principles Regarding Registration of Profit and Loss Sharing Certificates, Communiqué on the Registration of Asset Backed Securities with the Board and the Principles of Establishment and Operations of General Finance Companies, Communiqué on Principles Regarding Registration of Commercial Papers with the Board, Communiqué on Principles Regarding

Issuance of Participating Shares, Communiqué on Principles Regarding the Registration and Issuance Processes of Gold Silver and Platinum Bonds were revised in July 2003.

- Regulation on ISE Listing was changed in line with the European Union regulations and took effect in June of 2004.
- With the change to the Communiqué on principles of 2003, the rating and rating activities were classified as credit rating and the harmony rating of corporate governance principles. It is aimed to increase inflow of domestic and foreign capital in the financial market by providing a transparent mechanism to reach the information about publicly held companies with the implementation of this amendment altogether with the prior Communiqué on Accounting Standards in Capital Market which made the accounting standards in full harmony with International Financial Reporting Standards (IFRS).

On the other hand, the below works are planned for the following period of 2004-2007 to increase supply and demand in the capital markets, to provide trust and stability in the markets, to prepare legislative arrangements for Turkish legislations in compliance with the EU legislation and to establish the necessary framework for implementing these legislations.

- The establishment of the corporate, of which legal framework was completed and which will constitute the infrastructure and organization of an organized market in which capital market instruments issued by SMEs will be traded will be completed in 2005 and the market will become functional. It is envisaged that this market will operate based on Primary Dealership System in order to provide necessary liquidity.
- The completion of the registration with the board of the securities of corporations of which are listed in the stock exchange and the rights of these securities are planned to be completed until the beginning of 2005.
- The efforts aiming at restructuring settlement and custody systems will be maintained. An efficient and well organized Turkish lira money market will be formed by building a framework for enabling Stock Exchange Money Market existing in Settlement and Custody Bank to cover the whole financial system.
- In order to develop a risk transmission mechanism and provide a reference price for future, Futures and Options Exchange will be operated in İzmir where both future contracts of goods and financial instruments will be traded and the system will improved.
- A project, which has been drawn up in order to benefit from PHARE program under the 2004 program of Pre-Accession Financial Assistance, which is being extended by the EU to Turkey as part of the efforts to ensure alignment with EU regulations, is expected to be launched towards the end of 2004.
- Formation of financial institutions authorized to issue mortgage-based securities after completion of technical and legal infrastructure in 2004-2007 will also strengthen the real estate sector. This system, which will allow people to buy houses over the long term by paying installments not higher than monthly rents, will facilitate growth of both the finance sector and the real sector and thus contribute to economic development.

- Efforts to ensure compliance with the IFRS will continue in the coming period.
- Specialized courts will be established in order to finalize cases related to capital markets rapidly and correctly in the framework of the requirements of the market.
- Government domestic borrowing instruments will be kept and monitored on an individual customer basis by recording them to Central Registration Agency as well as securities and investment funds. Thus adverse events that break customer confidence in the market will largely be prevented.
- The employees of all professional firms operating in the market will have minimum standards as a consequence of licensing obligation which was initiated in order to provide the necessary qualifications for the employees required for informing and directing investors correctly.

4.2.3. Insurance Sector

In the insurance sector efforts are continuing in order to strengthen the framework for regulating and supervising the insurance companies as part of the process of alignment with the EU Acquis.

There were 50 companies in the Turkish insurance sector, including 47 insurance and 3 reinsurance companies in 2003. As compared with EU countries, main indicators of Turkish insurance sector imply that the sector is still at its early stage of development, but has a great potential still not used. The Draft Law on Regulation and Supervision of Insurance Operations has been drawn up and sent to the Prime Ministry. In this context, work is under way to draw up secondary legislation compatible with EU directives.

A project intended to strengthen the administrative structure of the General Directorate for Insurance and Insurance Supervisory Board and establishing a data processing system for overseeing and statistical reporting activities will be launched early in 2005 in order to achieve harmony with and to implement the EU Acquis as part of the Pre-Accession Financial Cooperation program for 2003. The project is expected to be completed in two years.

In addition, studies focusing on models used in EU countries are being conducted in order to contribute to creation of an efficient system for restructuring the regulative and supervisory functions in the insurance sector.

Meanwhile, the Private Pension System, which will be complementary to the public social security system and provide people additional income after their retirement and thus increase their welfare was launched in October 2003. The Individual Retirement System will also contribute to economic growth by increasing long term funds and employment.

There are total of 11 private pension companies in the private pension system. The latest data released in November 2004 shows that the number of participants involved and the size of contracts signed has reached 273,243 and 284,967 respectively and the volume of contributions converted into private pension funds by these companies has reached 208 trillion Turkish lira.

4.3. Labour Market

The labour market will be one of the key factors in ensuring a sustainable growth environment and enhancing the competitiveness of the economy during the process of EU accession.

Labour force participation and employment rate, particularly of women, is low in Turkey as well as education and productivity level of the labour force. On the contrary, unemployment rate, especially among young people, share of agriculture in employment and informal employment are high. There is a mismatch between supply and demand in the labour market due to the fact that an association between the education system and the labour market could not be fully established and the labour market does not have a flexible structure.

The labour force participation rate, which was 48.3 per cent in 2003, is very low as compared with the EU average. This mainly stems from a very low participation rate among women, which is 26.6 per cent. The low participation rate is caused by the downward trend in employment in agriculture, withdrawal from labour force, especially among women, as a result of migration to urban areas, a series of economic crises witnessed, the prolongation of average education period, high rate of unemployment, which discourages people, particularly women from job seeking, early retirement, and relatively low level of education among women. Although rising rate of enrolment in schools, and migration from rural to urban areas lower the labour force participation rate over the short term, it is expected that these factors will raise this rate over the medium-long term.

In parallel to increasing competition in agriculture, which has a high share in employment, the outflow from employment in this sector increases. This causes a rise in unemployment since enough jobs cannot be created for unskilled labour force migrating from rural to urban areas.

Programs implemented in order to ensure economic stability, the low course of investments, the severe economic crisis in 2001 and following rise in productivity and capacity utilization rates served as factors limiting increase in employment and leading to a rise in unemployment. However, capacity utilization rates reaching quite high levels and continuing economic recovery indicate that there will be a decline in the unemployment rate.

In 2003, those with an education level below high school, made up 68.4 per cent of the labour force, 70.2 per cent of employment, and 65.7 per cent of the unemployed. The low level of education of the labour force is factor reducing labour productivity and efficiency of the labour market. Productivity per employee in Turkey is almost a third of the EU average. The relatively low enrollment rates in secondary and higher education, the mismatch between supply and demand of the labour force and low vocational skills among the workforce are the main challenges.

One of the main problems of the labour market is the high level of informal employment. It is estimated that almost 45 per cent of the employed are not registered. This leads to a decline in tax revenues and social security premiums, unfair competition between enterprises, poor working conditions and lack of social security on the part of the employees.

Difficulties encountered by women, disabled, long-term unemployed and young people in accessing the labour market and during their working life, and child labour, although it has decreased, have yet to be addressed.

The primary objective is to provide an employment oriented and stable growth environment for reducing unemployment. To this end, policies aimed at addressing the problems encountered in the labour market include increasing the level of education especially among women, harmonization of vocational education with labour policy, implementation of active employment policies in order to increase employment while improving the skills of the labour force, supporting entrepreneurship and SMEs which have high capacity to create new jobs, and achieving rural development based on activities creating jobs and increasing income. Studies are carried on in these policy areas as part of the labour market reform.

In order to increase efficiency in the labour market, preparations of a National Employment Strategy in line with the European Employment Strategy have started, in the context of adjustment with the EU. The strategy is aimed at enhancing employability, supporting entrepreneurship, adapting to changing conditions, facilitating access, particularly of disadvantaged groups such as women and young people, to the labour market, and providing their integration with the labour market.

In this context, a Background Study on Labour Market and Employment was prepared, in 2003. The Joint Assessment Paper, which is the second step in this process, is being prepared and it is expected to be completed early in 2005. In the next phase, main priorities in terms of employment policy will be determined and transformed into a national action plan.

As part of the efforts aimed at enhancing employability and reducing unemployment, General Directorate of Turkish Employment Agency (İŞKUR) is organizing training courses especially targeting young people, women, and the disabled in addition to vocational training and training workshops for the industry. Efforts are being made regarding the utilization of the revenues of the Unemployment Insurance Fund for active labour market policies. In addition, an Active Labour Programs Project with a total budget of 50 million euro, including 10 million euro contributed by Turkey, was launched under Turkish-EU Financial Cooperation. It is aimed that a total of 25,000 unemployed people will benefit from the project and at least 50 per cent of them will be employed. Besides, seven private employment offices, which have been authorized within the framework of the Labour Code, have been opened.

The Privatization Social Support Project (PSSP), which is aimed at alleviating the negative social and economic effects of privatization that led to increased unemployment and at monitoring the social consequences of the economic reform program, will continue until the end of 2005. 11.8 million dollars was spent for labour redeployment under the PSSP by September 2004 and 22,737 people benefited from project services. Compensation totaling 203.7 million dollars was paid to a total of 11,900 employees working for the enterprises to be sold or closed down under the privatization program.

A total of 7,389 people, who participated in the projects, completed by İŞKUR, as part of the labour redeployment component of the PSSP, were employed. A total of 21,243 unemployed are expected to benefit from the completed and ongoing projects.

The Law No.5084 on Supporting Investments and Employment and Amendments to Some Laws was put into effect in February 2004. Tax and social security premium concessions are granted to entrepreneurs in order to increase employment and to reduce disparities between different regions, energy prices are subsidized, and free plots of land are allocated to potential investors in some provinces in accordance with the law. These incentives are also expected to give an impetus to development of SMEs. A total of 3,054 applications, including 2,010 for organized industrial zones, which have not yet been completed, were received after the Law No.5084 took effect.

SMEs make up 99.8 per cent of all enterprises and account for 76.7 per cent of total employment. SMEs, which have a flexible production structure allowing them to swiftly adapt themselves to changes in market conditions, play a key role in reducing unemployment and creating new jobs. Technical and financial support is being extended to SMEs in this context.

Child labour is one of the major problematic areas in the labour market due to its effects on both children's health and education and informal employment. According to the results of the Household Labour Force Survey, while the number of working children in the 12-17 age bracket was 1,507,000 in 2001, it fell to 948,000 in 2003. The projects carried out in this field were influential in this decline. The efforts being carried out within the framework of International Programme for Ending of Child Labour Project (ILO-IPEC), which was launched in order to prevent child labour, was extended up to 2006 and the Project on the Elimination of the Worst Forms of Child Labour was ratified by the EU Commission as part of EU-Turkish Financial Cooperation for 2004.

Efforts are also under way in the field of education, which is one of the main factors ensuring improvement of the quality of the labour force. In this context, due to improvement of physical infrastructure in secondary education and increasing importance attributed to non-formal education with the prolongation of compulsory education to eight years, school enrolment rates went up from 90.6 per cent to 96.1 per cent in primary education, from 49 per cent to 72.4 per cent in secondary education, and from 27.4 per cent to 36.8 per cent in higher education, in the past eight years. Considerable improvement was achieved in the level of education in the past decade. Information and communication technologies will be used and curricula will be revised in order to modernize the education system and to enhance its quality.

Table: 4. 4. Trends in School Enrollment Rates, 1998-2004

(Per cent)

Level of Education	1998-99	2003-04
Pre-school	10.2	12.5
Primary education	90.6	96.1
Secondary education (*)	49.0	72.4
Standard high schools	26.6	45.9
Vocational - Technical High Schools	22.4	26.5
Higher education	27.4	36.8
Formal	18.1	24.5
Non-Formal	9.3	12.3

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

Around 1,700 schools in rural areas were restored, 3,188 computer classrooms were set up in 2,802 schools, around 52,000 computers and various equipment were provided for 26,000 rural schools, approximately 50,000 teachers received on-the-job training on using computers, and educational materials and equipment were provided for primary school students in rural areas as part of the first phase of the Fundamental Education Project funded by a 600 million dollars loan extended by the World Bank in order to support the Fundamental Education Reform, which was launched in 1998. Similar investments in primary education will continue in addition to investments related to pre-school education, special education, and non-formal education, during the second phase of the project, which started in 2004.

Preparations aimed at establishing a National Institute of Professional Standards have reached their final phase as part of the efforts to ensure harmony between the labour market and the education system. In order to organize vocational education system in a more flexible and modular structure so that it could adapt itself to market conditions more easily, a project designed to strengthen vocational education and training system, which is financed by a MEDA fund, is being implemented.

The EU Education and Youth Programs, in which Turkey has been participating since April 1, 2004, will make significant contribution to the harmonization of education systems in Turkey and the EU countries, exchange of information and culture between students and academic personnel and ensure that young people acquire skills required by the EU. A total of 183 students have come to our country within the framework of Erasmus program while 475 students went to EU countries. The number of academicians that came to Turkey was 5 while the number of academicians that went to EU countries was 55. Similarly, around 1,900 students, new graduates or young workers will receive hands-on training in Europe and academicians will go on study tours as part of Leonardo da Vinci Program in the field of vocational training. Financial support was provided for the projects of 125 youth organizations or groups after 2003 under the Youth Program. Funds totaling 18.3 million euro and 30.9 million euro were earmarked for those projects in 2004 and 2005, respectively.

There was significant progress in the field of occupational health and safety, which is one of the key issues in employment. 19 of 20 directives in EU legislation were adapted while work on the last directive is about to be completed. 29 of a total of 46 regulations issued in accordance with the Labour Code No.4857 concerning occupational health and safety. Priority will be given to measures and controls related to the implementation in the field of occupational health and safety, at which laws and regulations are at a stage of completion.

It is fundamental that reforms regarding the labour market should be carried on, on a participatory approach. In this context, the EU Commission ratified the Project for Strengthening Social Dialogue for Innovation and Change within the framework of EU-Turkey Financial Cooperation Programming, in 2004, in order to eliminate the problems of current social dialogue mechanisms. In addition, a new draft law aimed at addressing problems regarding the operation of the Economic and Social Council, which is one of the fundamental mechanisms for social dialogue, is being drawn up with contributions of social partners.

Table: 4. 5. Matrix of Policy Commitments: Labour Market

(1000 Euro)

	2004	2005	2006	2007
1. Privatization Social Support Project				
A. Implementation Profile	X	X	X	X
B. Net Budgetary Effect	-119,279	-69,382	-	-
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Expenditure	-119,279	-69,382	-	-
2. Active Labour Market Programs Project				
A. Implementation Profile	X	X	X	X
B. Net Budgetary Effect	-3,373	-6,626	-	-
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Expenditure	-3,373	-6,626	-	-
3. Occupational Health and Safety Project				
A. Implementation Profile	X	X	X	X
B. Net Budgetary Effect	-536	-7,324	-	-
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Expenditure	-536	-7,324	-	-
4. Project for Strengthening Social Dialogue for Innovation and Change				
A. Implementation Profile	X	X	X	X
B. Net Budgetary Effect	-	-125	-	-
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Expenditure	-	-125	-	-
5. Basic Education Program				
A. Implementation Profile	X	X	X	X
B. Net Budgetary Effect	-430,521	-550,021	-703,155	-649,997
B.1. Direct Effect on Budgetary Revenues (1)	157,900	118,400	78,950	78,950
B.2. Direct Effect on Budgetary Expenditure (2)	-588,421	-668,421	-782,105	-728,947
Total Net Budgetary Effect				
A. Implementation Profile	X	X	X	X
B. Net Budgetary Effect	-553,709	- 633,478	-703,155	-649,997
B.1. Direct Effect on Budgetary Revenues	157,900	118,400	78,950	78,950
B.2. Direct Effect on Budgetary Expenditure	-711,609	- 751,878	-782,105	-728,947

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

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

4.4. Administrative Reform

Rising and diversified demands arising from the rapid and multi-dimensional transformation process in the world and in Turkey have necessitated a radical change in the bureaucratic structure and in the administration concept. In this context, corresponding regulations taken and laws adopted as part of the administrative reform are outlined below.

Fundamental Principles and Restructuring of Public Administration Law

Transformation taking place in Turkey and the rest of the world in parallel with globalization and shift to the knowledge based society has brought about the need for restructuring with dimensions of involving efficiency in public administration, rule of law, respecting for human rights and participation. Rising support for privatization and decentralization, adopting of a competitive strategy based on free market, improving the private sector steadily, and strengthening the non-governmental organizations necessitated redefining the role of government. In this context, by withdrawing from some industrial activities and strengthening the regulatory and supervisory role, the government should have a structure, which is smaller but more efficient, considering participation important, transparent and accountable. In addition, as a result of extreme centralization, central public institutions have diverged from the functions of guidance, forming strategy and supervision, which are supposed to be performed by them. The waste of public resources is increased and high quality in public services can not be provided as a result of unbalanced distribution of duties and resource allocation between central and local administrations, the strict control of central administration over local administrations, and the local administrations which do not have sufficient financial resources and working with less qualified personnel.

In the framework of the first phase of restructuring process of the government, the Law No.5227 with the date of July 2004, on the Fundamental Principles and Restructuring of Public Administration was ratified by the TGNA and submitted to the President for approval in order to provide guidance in the process and to prepare the necessary legal framework. The Law draws the general framework comprising the general principles of public administration, distribution of duties and powers between the central and local administrations, principles and procedures regarding to the organizational structures of public institutions as well as supervision in public administration. The Law lays down the procedures and principles that should be obeyed by the public institutions in performing their duties, and draws the general framework of the public administration. With this Law, the local administrations are transformed into general authorized units, while duties of central administration are restricted in order to strengthen the decentralization. In this context, it is aimed that efficiency and participation will be increased in line with strengthening the tendency of decentralization of public services, the number of hierarchical strata will be reduced to create a more horizontal organizational structure, thereby accelerating decision-making processes. In addition, the supervisory system is strengthened and the supervision mechanism is regarded as a tool to improve administration with special emphasis placed on performance supervision. In this context, a local ombudsman called Public Supervisor will be appointed in each province. Ombudsman system, which is one of the key components of the principles of preeminence of the state of law and improved democracy, is regarded as a way that should be preferred in settlement of administrative disputes between citizens and public administration in addition to the judicial process because it is less costly, more rapidly and more simple. Furthermore, a strategic governance concept is adapted to establish a link between duties and resource allocation, and it is also intended to develop long term policies at institutional base and to strengthen the capacity of implementation. The 22 Articles of the Law was, however, returned by the President to the TGNA.

Functional Review of the Government

Provision of services by several public institutions in the same field, cause some functions not to be assumed by any institution and thus be neglected while creating institutional conflicts or leading to poor coordination. For this reason, the need to review and clarify the duties, powers, and functions of public institutions providing services for the public and to establish a structure in which each of them will perform their primary duties are some of the reasons for reforming the public sector. The primary goal of the Study on the Functional Review of the Government, one of the projects undertaken as part of the Public Administration Reform, is to accelerate decision-making process by restructuring public administration and simplifying the organizational structure of government, and to reduce public spending. The corresponding study was carried out by SPO. By examining duplication of duties and power among public institutions, clarifying the subject of specific functions that will be fulfilled by which institutions, is taken into priorities in this study. In this context, a comprehensive survey has carried out among the public institutions, in light of the priorities identified interviews have been made with various institutions and a draft report was prepared after completing the study. The laws on establishment and organizations of public institutions will be reviewed by taking account of the findings of this report after Fundamental Principles and Restructuring of Public Administration Law is enacted.

Civil Service Reform

The public personnel management system has become ineffective, thereby a need for significant reform aiming efficiency and effectiveness has aroused in that field. The shortcomings in the public personnel system are observed in every stage from recruitment to promotion and from the salary and wage system to retirement. In the context of the Public Administration Reform, some of the principles taken as a basis for the Civil Service Reform are as follows:

- Implementation of norm cadre in all public institutions,
- Application of objective criteria regarding recruitment and promotion,
- Reduction of the number of ranks and removal of economic and social disparities between ranks,
- Simplification of the salary and wage system and elimination of imbalances,
- Establishment of flexible working procedures,
- Transformation to a performance-based payment system,
- Determining principle and permanent public employees.

A Draft Law for Civil Service has been prepared by State Personnel Administration in cooperation with Public Administration Institute for Turkey and the Middle East regarding of the principles outlined above. When the Draft Law is adopted and put into effect, it is aimed that some part of the shortcomings and lameness in the state personnel regime will be eliminated, thereby the increases in efficiency and quality of public services and ensuring the productivity in the usage of public resources is expected.

Local Administrations Reform

Local administrations cannot provide their services with desired efficiency and quality. The main reason of this situation is the encountered lameness in their administrative and financial structures. However, it is difficult to say that local administrations use their financial resources productively and in planned manner. Local Administration Reform has been launched in order to restructure the local administrations, which operate with excessive central supervision and insufficient local resources, in line with the principles laid down in the European Charter of Local Self-Government. In that context, Laws on municipalities, greater municipalities, and provincial special administrations were prepared. The corresponding Laws are aimed at restructuring local administrations in terms of their organizations, duties and powers, financial resources, employees, and their relations with the central administration and the local administrations are regarded as the generally authorized units, that is all types of duties and powers not vested by the Law in other institutions are endowed with local administrations. The Law on Provincial Special Administrations and the Law on

Municipalities were returned by the President to the TGNA for review. Meanwhile, the Greater Municipalities Law No.5216 was put into effect with the exception of some of its articles when it was published in the Official Gazette in July 2004.

Draft Law on Regulatory and Supervisory Agencies

There is a need for independent institutions functioning as regulatory bodies after separation of operating and regulating functions in parallel with the reinforcement of regulatory and supervisory duties of the public and opening up some of the monopolistic public services to competition. Independent regulatory and supervisory agencies established in that context are subjected to discussions over their positions, functions and duties, supervision, budgets and legal status. Enacting a law in order to eliminate contradictions and confusions in the legal status of these regulatory and supervisory agencies and to restructure them has, therefore, become necessary. A Draft Law on the Regulatory and Supervisory Agencies was drawn up and sent to the Prime Ministry. The draft specifies common principles and procedures concerning establishment, organizations, duties and responsibilities and supervision of regulatory and supervisory agencies as well as status of their employees and members of boards. When the draft is enacted, uncertainties in public administration arising from different structures defined in their laws will be eliminated and thus they will operate efficiently.

Right of Access to Information

The prevailing conviction in the public opinion that public resources are used unproductively and frequently experienced corruption scandals have caused the transparency as a significant issue. Transparency is perceived as presentation by public institutions of their objectives, policies being pursued in order to attain these objectives as well as the information needed to monitor the results of these policies in a regular, coherent, correct, and comprehensible manner. Transparency is also regarded as a major tool in making public institutions, using public resources, more responsible and accountable to the public. In this context, in order to guarantee the citizen's right of access to information produced by public sector, the Law No.4982 on Right of Access to Information was enacted in October 2003, which is in accordance with democracy and transparency in public administration. Thus citizens can seek information for their requests in the public institutions in the context of the right of access to information. The right of access to information also serves as an indication of public supervision, which is one of the ways to supervise the public, and thereby increasing the transparency and the accountability in respect of provision of public services and utilization of public resources.

Ethical Code of Conduct in the Public Sector

One of the steps that should be taken in order to achieve transparency in the public sector and to reduce corruption is to enact a law defining professional standards obeyed by civil servants. In this context, the Law No.5176 on Establishment of an Ethics Board for Civil Servants and Amending Some Laws was put into effect in May 2004. The Law determines the principles of conduct for civil servants, including transparency, impartiality, integrity, accountability, and protecting public interest and establishes an Ethics Board for Civil Servants, which will be responsible for monitoring the execution. The Board has been entrusted with the task of issuing regulations defining the principles of ethical standards to be obeyed by civil servants while performing their duties, and also it is authorized to conduct examinations and investigations into allegations of violation of these ethical standards and to report its findings to the regarding authorities. In addition, the board has been entrusted to undertake efforts in order to ensure that a culture of ethical standards is established within the public sector.

SEEs Management Reform

In the context of restructuring and strengthening the governance of the SEEs, the transformation of the SEEs to a more transparent and a target oriented management structure and the improvement of the internal governance and autonomy of the administration are aimed at.

A commission has been established to prepare the necessary strategy in order to achieve these goals. The commission has completed its study by interviewing with the directors of the SEEs and analyzing the country examples especially in the OECD countries and has prepared a strategy report towards the improvement of governance of the SEEs. The corresponding strategy includes basic principles like constituting performance targets for the SEEs, improving accountability and effectiveness of administration of the SEEs, allowing external auditing on performance and financial matters and informing public regularly about the activity of the SEEs. In the following period, implementation of legal changes compatible with this strategy are foreseen.

Public Financial Management and Control Law

Public Financial Management and Control Law No.5018, which is a major component of the public sector reform, was approved by the TGNA in December 2003 and published in the Official Gazette. It is envisaged that the Law will take effect on January 1, 2005 and abolish the Public Accounting Law No.1050, which had been in practice since 1927.

The Law No.5018 is aimed at establishment of a public financial management and control system compatible with international standards and EU norms; ensuring that optimum use is made of budgetary right by extending the scope of budget; providing budgetary unity, increasing effectiveness, fiscal transparency, and accountability during the process of preparation and implementing budgets; ensuring transparency in financial management; and restoring the balance between authorizations and responsibilities in the spending process by establishing an efficient accountability mechanism. The following steps will be taken in this context:

- Financial management and control of public agencies will comprise the central government, social security institutions and local governments, which are parts of the general government, in line with international standards. As specified in charts I, II, and III of the Law, public administrations, which form a part of the central government are public administrations within the scope of general budget, special budget together with regulatory and supervisory agencies.
- The principle of budgetary unity has been improved and the control of the budget by the TGNA has been strengthened.
- In line with the objective of strengthening the relationship between plans and budgets, a strong link between development plans, programs, and the budget will be set up. It is foreseen that public agencies will prepare strategic plans within the framework of development plans, programs, and applicable laws and regulations and they will base their budgets on performance programs under their strategic plans. The budgeting system based on strategic planning and performance will be adopted by all public agencies under the scope of the Law within the framework of a phased transition program.

- A medium-term program will be endorsed by the Council of Ministers and a medium-term fiscal plan will be devised in compliance with that program. In this context, a multi-annual budgeting system, which will be detailed in the first year and include main indicators in the following two years, will be established.
- In accordance with the Law, it is stated that the minister in charge of public agencies will publicly announce the objectives, strategies, and annual performance plans of public agencies in the first month of each fiscal year in order to ensure financial transparency. Meanwhile, authorizing officers will draw up accountability reports, heads of public administrations will prepare administration accountability reports, the Ministry of Interior will draw up an evaluation report about the activities of local governments, and the Ministry of Finance will be responsible for issuing a general accountability report in order to inform the public and the legislature about the results of the government's activities, which is dictated by the principle of executive accountability. In addition, the Court of Accounts will make its own assessments in light of these reports and report to the TGNA.
- In the budget preparation and implementation process, authority given to the line agencies is strengthened. Power and responsibility tradeoff in the utilization of public resources are reshaped. Public administrations under the central government are entitled to shift the appropriations between the line items up to the amount of 5 per cent of the appropriation in the item from which the appropriation will be transferred, unless a different ratio is defined in the budget law of the pertaining year.
- A new system is foreseen for the public administrations in order to enable them to conduct ex ante expenditure control and ex post internal audit alongside their budget preparation and implementation tasks.
- The visa of commitments and draft contracts, which are still conducted by the Ministry of Finance in an ex-ante fashion, and the visas and registrations conducted by the Court of Accounts are abolished. Consequently, expenditure process is accelerated through the reduction on ex-ante operations.
- The establishment of an internal audit system, which works in a continuous and systematic manner, is aimed. In order to ensure continuous and regular auditing, it is foreseen that internal auditors will be assigned to carry out ex-post internal audit. The Internal Audit Coordination Board, under the Ministry of Finance, has been established in order to determine standards and methods for internal audits and reporting procedures and to provide guidance services as an independent and impartial body.
- The unity of accounting in the public sector is ensured. All public administrations within the scope of general government will use the same accounting system. This Law brings the opportunity to consolidate all accounts and perform international comparisons. The accounting and reporting standards to be implemented by the administrations within the scope of the general government and formats, periods and types of the reports compatible with the international standards, to be drawn up under the Framework Chart of Accounts shall be set forth by a Board to be established under Ministry of Finance. It is mandatory that all financial transactions are booked and all account records are based on documents.

- It is foreseen that financial statistics on public finance will be prepared and publicized. According to this, it will be possible to present the central financial data of all public administrations as a whole, while assisting the decision-making processes and ensuring to make sound estimations regarding public finance. Financial statistics of public administrations within the scope of central government shall be publicized monthly by the Ministry of Finance. Public administrations outside the scope of central government will prepare their financial statistics and submit them to the Ministry of Finance within the determined time period. Therefore, the financial statistics of public administrations within the scope of general government will be compiled by the Ministry of Finance
- This Law provides that the budgets of the Revolving Funds and Extra Budgetary Funds' (EBF) under general government shall be included in the budgets of relevant administrations. Revolving Funds and EBF's switch in the scope of this Law shall be liquidated until the end of 2007.

Budget Accounting Code System and Fiscal Transparency

Budget Management and Information System (BMIS) is being used in the process of preparation and implementation of the consolidated budget since January 2004.

BMIS allows public agencies to record their own budget proposals in an electronic medium and then sent to the General Directorate for Budget and Financial Control through the Internet. Thus, the budget proposals of spending agencies can be monitored and combined in electronic medium. In addition, budget departments under the Ministry of Finance and the public agencies concerned can perform allocation of funds based on an analytic budget code system during the implementation of the budget and transactions related to transfer of allocations could be monitored on-line by the budget departments.

Thus, all phases from preparation and implementation of the budget and compilation of results are carried out in a rapid, reliable, and transparent manner.

The budgets of the general and annexed budget agencies for fiscal year 2004 are being drawn up and implemented in accordance with the code structure of Analytic Budget Classification, which is based on Government Finance Statistics (GFS) as part of efforts to reform public financial management.

Efforts are also under way to ensure that analytic budget classification is implemented by the departments and agencies outside the consolidated budget. It is planned that social security institutions, regulatory and supervisory agencies, and departments and agencies with special budgets will apply the new budget code system in 2005, local governments in 2006 and agencies with revolving funds in 2007.

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

The General Regulation on Government Accounting comprising the fundamental standards concerning government accounting and a framework accounting plan, which will be applied to all the public agencies within the scope of the general government, was approved by the Council of Ministers' Decree No.6334 of October 2003 and was published in the Official Gazette in November 2003. The Regulation includes provisions, which will allow establishment of a common accounting and reporting system in all public agencies within general government and obtaining government financial statistics directly from the accounting system. An accrual-based detailed account plan has been drawn up for the agencies with general and annexed budgets, which form a part of the central government, in line with the framework account plan and pilot projects were completed in 2002 and 2003. The Regulation on Accounting Systems of Agencies with General and Annexed Budget, which was drawn up in accordance with the General Regulation on Government Accounting and included a detailed accounting plan put into force on January 1, 2004.

Agencies with general and annexed budgets forming a part of the general government switched to accrual-based accounting in 2004. The new accounting system is expected to be launched in local governments and social security agencies in January 2006. Principles and procedures related to physical count and accounting of tangible fixed assets and determination of methods to be used for calculation of depreciation and revaluation will be established by the end of 2006.

4.5. Agriculture and Rural Development

The ultimate objectives of the reform in the agriculture sector are to acquire a well-organized, highly competitive and sustainable structure based on the principle of EC Common Agriculture Policy and the World Trade Organization obligations and efficient use of resources by considering economic, social, environmental and international aspects.

Increasing production and achieving a balance of agricultural employment between urban and rural areas are the fundamental principles in order to ensure sufficient and balanced nutrition of the population by taking food security principle into account.

It became necessary to review the existing support policies, which have become inefficient due to steadily rising budget costs and to launch a reform process in the agriculture sector. In this context, a reform program, which is aimed at replacing price and input subsidies with direct income support (DIS), was launched in 2000. In order to support the reform program, a project named Agricultural Reform Implementation Project (ARIP) was put into implementation in the same year. The goals of the reform project are establishing a farmer registration system and a related land registration-cadastral system in order to carry out policy changes effectively, ensuring a changeover from crops, which are in excess supply, to alternative crops, restructuring agricultural sales cooperatives and unions and payment of severance benefits during this process. The Project is funded by a 600 million dollars loan, of which 200 million dollars is the program loan, provided by the World Bank.

Since acceptable progress could not be made in the existing components referred to above, the scope and the term of the ARIP is being revised in order to make a more efficient use of the remaining term of the project. In this context, while the term of the project is planned to be extended by one year, actions are being taken in order to ensure that responsibility for completion of each component is assumed by the implementing agencies concerned so that establishment of the farmer registration system and the supporting cadastral task is accelerated.

DIS program, which has replaced price subsidies for the last three year, receives the highest portion from the support budget (62 per cent of the total budgetary transfers for agriculture in 2004). DIS payments are received by the farmers registered to the Farmer Registration System. In this context, DIS payments were made to 2.1 million farmers in 2001, 2.5 million farmers in 2002 and 2.8 million farmers in 2003.

In order to respond to the needs in the sector other than ensuring stability in income through the DIS program, a strategy document covering 2006-2010 period was drawn up, in order to assist the parties concerned with the agriculture sector in making decisions and to ensure that the sector achieves growth in line with development goals and strategies, giving due consideration to harmonization with the EU and an Agriculture Framework Draft Law was foreseen to be prepared by the end of 2004 within this framework of Strategy. This law is expected to allow more goal-focused implementation of the DIS program, while facilitating protection of arable lands suffering from erosion and negative environmental effects by taking account of interaction between farming activities and environment and encouraging use of support tools that will not distort the market mechanisms with a view to a market-oriented production. In this context, the draft Agricultural Framework Law, which will be drawn up by the end of the year, will include provisions aimed at institutionalization of the DIS program and will basically serve as a general agricultural support framework law including other tools referred to above. Studies on costs and effects of the new system on income are continued.

In order to ensure alignment with the Common Agricultural Policy and to fulfill the commitments, in the field of agriculture, which are defined in the Turkey's National Programme For the Adoption of the Acquis, alignment works on food safety and control, organic farming, Integrated Administrative Management and Control System / Land Parceling System-IACS/LPIS and preparation of the Rural Development Plan are being supported within the framework of Turkey-EU Financial Cooperation in 2004.

Plant Production

Although plant production, which largely depends on climatic conditions, maintains its importance in the agriculture sector, it is observed that it could not fully realize its potential and its productivity remained low.

A Draft Law on Seeds has been prepared in order to change the Law No.308 on Registration, Control and Certification of Seeds by taking into consideration the international seed systems and technological advances, within the framework of alignment with EU legislation and was sent to the TGNA. This Draft Law is intended to create a legal ground for the determination of seed production areas, to record the country's genetic resources, to encourage seed industrialists, producers, growers, users and distributors and producers of seedlings and young trees and growers of decorational plants to organize in their respected unions and to establish the Union of Turkish Seed Growers as an umbrella organization.

Conservation of new plant species is one of the key obligations related to protection of intellectual property under the Agreement on Intellectual Property Related to Trade and the decision of the Association Council on completion of a customs union between Turkey and the EU. In order to fulfill the international obligations and to make a legal regulation in that field, which is also highlighted in Turkey's National Programme For the Adoption of the Acquis, while encouraging cultivation of new varieties and protecting new varieties and growers' rights, the Law No.5042 on Protection of Growers' Rights Related to New Plant Varieties was put into effect in January 2004. Preparation of regulations on the implementation of this Law is under way.

Preparatory work on a law about insurance of agricultural products, aimed at elimination of risks arising from climatic conditions is underway and it is expected to be enacted by the end of 2004.

The Law on Producers' Unions, which allows producers to establish their unions based on a certain type of crop or a crop category, in order to ensure that production is planned according to demand, quality of products is improved, supply responds to market needs and measures to improve marketing are taken, came into force in July 2004.

Land and Farmer Registration Systems

Works on Farm Accounting Data Network, which crucial in the implementation, monitoring and assessment of agricultural policies, and Establishment of an Integrated Administration and Control System (IACS), which consists of farmer registration, animal identification, and land registration systems, has been given a fresh impetus and a project aimed at preparing the ground for implementation of the EU common agricultural policy, which also comprises the IACS and Land Parcel Identification System was drawn up in 2004 as part of Turkey-EU Financial Cooperation Programming of 2004. In this context, the Ministry of Agriculture and Rural Affairs is expected to initiate preparations for establishment of a well functioning integrated administration and control system over the medium term and provision of support for formation of the IACS' basic components in line with EU norms.

Actions are being taken in order to establish a reliable Farmer Registration System, which is a prerequisite of efficient implementation of DIS. Since the system will be based on information about lands, efforts aimed at strengthening land registration and cadastral system and performing efficient controls to verify that payments are allocated to lands actually cultivated and received by the correct beneficiaries, continue under ARIP.

Phytosanitary Issues

As part of the Project to Ensure Alignment of Turkish Legislation in the Field of Plant Health with the EU Acquis, which was launched in 2003 and partly funded by the EU, efforts have been initiated to establish four agricultural quarantine laboratories. In addition, the Regulation on Agricultural Quarantine was put into effect in July 2003. The project has total budget of 5.3 million euro of which 1.1 million euro will be contributed by Turkey. Major renovations of the quarantine laboratories were completed in 2004 as a result of a procurement process initiated in the last quarter of 2003 and the twinning component of the Project will be launched in 2004.

Livestock Sector

In order to ensure a balanced and sufficient diet in terms of protein intake and to create a competitive structure in the livestock sector, intensive efforts are being made to improve animal species, increase production of concentrated feed and fodder crops of high quality, eradicate animal diseases and pests, organize animal breeders and diversify publications.

The Decree No.2000/467 on Supports on Livestock will remain in force until 2005. Around 100 million euro was allocated from the General Budget, in 2004, in order to increase production of fodder crops, promote breeding of studs, spread artificial insemination and create an area free of animal diseases.

In addition, works on the alignment of national legislation on livestock with the related EU regulations are underway. In this context, almost 9 million of a total of 10 million cattle was included in the animal identification system. Works in this field are expected to be completed by the end of 2004 and the newborns will be included to the system starting from 2005.

In order to achieve harmony with the EU Acquis in the field of animal health, a project aimed at establishing a database for animal health and border inspection ports, which has a total budget of 17 million euro, with a 13.3 million euro EU contribution and a 3.7 million euro Turkey contribution, was launched. In this context, the first phase of the twinning program has been completed. Bids will soon be invited for procurement of laboratory equipment and establishment of a database for animal health and border inspection ports.

Rural Development

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

Successful implementations were achieved in the field of rural development in EU countries (such as Netherlands, Poland, etc.). A multi-sectoral integrated plan, which is the foundations of rural development, have been implemented in these countries. Investments were made mainly in the fields of infrastructure (such as drainage, drinking water, highways, etc.), non-agricultural income generating activities and socio-culture.

While agricultural activities play a key role in rural development, rural development policies mainly consisting of non-farming activities, including forestry, will be put into practice as the rural area relatively underdeveloped economically and socially. Maximum attention will be given to cooperation between agencies since rural development is multi-dimensional and covers various sectors.

The activities for development of the rural areas will be improved on the following principles: to consider the integrity between rural development and agricultural development, to accord with the agricultural and rural policies of the EU, to carry out rural development projects compatible with national development plans, to ensure coordination among organizations responsible for the implementation of all rural development projects, to include local administrations, the non-governmental organizations and beneficiaries in the decision-making and implementation process, to develop a financing system for rural areas and to ensure the sustainable use of natural resources.

Efforts are also under way to draw up a Rural Development Strategy and Program, which will constitute a framework for rural development projects in Turkey and ensure harmonization with the EU's rural development policies, which is becoming the main component of its Common Agriculture Policy. These efforts will be underpinned by a technical support project in 2005 as part of Turkey-EU Financial Cooperation. The implementation program will be designed to ensure close cooperation with the implementing agencies and comprise not only harmonization with the EU, but also all rural development activities.

Various rural development projects, mostly funded by foreign loans and grants, have been carried out in Turkey and some of them are currently being implemented.

Development and implementation of new rural development projects, which will be based on involvement and responsibility of producers and provide direct funding to producers, will start in the forthcoming period. Small agricultural production projects, which are designed to support non-farming sectors and to create new jobs for people leaving the farming sector and to provide adequate food for people who are undernourished, will be drawn up.

Meanwhile, a decision concerning the training and project development phases of Anatolian Watersheds Rehabilitation Project, which comprises various activities in the rural parts of 13 provinces located in central Turkey and 70 micro-basins where poverty is widespread, was issued by the High Planning Council in 2004. This project includes the activities for rehabilitation of natural resources like soil protection, pasture improvement, etc. and income increasing activities like improving livestock and greenhouses, small scaled irrigation infrastructure etc. In addition, procurement and implementation will start in 2005, which will be followed by construction works in 2006. Meanwhile, providing technical and financial support was planned for 111 cooperatives in rural areas as part of policies aimed at realizing agricultural potential, supporting entrepreneurship and acceleration of socio-economic development in rural areas. In this respect, resource allocation is planned for these cooperatives related to greenhouses and livestock areas in 2005 investment program.

Electrification, communication and stabilized-road infrastructures in rural areas have been almost completed. However, modernization is needed.

Efforts are under way to extend and improve water supply networks, sewerage, and waste water treatment facilities in rural areas. In order to supply drinking and service water for rural settlements, plans were programmed to provide drinking water for 2,423 settlements, including construction of 423 new networks and renovation and maintenance of 2,000 networks but 1,609 of them have been completed. By July 2004, 242 new drinking water networks were completed while 1,578 of them were planned in 2004. Efforts continue on wide spreading the sewerage and waste water treatment facilities in rural areas. Although sewerage systems were planned to be constructed in 500 settlements in 2003, sewerage systems were constructed in 630 settlements. Works are underway to build new systems in 808 settlements in 2004.

Fisheries

It is important to carry out structural reforms in the fisheries sector, in order to increase sustainable contribution of fishery sector to the national economy and to ensure harmonization of the sector with EU Common Fishery Policy. In this context, a project aimed at institutional strengthening and development of the fishery products sector, which will be implemented in 2004-2006, has been drawn up. Turkey will contribute 434,000 euro to the project, which has a total cost of 6.6 million euro. In the context of this project, necessary arrangements are going to be made on legal and structural policies, conservation, control and resource management, market organization, and fishery products information system.

No funds were spent in 2004 under the project due to extension of the twinning project and some technical problems. Thus, no progress was made regarding the project's physical goals, but the legislative process continued. In order to increase efficiency of conversation and control services and to strengthen the information systems, the establishment of 30 port offices and completion of legislative process are among the priorities in 2005.

Foodstuffs

The most important development concerning foodstuffs and food safety was the enactment of the Law on Amendments to the Decree With Force of Law on Production, Consumption and Control of Foodstuffs, which came into force in May 2004. Thus, legislation on foodstuffs was harmonized with the EU's General Food Law (EEC 178/2002). The Law authorized the Ministry of Agriculture and Rural Affairs to control foodstuffs at production and sales points in order to ensure an efficient food control system and some concepts, including trace-ability, risk analysis, state of risk alerts, etc. were included in legislation. Regulations related to this Law are being issued in line with EU legislation.

A total of 68 regulations on Turkish Food Codex which covers some arrangements of the EC-Turkey Association Committee's Decision 2/97 in the field of foodstuffs, were issued and put into effect. Turkish legislation will be harmonized with 51 other EU Directives by 2005 as part of alignment of legislation, which are among short and long term priorities. A National Commission of Food Codex will be established soon.

As part of an ongoing project aimed at improving food supervision services, which is included in the Public Investment Programme, technical equipment needed for 15 food control laboratories are being provided. The project is partly financed by a grant from MEDA-I fund. Training of personnel and accreditation of laboratories are continuing under the same project. The project, which will cost 14.1 million euro, was approved by the EU in 1997 and it will be partly funded by a grant of 10.1 million euro. Delivery of technical equipment as a grant under the project was delayed due to various reasons. The project is expected to be completed except for training and accreditation by the end of 2004.

With the Project on Reinforcement of Food Quality and Security System (FAO/TCP/TUR/2901(A)) efforts continues to provide training on food safety subjects like improving and updating the good hygiene practices in the food industry and officials, hazard analysis of critical control points (HACCP) and risk analysis and to harmonize the integrated food control information and communication systems with EU Rapid Alarm System.

A project is being implemented in order to ensure compliance with the European Council regulation 339/93/EEC in the context of MATRA technical cooperation of the Netherlands with the participation of various public agencies. With this project, the necessary infrastructure is established for reducing border inspections applied to products to be imported from third countries based on risk analyses and performing product control in accordance with market supervision and regulation principles. With a total cost of 483,000 euro, the project is expected to be completed by the end of May 2005.

A new project was decided to be launched in 2005 that will be funded by EU for improving the infrastructure of food inspection in Turkey. With the Project for Restructuring and Strengthening of Management of Food Safety and Control System in Turkey, increasing efficiency in the food control system and strengthening the structure of current services and personnel of the Ministry of Agriculture and Rural Affairs in the central and provincial administrations and establishing a reference laboratory are aimed. The project will cost 10.7 million euro of which 2 million euro will be the contribution of Turkey.

Monitoring programs for foodstuffs are being implemented in harmony with the EU. A National Residue Monitoring Program comprising milk, honey, fishery products and poultry meat to monitor pesticide residues are being implemented in accordance with the Council's directive 96/23 EC. Efforts are under way to monitor and prevent aflatoxin in hazelnut, pistachio, peanut, and dried fig from production to consumption. Alignment of legislation related to prevention of aflatoxin with related EU regulations have been completed.

Table: 4. 6. Matrix of Policy Commitments: Agriculture

(1000 Euro)

	2003	2004	2005	2006	2007
1. Agricultural Reform Implementation Project (1)					
A. Implementation Profile	X	X	X		
B. Net Effect on Budget	-50,000	-48,713	-42,026		
B.1. Direct Effect on Budgetary Revenues	0	0	0		
B.2. Direct Effect on Budgetary Spending	-50,000	-48,713	-42,026		
2. Plant Health – Project To Eradicate Plant Diseases and Pests (2)					
A. Implementation Profile	X	X	X		
B. Net Effect on Budget	-1,363	-1,013	-910		
B.1. Direct Effect on Budgetary Revenues	0	0	0		
B.2. Direct Effect on Budgetary Spending	-1,363	-1,013	-910		
3. Animal Health – Project To Eradicate Plant Diseases and Pests (2)					
A. Implementation Profile	X	X	X		
B. Net Effect on Budget	-9,187	-7,819	-8,233		
B.1. Direct Effect on Budgetary Revenues	0	0	0		
B.2. Direct Effect on Budgetary Spending	-9,187	-7,819	-8,233		
4. Pursuant to the Decree 2000/467 on Supporting Animal Husbandry					
A. Implementation Profile	X	X	X		
B. Net Effect on Budget	-104,824	-91,500	-104,000	-230,000	-270,000
B.1. Direct Effect on Budgetary Revenues	0	0	0	0	0
B.2. Direct Effect on Budgetary Spending	-104,824	-91,500	-104,000	-230,000	-270,000
5. Fisheries Sector- Legal and Institutional Alignment to the EU Acquis Project					
A. Implementation Profile		X	X	X	
B. Net Effect on Budget		3,588	1,083	1,064	
B.1. Direct Effect on Budgetary Revenues		3,812	1,293	1,064	
B.2. Direct Effect on Budgetary Spending		-224	-210	0	
6. Project on Improvement of Food Control Services					
A. Implementation Profile	X	X	X		
B. Net Effect on Budget	7,415	-1,143	-1,246		
B.1. Direct Effect on Budgetary Revenues	9,854	368	0		
B.2. Direct Effect on Budgetary Spending	-2,439	-1,512	-1,246		
7. Restructuring and Strengthening of Food Safety and Control Management in Turkey					
A. Implementation Profile			X	X	X
B. Net Effect on Budget			139	1,835	6,738
B.1. Direct Effect on Budgetary Revenues			352	2,546	7,802
B.2. Direct Effect on Budgetary Spending			-213	-711	-1,064
8. Direct Income Support (3)					
A. Implementation Profile	X	X	X		
B. Net Effect on Budget	-1,298,310	-1,443,863	-1,362,351		
B.1. Direct Effect on Budgetary Revenues	0	0	0		
B.2. Direct Effect on Budgetary Spending	-1,298,310	-1,443,863	-1,362,351		
Total Net Effect on Budget					
A. Implementation Profile	X	X	X	X	X
B. Net Effect on Budget	-1,456,269	-1,590,464	-1,517,544	-227,101	-263,262
B.1. Direct Effect on Budgetary Revenues	9,854	4,180	1,645	3,610	7,802
B.2. Direct Effect on Budgetary Spending	-1,466,123	-1,594,644	-1,519,189	-230,711	-271,064

Note: Net Effect on Budget was calculated by subtracting expenditures from budgetary revenues.

(1) They represent spending from the budget in the current year and excludes payments related to the respective year

(2) No amount was spent by the EU and Turkey under the projects as the bidding projects related to the EU project have yet to be completed. Figures recorded as budgetary spending represent spending related to the national project, which is being implemented under the National Investment Program and also comprises the EU Projects.

(3) It includes all spending under the Agricultural Reform Implementation Project including investment and transfers. DIS payments for the years 2006 and 2007 will be determined in the context of Agriculture Framework Law which is expected to be enacted in 2005 and no figure is given for these years.

* In EU-funded projects, impact on budgetary revenues result from EU contributions with grant and investment component in the related projects.

4.6. Other Reform Areas

4.6.1. Regional Development

The fundamental objective of regional policies is to increase the revenues and competitive edge of the regions in national and international markets, to reduce the inter regional development disparities among regions, to divert uncontrolled migration to big cities to medium sized cities in order to achieve demographic balance, to minimize problems arising from unplanned urban growth while maintaining quality of environment and urban space in cities, to draw up plans designed to increase employment and productivity in rural areas while supporting income-generating activities, and to increase efficiency in implementation of those plans by supporting them through appropriate institutional organization and funding.

Sustainability and participation are the main principles guiding implementation of regional development policies. A Preliminary National Development Plan (PNDP) was drawn up for being implemented in 2004-2006 and it is intended to formulate a national economic and social cohesion policy in order to reduce regional disparities and to create an operational infrastructure allowing an efficient use of pre-accession financial assistance received from the EU and allocation of post-accession structural funds. Regional development programs supported by pre-accession financial assistance received from the EU will be launched in 12 NUTS II regions, which have been designated as priority areas in terms of socio-economic development indicators, under the PNDP. These programs aim at development of a mechanism for efficient management, implementation, and monitoring of regional development and structural cohesion policies at central and regional levels.

Meanwhile, at central level, it is planned to implement a Twinning Project, called Improving the Institutional and Administrative Capacity of General Directorate of Regional Development and Structural Adjustment of SPO. The implementation of the Project will be started by the end of 2004 after the approval of the Twinning Contract. The project is aimed to provide technical assistance in regional development and establishment of the legal and organizational framework for the management of EU funds, improvement of the coordination capacity at central and regional level to implement regional development programs, and improvement of implementation capacity of identified projects in EU norms.

At regional level, a Draft Law on the establishment, coordination, and duties of Regional Development Agencies (RDAs) at NUTS II regions as part of efforts to accelerate regional development in line with the guidelines and policies laid down in the Development Plan and Annual Programs, to ensure proper and efficient use of funds; to implement EU programs, to increase cooperation between the private sector and non-governmental organizations and the public sector, to ensure coordination between provinces in this regard. The Draft Law has been submitted to the Prime Minister's Office and it is expected to be enacted before the end of 2004. When those agencies are established and become functional, regional programs supported by the EU pre-accession grants will be locally coordinated, implemented, and monitored by those units. Presently, this task is undertaken by Project Coordination and Implementation Units set up by the SPO in the regions. Knowledge, experience, and technical facilities acquired by these project units in this field will be transferred to the new agencies pursuant to provisions in the provisional articles so that they will not be lost. The agencies assume a crucial role in this regard and function as local implementation and coordination units responsible for EU-funded regional development programs, which are expected to continue at a larger scale in the future. Nine agencies are expected to be established in 2005, two in 2006 and three in 2007 mainly in the regions where regional development programs supported by EU grants.

Agencies are assumed to have functions of intermediation to use the direct resources from budget for the purpose of regional development as well as the functions of allocating the EU funds. Thus, it is foreseen that entrepreneurship aiming regional development in both the priority regions under the PNDP and in the other regions will be supported. The funds allocated for micro-projects of local administrations in regions with development priority from the funds in the SPO's budget are quite limited. With this implementation, local development is aimed rather than regional development. Similarly, it is foreseen that the support to all segments will be provided through agencies.

Eastern Anatolia Development Program, which is one of the 12 NUTS II Regions with priority as defined in the PNDP, is approved by the European Commission in 2001. Implementation of the Program which is funded by MEDA resources, has been started in the first quarter of 2004. Preparation of a three-year implementation plan and grant application guidelines are under way. The program is aimed at contributing to socio-economic development of the region and conservation of its ecological assets by means of activities to be carried out in the fields of agriculture and rural development, SMEs, tourism, environment, and social development as well as pilot projects to be funded. The EU has earmarked 45 million euro for the Program. Turkey does not provide co-funding because the program is being funded under MEDA.

Another program being funded from MEDA resources is the Southeastern Anatolia Project Regional Development Program, which covers a five-year implementation period starting from 2002. The fundamental goal of the program is to improve economic and social conditions of people living in the southeastern Turkey in line with national objectives including elimination of regional disparities, achievement of sustainable economic growth, enhancement of regional employment capacity, improvement of environmental conditions, and conservation of cultural heritage. The program budget is 47 million euro and it will be wholly funded by EU grant.

Meanwhile, implementation of Regional Development in TR82 (Çankırı, Kastamonu and Sinop provinces), TR83 (Amasya, Çorum, Samsun and Tokat provinces) and TRA1 (Bayburt, Erzincan and Erzurum provinces) NUTS II Regions Program, which was approved under the Financial Assistance Package for 2003, will start in the last quarter of 2004. The program, which has a total budget of 52.3 million euro including a national co-finance totaling 12.3 million euro, is generally intended to implement an integrated regional development policy based on projects aimed at acquiring skills in implementation of EU grant mechanisms at regional level. The program is expected to be completed in 2006.

In addition, the Turkey-Bulgaria Cross-Border Cooperation Program, which will be implemented in 2004-2006 period, has a total budget of 19.5 million euro, including 4.5 million euro to be co-financed by Turkey. Implementation of Joint Small Projects Fund Program, which will cost 500,000 euro and supported under Financial Assistance Programming for 2003, begun in the third quarter of 2004. Besides, preparation of Interreg III/A Greece-Turkey Program is under way. 19.4 million euro, including a 4.4

million euro to be co-financed by Turkey, was earmarked for implementation of the program in 2004-2006.

Implementation of Regional Development in TR72 (Kayseri, Sivas and Yozgat provinces), TR52 (Karaman and Konya provinces), TRB1 (Bingöl, Elazığ, Malatya and Tunceli provinces) and TRA2 (Ağrı, Ardahan, Iğdır and Kars provinces) NUTS II Regions Program, which will probably be approved under the Financial Assistance Program for 2004, is planned to start in the last quarter of 2005. With a total budget of 90.7 million euro, including a 20.7 million national co-finance, the program is aimed at contributing to economic development in the region and enhancing project implementation capacity at regional and central levels.

In addition, a new regional development program, will be launched in 2006 under the Financial Assistance Program for 2005. The Program comprises TR90 (Artvin, Giresun, Gümüşhane, Ordu, Rize, Trabzon) NUTS II Region, which is one of the priority NUTS II regions included in the PNDP and pilot metropolitan areas.

It is assumed that potential contribution of the regional development programs, which have been drawn up and launched, to the national economy will be limited especially during the pre-accession period given their implementation periods, amount of funds allocated to the programs, and the capacity of regional and central agencies to draw up and implement projects. It is, however, expected that project development and implementation capacity at regional and central level will be enhanced through efficient use of pre-accession funds and positive effects on income and employment will be observed in these regions during this period although they will be limited in scale.

Table: 4. 7. Matrix of Policy Commitments: Regional Development

(1000 Euro)

	2004	2005	2006	2007
1. Regional Development in TR82, TR83 and TRA1 NUTS II Regions Program				
A. Implementation Profile	X	X	X	
B. Net Effect on Budget		-5,060	-7,270	
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending		-5,060	-7,270	
2. Turkey-Bulgaria Cross-Border Cooperation Program				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget		-840	-1,490	-2,180
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending		-840	-1,490	-2,180
3. Interreg III/A Greece-Turkey Program				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget			-1,940	
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending			-1,940	
4. Regional Development in TR72, TR52, TRB1 and TRA2 NUTS II Regions Program				
A. Implementation Profile		X	X	X
B. Net Effect on Budget			-8,200	-12,470
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending			-8,200	-12,470
5. Program for Reduction of Infrastructure-related Problems in Pilot Urban Areas and Regional Development in TR90 NUTS II Region (1)				
A. Implementation Profile			X	X
B. Net Effect on Budget				-8,000
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending				-8,000
6. Allocations for Local Administrations (2)				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget	-1,370	-2,530	-2,000	-1,000
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending	-1,370	-2,530	-2,000	-1,000
7. Regional Development Agencies				
A. Implementation Profile		X	X	X
B. Net Effect on Budget		-5,060	-102,860	-113,940
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending		-5,060	-102,860	-113,940
Total Net Effect on Budget				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget	-1,370	-13,490	-123,760	-137,590
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending	-1,370	-13,490	-123,760	-137,590

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

(1) This program will be proposed under the Financial Assistance Program for 2005.

(2) This amount will be allocated through the budget of Agencies as the RDAs are established.

4.6.2. Health Care-Social Security Reform and Improvement of Income Distribution

Social security system in Turkey is experiencing various structural problems. The primary problem is that revenues of the system are not enough to finance its expenditures. Large amounts have to be transferred to social security institutions from the budget every year due to the deterioration of their actuarial balances. The total amount of transfers by the Treasury to SSK, Civil Servants Retirement Fund and BAĞ-KUR accounted for 4.4 per cent of the GDP in 2003.

Another structural problem is that the system cannot cover the entire population. The share of the population registered to social insurance programs was 86.4 per cent in 2003. The share of people, who had a health care certificate from a social security institution and actually benefited from health services, was 62.9 per cent of the population. The main objective is to extend the scope of social security to cover entire population thereby use social security as an efficient tool to reduce poverty and provide high quality and efficient health care services for all segments of society.

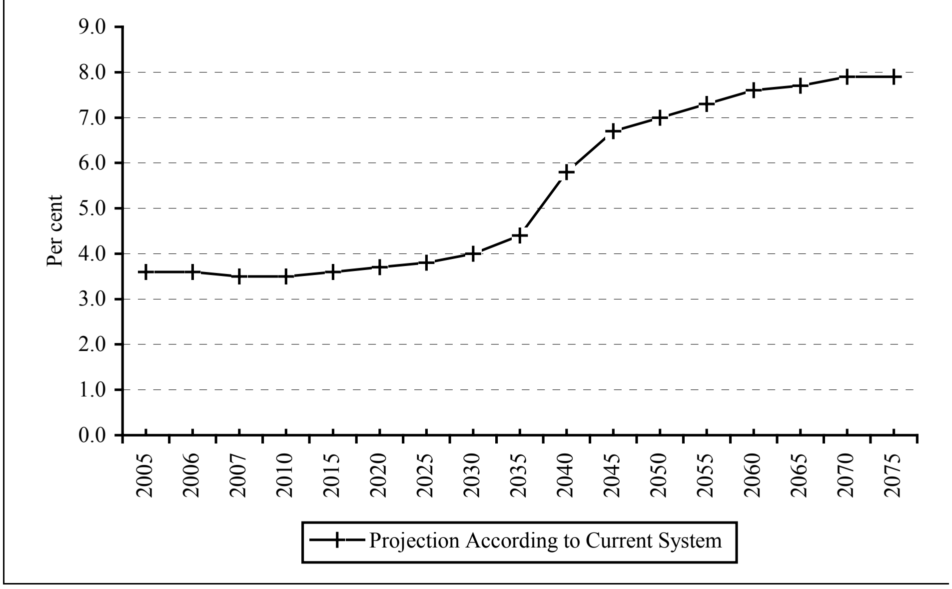
Failure to provide social security services efficiently and utilization of the system according to different criteria by the people under the system constitute a major problem. Although long term and short term insurance programs (pension and health care) should be managed according to different principles, their management are under the same system. In addition, the unity of quality and standards of health care services could not be ensured since provision and funding of these services take place within the same system.

The expected results of the Social Security Reform carried out in 1999 has not been realized at a desirable level due to the negative effects of the economic crisis experienced in 2001. Therefore, a new draft reform consisting of four main components complementing each other was drawn up by the Ministry of Labor and Social Security to restructure the social security system, in accordance with the Urgent Action Plan.

The first component of the reform aims to establish a pension system governed by uniform norms and standards. In order to establish a pension system with financial sustainability and a long term actuarial balance, the fundamental parameters of the system, including retirement age, wage indexation and replacement ratios will be changed. As a result of this reform, the ratio of the deficit of pension system to national income is targeted to decline to around 1 per cent over the long term.

Figure: 4. 1. Projection for Financial Deficit of the Pension System

(Per cent of the GDP)



The general health insurance, which is the second component of the reform, is intended to include the entire population in the health insurance system based on uniform norms and standards by separating health insurance from old-age insurance to build a unified system. Insurance in the new system will be based on compulsory participation and a premium based system. A cost-effective financial management will be implemented due to a possible increase in health care expenditures because of extended scope of the insurance system, aging of the population, technological advances and increase in quality of services. The new system will be launched concurrently with The Health Transformation Project.

Current health care system cannot serve efficiently due to the problems stemming from the institutional structure, functioning, the personnel profile as well as personnel allocation. These factors caused to a need for initiation of a study on a reform in health care system.

In this context, The Health Transformation Project is being carried out jointly by the Ministry of Health and the Ministry of Labor and Social Security. The first phase of the project focuses on pilot applications, necessary training, and establishment of a health care system database. The Health Transformation Project consists of five components, which are:

1. Restructuring the Ministry of Health
2. Establishment of a general health insurance and strengthening institutional capacity of social security institutions (the general health insurance is the common component of the social security reform and the health care reform)
3. Reorganizing the delivery of health care services
4. Strengthening human resources capacity
5. Building infrastructure for health and social security

An efficient, high quality and easily accessible health care system will be established through implementation of the five components of The Health Transformation Project in care and reorganization of the system. In this context, Düzce province was selected as the pilot province where the general health insurance and common use of health care service units will be launched in 2005 under the Draft Law on Pilot Application of Family Medicine, which was sent to the TGNA. The Health Transformation Project also takes into consideration the harmonization with the EU Acquis. The Ministry of Health is aligning legislation on health care with the EU Acquis within the framework of the Turkey's National Programme For the Adoption of the Acquis.

Pursuant to Article 152 of the Amsterdam Treaty, EU policies have been broadened to improve public health, to prevent diseases, and to eliminate risks to human health. In parallel to this, strong emphasis is put on protective and public health care services in restructuring the Ministry of Health as part of the reform.

The third component of the social security reform is intended to integrate the different social aid and services, which are currently provided by different organizations. Fairness of the provision of social aid and services to people who actually need them, will be maintained through objective criteria in selecting the beneficiaries, and a system accessible by the needy will be established.

The second and third components of the social security reform are crucial in redressing inequality in income distribution and in reducing poverty. The second component presumes the government to pay for the premiums of the poor under the general health insurance system.

There is an increasing need for social aid and services in our country as a result of unemployment, increased poverty as well as transformation of the traditional family structure. Policies concerning social aid and services are, however, being implemented by different institutions in a disorganized and inefficient manner. Reorganization of social aid and services, which is the third component of the reform, intends to reorganize the tools and resources to be utilized in the fight against poverty in an efficient manner.

The last component of the social security reform aims to ensure that the administrative units responsible for the three components outlined above function under an integrated mechanism. The reform will facilitate citizens' access to services while creating an efficiently functioning new institutional structure. Services will be provided by fully automated units established countrywide through a central database.

The draft laws of the reform are expected to be sent to the TGNA by the end of 2004 and enacted in 2005. The reform will be fully implemented when the new institutional system is established by the end of 2007.

Box: 4.2. Social Expenditures in Turkey

Although discipline is maintained in public spending to achieve the primary budget surplus target, a strong emphasis is being put on to increase expenditures in health care and social protection. The table shows that the share of social expenditures in GDP rose from 17.1 per cent to 19 per cent in the last two years.

Table: Social Expenditures

	1998	1999	2000	2001	2002	2003	2004 *
			Trillion Turkish lira				
Education (1)	2,185	3,609	5,018	7,536	12,312	14,934	17,071
Health Care (1)	1,480	2,567	4,359	7,607	13,115	17,100	23,172
Social Protection (2)	3,279	5,675	8,312	13,748	22,041	32,671	39,320
Total	6,944	11,850	17,689	28,892	47,468	64,705	79,563
			Per cent of the GDP				
Education	4.2	4.7	4.0	4.2	4.4	4.2	4.1
Health Care	2.8	3.3	3.5	4.3	4.7	4.8	5.5
Social Protection	6.2	7.3	6.7	7.7	8.0	9.1	9.4
Total	13.3	15.3	14.2	16.2	17.1	18.0	19.0

(1) It includes the expenditures of Institutions in the Consolidated and Annexed Budgets, Extra-Budgetary Funds, SEEs, Social Security Institutions, Revolving Funds and Local Administrations.

(2) Social Protection includes Direct Income Support, expenditures of the Social Security Institution and Social Solidarity Fund excluding health care and education, expenditures of the General Directorate for Social Services and Child Protection Institution, the Presidency of Administration on Disable People and the Unemployment Insurance Fund.

* Program

There has been a decline in education expenditures for the last two years. As part of the campaign to support education, which was launched in 2003, all contributions to education have been declared as tax exempt and thereby private sector was encouraged to invest in education. Payments to pensioners, who were affected by the economic crisis, and direct income support have an important share in social protection expenditures. Quality of health care services will be improved by ensuring a cost-effective management in the health care system and income of the population receiving social aid will be increased in the forthcoming period.

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Table: 4. 8. Matrix of Policy Commitments: Health Care-Social Security

(1000 Euro)

	2004	2005	2006	2007
1. Neonatal Screening Program (Phenylketonoury, Hypothyroid)				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget	-127	-509	-1,500	-1,500
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending	-127	-509	-1,500	-1,500
2. SB/ AB Healthy Reproduction Program				
A. Implementation Profile	X	X	X	
B. Net Effect on Budget	-1,000	-1,000	-1,500	-
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending	-1,000	-1,000	-1,500	-
3. Cancer Screening and Research Centers Project				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget	-97	-814	-611	-1,000
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending	-97	-814	-611	-1,000
4. RSHM Laboratory Development				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget	-3,255	-5,158	-10,000	-9,269
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending	-3,255	-5,158	-10,000	-9,269
5. Eradication of Epidemics				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget	-5	-6	-5,169	-5,000
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending	-5	-6	-5,169	-5,000
6. Health Transformation Project in Health Care (1)				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget	-5	-6	-5,169	-5,000
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending	-5	-6	-5,169	-5,000
7. Other (Medication, Biocidal project, etc.)				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget	-6	-2,000	-2,000	-2,000
B.1. Direct Effect on Budgetary Revenues				
B.2. Direct Effect on Budgetary Spending	-6	-2,000	-2,000	-2,000
Total Net Effect on Budget				
A. Implementation Profile	X	X	X	X
B. Net Effect on Budget	-6,015	73,967	223,719	260,831
B.1. Direct Effect on Budgetary Revenues		100,000	270,000	300,000
B.2. Direct Effect on Budgetary Spending	-6,015	-26,033	-46,281	-39,169

(1) Establishment of institutional and database infrastructure of general health care insurance and social security is included in this project.

Box: 4.3. Income Distribution in Turkey

Improvement of income distribution and fighting against poverty is a top priority in Turkey's agenda in the economic and social aspect. The decline in the Gini coefficient for Turkey in the Survey of Household Income Distribution to 0.42 in 2003, from 0.49 in 1994, indicates a tendency towards an improvement in income distribution. According to the results of Survey of Household Budget Inquiry of 2003, the share of the first 20 per cent quantile with the lowest share from the total disposable income has increased to 6 per cent of the total disposable income, whereas the fifth 20 per cent quantile with the highest share from the total disposable income has decreased to 48.3 per cent.

Table: Distribution of Annual Disposable Income as per 20 Per cent Quantiles

	1994	2002	2003
First 20 Per cent Quantile	4.9	5.3	6.0
Second 20 Per cent Quantile	8.6	9.8	10.4
Third 20 Per cent Quantile	12.6	14.0	14.5
Fourth 20 Per cent Quantile	19.0	20.8	20.9
Fifth 20 Per cent Quantile	54.9	50.1	48.3
The Gini Coefficient	0.49	0.44	0.42

The common practices of unpaid family workers in agriculture, low efficiency in agriculture production, and the high number of inactive population are among the important factors contributing to the inequality in the income distribution. In 2003, the share of agricultural employment in total employment was 34.8 per cent, whereas their share from the total income was 13.9 per cent.

Notwithstanding the relative improvement in the distribution of income, poverty is an important social problem of Turkey. According to the results of the study carried out in 2002 by SIS on poverty has shown that 1.4 per cent of the individuals in Turkey live below the poverty line regarding expenditures on food, whereas 27 per cent live below the poverty line regarding the food and non-food expenditures.

4.6.3. Information and Communication Technologies

The ultimate benefits that Turkey expects from transformation into an information society is to improve international competitiveness and social welfare by increasing resource and cost efficiency through effective use of information as the most valuable input in each area of economic and social life.

The e-Transformation Turkey Project aiming such transformation foresees new improvements in every area of economic and social life. Under the Project, formulation of policies and strategies, technical infrastructure and information security, education and human resources, legal infrastructure, standardization, e-government, e-health and e-commerce are acknowledged as the basic components of the process of transformation into an information society. The targets of the e-Europe Action Plan 2005 were also taken into consideration. Comprising 73 actions, the e-Transformation Turkey Project Short-Term Action Plan, based upon the studies carried out under the coordination of SPO in a collaborative approach was put into effect through Circular No. 2003/48 of the Prime Ministry. Pursuant to the Circular, the e-Transformation Turkey Executive Committee has been set up to steer and monitor the Project at the highest level.[5] In order

[5] The e-Transformation Turkey Executive Committee consists of the Minister of State and the Deputy Prime Minister, the Minister of Transportation, the Minister of Industry and Trade, the Undersecretary to SPO, and the Chief Consultant to The Prime Minister. The Executive Committee regularly meets each month and evaluates the developments as per the Action Plan.

to ensure participation and opinion exchange, the relevant professional associations and non-governmental organizations as well as the related public agencies have also been included among the participants to the Committee meetings.

The e-Transformation Turkey Executive Committee has adopted the Document of Policy of Transformation into Information Society, which is prepared by the collective studies of the related public institutions and non-governmental organizations as well as the contribution by the e-Transformation Turkey Project Advisory Board. The document, which will be the basis of the Information Society Strategy, the first article of the e-Transformation Turkey Project Short-Term Action Plan, specifies the fundamental policies that will enable Turkey to proceed to information economy and to transform into an information society in order to obtain a higher share from the global market by achieving a global competitive advantage and improve the social welfare.

Studies on the Information Society Strategy are in progress. Once the Strategy is finalized, the medium and long term objectives will have been determined, with the e-Europe Initiative also considered.

Important steps have been taken in the area of education in order to provide such human resources as required by an information society. Under a protocol signed within this framework by the Ministry of National Education (MNE) and Türk Telekom A.Ş., 42,534 schools throughout Turkey will be provided with Asymmetric Digital Subscribers Line (ADSL) Internet access and services by the end of 2005. 9,126 schools of the MNE were already provided with ADSL Internet access by August 2004. Computer laboratories have been furnished and Internet connections have been set up for 2,802 schools within the framework of Basic Education Project Phase I, and 26,276 schools including those in rural areas have been supplied with computers and Internet access.

With a perspective of life-long learning, MNE has launched studies for an Education Portal to serve all the citizens. Furthermore, an arrangement has been made to allow all citizens to benefit from the Internet facilities of primary and secondary schools in the periods of day when no education takes place.

The major component of the e-Transformation Turkey Project is the e-government. In this context, an e-government portal focused on citizen and business requirements is foreseen, through which the users will be able to access to integrated public services from a single point, and studies to such effect have been started.

The Central Census Management System (CCMS), one of the major components of e-government services, which allows access to identification data of the citizens with a single and unique number, was completely implemented in January 2003. So as to enable the citizens to use a single and unique number in their relations with the government, an important progress has been made to replace such numbers as tax, citizenship, social insurance, etc. with this unique number. Identification Data Sharing System aiming to allow public institutions to share CCMS identification data is expected to take effect by the end of 2004. In the transactions between public institutions and legal persons, the tax number assigned by the Ministry of Finance will be used as the unique number.

Major progress has been achieved towards the constitution of the legal infrastructure of an information society. Within this framework, Law on Electronic Signature No.5070 took effect in July 2004 to contribute to the spread of electronic commerce and to be an integrated part of the e-government services. Secondary legislation related with the enforcement of the e-signature law will be completed by the Telecommunications Authority by the beginning of 2005. The related studies are in progress, and draft legislations have been completed and presented for public opinion. The Regulation on Certificate Financial Responsibility Insurance concerning the risks to arise from the usage of electronic signature took effect in August 2004. Furthermore, it has been decided through Circular No.2004/21 of the Prime Ministry that a Public Certification Center be set up to ensure a safe, interoperable and compatible accomplishment of the actions by the public institutions in electronic medium and to prevent any redundant infrastructure investments.

The Law No.4982 on Right of Access to Information and the regulation specifying the procedures concerning the principles and procedures of the law took effect in April 2004. Pursuant to such legislation, an Information Access Evaluation Committee has been set up, and public institutions have also established information access units.

In the context of the regulations of Law No.5101 on the protection of intellectual properties in the electronic medium to make up the deficiencies in this area. The Law No.5194 has been enacted to provide new legislation concerning the function of the judicial bodies regarding the intellectual properties as well as the related sanctions to be imposed. Additionally, Turkish Penal Code No.5237 contains legislation concerning cyber crimes, and such legislation will take effect on 1 April 2005. A Draft Law on Protection of Personal Data has been formulated and was presented in July 2004 to public institutions for opinion.

eEurope+ Initiative, in which Turkey also takes part, was concluded with the presentation of the final progress report during the Information Society Conference of European Ministers held in Budapest in February 2004 and Turkey participates in eEurope 2005 as an observer. Turkey has also been a party to the Interchange of Data Between Administrations (IDA) Programme of EU since 16 March 2004.

Certain studies to support the e-Transformation Turkey Project and Turkey's transition to information society have been carried out in cooperation with international organizations. In this connection, the Knowledge Economy Assessment Report was prepared in cooperation with the World Bank and this report was published in May 2004. Efforts are being made to ensure Turkey's inclusion in e-government peer review of OECD in 2005, which aims at evaluating the level of preparedness for e-government.

Benefits expected from the transformation into an information society are likely only when widespread and quality telecommunication services accessible by everyone at low costs exist. In this respect, studies on adaptation of the telecommunication sector to liberalization and EU Acquis are ongoing. The monopoly held by Türk Telekom in infrastructure and voice services expired in the beginning of 2004, and the sector was opened to competition. The Telecommunications Authority, also considering the EU legislation, is completing the studies on secondary legislation needed in a liberalized market. A substantial part of the secondary legislation required in this connection has been completed. Important steps have been taken via such legislation to ensure efficient and competitive functioning of the electronic communications sector. Positive economic effects of such steps, however, depend on licensing of new operators, enforcement of legislation on interconnection and access as well as on opening the network owned by Türk Telekom to other operators' access, legislation on numbering and similar issues, and an effective enforcement of the decisions to be made by the Authority to make up the deficiencies. With the help of liberalization, access of new operators to the market, improvement of service quality and variety, extension of infrastructure, and reducing the costs of access would be facilitated.

The studies on a market demand analysis regarding the privatization of Türk Telekom have been completed, and a Cabinet's Decree containing the new sales strategy was issued in November 2003. Pursuant to the Decree, 51 per cent of the company's shares will be sold in one time and as a whole, and the remaining shares will be offered to the public within a process that will be determined by the Cabinet. However, the percentage of the shares to be sold as a whole in one time was increased to 55 per cent by the Cabinet's Decree published in the Official Gazette of 15 October 2004, and it has been decided to effect the invitation to bidding by 31 December 2004. Furthermore, the informing process started in order to inform the potential investors of the legal, operational and financial status of the company, to give information on the sales process, and to ask their opinions regarding the process of privatization before the contract award as regards the sales of Türk Telekom shares in bulk was completed at the end of July 2004. Additionally, the Law No.5189 that took effect in July 2004 annulled the provision of the Law No.406, which restricts the percentage of sales of Türk Telekom shares to foreigners by 45 per cent. Pursuant to the same law, TÜRKSAT Satellite Communication and Operation Inc. has been established, and the satellite services previously provided by Türk Telekom are now provided by that company.

Studies on a framework law have been launched in order to eliminate the disorganized structure of the legislation in the area of telecommunication and to introduce new legislation needed by the sector as parallel to the new developments. A draft version of the Electronic Communications Law has been formulated in cooperation with all the relevant parties and presented to public opinion as of September 2004. Furthermore, a draft version of a law has been formulated and presented to the relevant parties for opinion by the Ministry of Transportation with respect to the fulfillment of universal service obligations as well as the specification of the principles and procedures concerning the financing of such services.

Licensing as regards long-distance telephone service was started in May 2004 upon full liberalization, and 40 operators have been licensed as of September 2004. Besides, the studies on licensing as regards the Fixed Wireless Access services are planned to be completed by the end of 2004.

Progress on the secondary legislation in the telecommunications area is presented in Table 4.10. Cost modeling studies, on the other hand, carried out for PSTN and GSM networks to estimate interconnection and end-user prices in order to ensure the enactment of the Access and Interconnection Regulation that took effect in May 2003 are in progress. Studies on clearing of the frequency bands to be used for the third-generation mobile telecommunication system are ongoing as well. Additionally, in accordance with the Regulation on Certified Bodies, a protocol on Evaluation and Supervision of Certified Bodies was made between the Telecommunications Authority and the Turkish Accreditation Authority in December 2003, which aims to ensure the evaluation and supervision of the candidate bodies to be appointed by the Telecommunications Authority for technical eligibility, impartiality and independency in line with the practices in Europe and strategies in Turkey.

Table: 4. 9. Legislation within the Framework of Adaptation to the EU Acquis

Date	Number	Title	Remarks
26 August 2004	Official Gazette No.25565	Regulation on Licensing Concerning Telecommunication Services and Infrastructures	
10 February 2004	Resolution by Telecommunications Board No.2004/73	Principles and Procedures Concerning Account Separation and Cost Accounting	Formulated to ensure the enactment of Regulation on Access and Interconnection that took effect in May 2003.
20 July 2004	Official Gazette No.25528	Communiqué on Principles and Procedures Concerning Unbundled Access to the Local Loop (to take effect on 1 July 2005)	
6 March 2004	Official Gazette No.25394	Regulation on Installation and Use of Short Distance Radio Equipments	
26 February 2004	Official Gazette No.25385	Regulation on Numbering	National Numbering Plan was published under the regulation.
11 May 2003	Official Gazette No.25105	Regulation on Radio and Telecommunication Terminal Equipment (R&TTE)	The regulation adapted from R&TTE Directive No. 1999/5/EC. It took effect in May 2004.
26 February 2004	Official Gazette No.25385	Regulation on Certified Bodies	Prepared under the Regulation on R&TTE.
27 February 2004	Official Gazette No.25386	Regulation on Market Surveillance and Monitoring	Prepared under the Regulation on R&TTE.
6 February 2004	Official Gazette No.25365	Regulation on Personal Data Processing and Protection of Privacy in Telecommunication Sector	Prepared in line with the EU Directives No. 2002/58/EC and 2002/21/EC.
31 December 2003	Official Gazette No.25333	Communiqué on Principles and Procedures on Common Location and Facility Sharing	Prepared for the purpose of adaptation to Directive No. 97/33/EC.
-	-	Legislation on Rights of Way	Studies on adaptation to Full Competition Directive No. 96/19/EC are ongoing.
-	-	Regulation on User and Consumer Rights	Draft version has been completed and planned to be published in 2004.

Studies carried out under coordination of the Radio and Television Supreme Council to constitute an infrastructure for digital broadcasting have been completed and presented to the Higher Board of Communication.

A draft version of law is being formulated in order to provide a gradual and controlled abolition of the state monopoly in the mail sector in line with the liberalization efforts in the EU countries, to create an independent regulatory authority, and to reconstruct the sector in terms of speed, quality, reliability and accessibility to be in line with Directives No. 97/67/EC and 2002/39/EC. After the commission set up to finalize the said draft completes its studies, the opinion and recommendations of the relevant parties will be sought.

It has been decided within the framework of the Turkey-EU Financial Cooperation Programme in the year 2002 to fund a project amounting to 2.3 million euro so as to enhance the institutional capacity of the Telecommunications Authority. The participation amount of 40,000 euro as regards the project has been paid by Turkey. The process of contract award concerning the first stage of purchase of service under the project is still ongoing and foreseen to be implemented by the end of 2004.

Under the programme of Turkey-EU Financial Cooperation, the studies on Physical Infrastructure Enhancement Project are in progress. A support of 4.8 million euro will be provided under the project for the infrastructure enhancement of the present laboratory of the Telecommunications Authority where the market monitoring will take place in order to ensure the enactment of the Regulation on Market Surveillance and Monitoring. Furthermore, 1.1 million euro will be provided within the framework of the Regulation on Certified Bodies for the enhancement of the capacities of present laboratories where the candidate certified bodies would carry out their studies for the evaluation of eligibility. The Authority is currently working on the prerequisites of 5.9 million euro financial supports. For this reason, the participation amounts to be paid by Turkey have been postponed until the following year.

Table: 4. 10. Matrix of Policy Commitments: Information and Communication Technologies

(1000 Euro)

	2003	2004	2005	2006	2007
1. Project of Enhancement of Physical Infrastructure of Telecommunication Authority					
A. Implementation Profile			X	X	
B. Net Budget Effect			-1,070	-120	
B.1. Direct Effect on Budget Revenues					
B.2. Direct Effect on Budget Expenditure			-1,070	-120	
2. Project of Enhancement of Institutional Capacity of Telecommunication Authority					
A. Implementation Profile	X				
B. Net Budget Effect	-40				
B.1. Direct Effect on Budget Revenues					
B.2. Direct Effect on Budget Expenditure	-40				
Total Net Budget Effect					
A. Implementation Profile	X		X	X	
B. Net Budget Effect	-40		-1,070	-120	
B.1. Direct Effect on Budget Revenues					
B.2. Direct Effect on Budget Expenditure	-40		-1,070	-120	

4.6.4. Transportation

Preliminary studies on a transportation master plan to develop strategies in order to maintain a balance among the modes of transportation to meet the requirements of the country's economy and social life are still ongoing. Upon completion of the master plan studies, a more balanced structure of the modes of transportation will have been provided.

Preliminary studies on Transport Infrastructure Needs Assessment which will determine the transportation arteries to provide Turkey's integration to EU transportation networks have already been launched. The study aims at determining the arteries, connections and transit points to serve as Turkish extensions of the Trans-European transportation network and integrating Turkey to Trans-European networks. The study is planned to be contracted out until the end of 2004.

Organization of the Turkish State Railways (TCDD) is one of the areas of substantial reforms in the transportation sector.

An Organization Action Plan has been formulated to span the period of 2003-2008 in the area of railway transportation by TCDD. In line with this action plan, a Project of Organization of Turkish Railways Sector and TCDD has been prepared. The Project amounting to 4.7 million euro with the objectives of reconstructing the Turkish railway sector and reorganizing TCDD has been launched under Turkey-EU Financial Cooperation Programme and planned to be completed by the end of November 2006. The contract award procedures for the project have already been finalized and the project will be carried out by the German Railways. Draft versions of laws on the reconstruction of the railway sector under the project will be formulated at first, with due consideration given to the EU directives. The project will serve to the improvement of the institutional and financial structure of TCDD as well as to the economic development and environmental sustainability of the railway sector by ensuring its efficient operation.

Meanwhile, studies are in progress to obtain a loan of about 200 million dollars within the framework of the World Bank Country Assistance Strategy Crediting Programme for the organization of the Turkish State Railways. The Country Assistance Strategy Programme is planned to fund the signalization projects that will reduce the personnel costs, the investments needed to establish the information communication infrastructure and the source required for the requirements after the reconstruction.

With respect to maritime transportation, the conventions on maritime safety involving flag and port state controls to which Turkey is a party and their future amendments and protocols will be approved in a timely manner and the required legislation and infrastructure improvements for adaptation to the EU Acquis and its implementation will be affected. The enhancement of Maritime Safety Project started under the Financial Cooperation Programme of 2002 is an important step towards improving the maritime safety. An effective database will provide a further improvement in control.

The Highways Transport Law was enacted in 2003 to organize domestic and international passenger and freight transport. Its supplementary regulations, along with regulations governing the scope, principles and procedures of occupational proficiency training, both prepared in accordance with the EU transport legislations, were put into effect in 2004.

The Project on Support to Road Sector containing the legislation to be effected in the process of adaptation to EU, and strengthening of personnel training and traffic controls has been included in the Turkey-EU Financial Cooperation Programme of 2004.

Table: 4. 11. Matrix of Policy Commitments: Transportation

(1000 Euro)

	2004	2005	2006	2007
1. Reconstruction of TCDD and Turkish Railway Sector				
A. Implementation Profile		X		
B. Net Budget Effect		-477		
B.1. Direct Effect on Budget Revenues				
B.2. Direct Effect on Budget Expenditure		-477		
2. Enhancement of Maritime Transportation Safety				
A. Implementation Profile		X		
B. Net Budget Effect		-417		
B.1. Direct Effect on Budget Revenues				
B.2. Direct Effect on Budget Expenditure		-417		
3. Project on Support to Road Sector				
A. Implementation Profile		X		
B. Net Budget Effect		-1,500		
B.1. Direct Effect on Budget Revenues				
B.2. Direct Effect on Budget Expenditure		-1,500		
Total Net Budget Effect				
A. Implementation Profile		X		
B. Net Budget Effect		-2,394		
B.1. Direct Effect on Budget Revenues				
B.2. Direct Effect on Budget Expenditure		-2,394		

4.6.5. Energy

Turkey attaches utmost importance to implement the energy market reforms and to completely adapt the national energy legislation to the EU legislation. In this context, significant reforms have been made in Turkey during the last three years. The reforms aim at opening the energy sector to competition and providing a transparent structure where the private sector will freely operate.

Major steps have been taken to liberalize the electricity market so as to involve the private sector in the energy sector more actively. In this context, the Energy Market Regulatory Authority (EMRA) operating independently under transparent rules has been set up to ensure the reliance of investors. The Law on Electricity Market that took effect in March 2001 aims at providing a structure where the private sector may operate by way of ensuring competition in the electricity sector and thus achieving a reliable and stable market by way of overcoming the shortages of the means of public financing.

Reconstruction of the state enterprises in the electricity sector and a successful privatization of the generation and distribution facilities are of utmost importance as regarding to the implementation of reforms. Within this framework, the Strategy Document covering the implementation process as regards the liberalization of the energy sector and privatization of generation and distribution facilities was approved and announced by the Supreme Planning Board in March 2004. The document specifies such basic issues as supply and demand projection, supply safety, tasks and responsibilities of public authorities and establishments and sets a calendar for privatization activities. The process of privatization is planned to be carried out in line with the reformation studies regarding the liberalization of the energy market (tariff mechanism, balancing and settlement mechanism based on bilateral agreements, licensing procedures, etc.). All such activities are being carried out under the coordination of the Ministry of Energy and Natural Resources.

The Strategy Document includes the issues of arranging 21 distribution regions, establishing them as legal bodies and their licensing, identifying performance standards for each distribution region and estimating distribution losses, designing load profiles and tariff mechanisms, deciding on and implementing a price equalization mechanism, starting the process of contract award as regards the privatization of distribution companies in 2005, deciding on the hydro electric power plants to be operated by the state, deciding on the generation plants subject to privatization, grouping and establishing them as legal bodies, licensing the generation groups, introduction of a market management system by the transmission system operator, and starting the privatization procedures in 2006 as regards the generation plants.

A Long-Term Electricity Energy Demand Study Report for Turkey was produced and presented to public opinion in May 2004 within the framework of the studies under the Strategy Document. Within the same framework, the hydro electric power plants to remain in the public domain have been identified and studies have begun to group the other generation facilities. Studies are still in progress to reduce the distribution losses, to improve the service quality, to identify performance standards for each distribution region, to estimate distribution losses, and to design a price equalization mechanism.

The studies carried out under the Strategy Document indicate the major progress achieved in such issues as regards the energy sector as listed under the Pre-Accession Economic Programme for 2003. The fact that the major stages of the reformation process have been scheduled is of significance as such action has mapped out the reformation process that will take a long time. The studies contained under the Strategy Document have been carried out in accordance with the scheduled calendar until the present. The effective completion of the reformation process will be possible in case of completion of the privatization procedures of the generation portfolio groups to start in 2006 and creation of a competitive structure where multiple actors will be involved in the market both in the generation and in the distribution fields. According to the Strategy Document, the substantial proportion of the reforms is expected to be completed beginning from 2008.

It is possible to have a significant amount of saving with increasing productivity and reducing distribution losses by implementing the Electricity Market Law.

It is also possible to mention about the contributions and positive externalities of the reformations that are not easy to estimate in the first stage. Accordingly:

- With the improvement of the service quality, the frequency instabilities will be reduced to the standards in EU, the time and frequency of blackouts will be reduced, and thus the extra costs arising from such technical shortages in the system will be avoided.
- Customer demand management mechanisms will facilitate the mitigation of the load curves and the balancing of the distribution of the load on the system.
- As the prices to occur in the market will reflect the real costs, an efficient distribution of the economic resources will be ensured. Similarly, reflection of the real costs to the consumer groups will eliminate the inappropriate pricing, reduce especially the cross-subsidy burden on industrial subscribers, and enhance the competitiveness of the industry in the international arena.

- Incorporation of the service quality into the system as a performance standard and the diversification of the end-user tariffs will provide an alternative means of pricing matching and the satisfaction of the customer will increase.
- Bilateral agreements and creation of a spot market will increase the competition in the area of generation, thus resulting in an increase in efficiency and a decrease in prices.

Regulatory actions have also been taken in Turkey as regards the natural gas market as parallel to the electricity sector. The Law on Natural Gas Market that took effect in May 2001 aims at reconstructing the sector by way of creating a competitive atmosphere in the natural gas market and offering natural gas to the consumers in a reliable and economical manner. In this connection, several regulations on licensing, plants transmission, distribution and customer services, certification, inner installations, tariffs and control have been put into effect during the last three years. Such secondary legislation means the infrastructural studies necessary for the creation of a market structure as provided under the law.

Natural gas distribution licenses have been contracted out in provinces and gas distribution networks have already been developed in six provinces.

The most significant improvement observed in the issues regarding the natural gas sector listed under the Pre-Accession Economic Programme for 2003 is the rapid progress in the contract award procedures regarding the natural gas distribution licensing that will end the monopoly held by BOTAŞ.

BOTAŞ, a public enterprise, owns all the import agreements and has a monopoly in gas supply as a whole. In accordance with the Law on Natural Gas Market, BOTAŞ may not enter into a new purchase agreement until its share in import declines below 20 per cent of the national consumption. BOTAŞ is obliged to transfer the current purchase and sales agreements to independent supply companies by 2009. Although there are difficulties in the transfer of the contracts to the private sector, efforts are being made to overcome such difficulties.

Important steps have been taken also in the issue of liberalization of the oil market, which is another item of the energy sector. Turkey, being a permanent member of the International Energy Agency (IEA), regularly reports its oil stocks to the Secretariat of the IEA and complies with the condition that an oil stock of 90 days be maintained within the framework of the EU legislation concerning the IEA commitments. The Law on Oil Market formulated in consideration of the supply stock condition took effect in December 2003. The Law on Oil Market aims at creating a market that is competitive in reliable energy supply. In this connection, EMRA has been authorized as regards the procedures concerning the regulation of distribution-sales activities in the oil market. The Law provides that EMRA introduce the regulations and effect licensing in the oil market as in the electricity and natural gas markets. With the adoption of the Law on Oil Market, the studies on secondary legislation for the liberalization of the market activities as regards crude oil, fuel and other petroleum products have been launched. The new market structure defined under the law is planned to be introduced in January 2005.

To increase the contribution of renewable resources to the energy supply, a Draft Law on Renewable Energy has been formulated and forwarded to the TGNA to start its adoption process. In line with the EU Directive aiming at the extension of the usage of electricity generated by means of renewable energy resources, the draft version aims at furthering the usage of renewable resources without stressing the conditions prevalent in the free market mechanism. It is expected that responding to the overall energy demand with a reliable, economical and environment-friendly manner will be possible upon the approval of the Draft Law. Moreover, the dependency on import will be reduced, resource diversity will be extended and reduction of greenhouse gas emissions and the protection of environment by way of recycling of wastes will be more possible.

The Draft Law on energy efficiency is expected to be adopted in the coming period. The National Energy Savings Center set up within the Electrical Power Resources Survey and Development Administration carries out studies on an effective and efficient usage of energy and coordinates the activities in the area.

Efforts towards creating integrated energy markets in the Southeastern Europe as regards gas and electricity as well as creating a market frame that will attract investments in the region as regards gas networks, electricity generation and transmission facilities are still ongoing. Turkey takes an active part in such efforts aiming to create a regional energy market. In this connection, studies on the adoption of a legally binding regional market agreement are in progress.

In addition, the agreement on the establishment of International Hydrogen Institute Technologies Center in İstanbul to support the studies on alternative fuels was signed between the United Nations Industrial Development Organization (UNIDO) and Turkey in October 2003.

Two different projects are being carried out together with the EU within the framework of the reforms in the energy sector.

The twinning project entitled Enhancement of the Institutional Capacity of EMRA contained under the Pre-Accession Economic Programme for 2003 and foreseen to be launched in October 2003 was started in July 2004 jointly with the Italian Energy Regulation Authority upon completion of the required procedures. The total budget of the project is 1 million 68 thousand euro. A part of the project amounting to 84 thousand euro has been allocated for purchases. 21 thousand euro out of this amount is the domestic share. Certain actions will be taken under the project to enhance the organizational structure and personnel capacity of EMRA.

The Regulatory Board Information System Project being carried out by EMRA aims at creating a regulatory information systems structure to support EMRA effectively regulating and controlling the energy markets.

Under the project, information technologies infrastructure will be constructed, administrations' demands for regulatory information systems will be identified, EMRA portal will be provided, work flow system will be created, document processing system will be furnished, special processing practices will be improved, support services will be provided, and training will be offered. The total budget of the project is 1,085 thousand euro. 35 thousand euro out of 150 thousand euro allocated for purchases will be paid by EMRA as domestic share.

With the consultancy services provided under the Regulatory Information Systems Project, a project record has been prepared, and the project has been approved by the PHARE Commission. The preliminary invitation to bidding for service purchases under the project has been disclosed on the web pages of the Delegation of the European Commission to Turkey and of EMRA. The service purchase and goods purchase contracts under the project are planned to be awarded simultaneously in the last quarter of 2004.

ANNEX TABLES

Table:1- Growth and Associated Factors

Percentages unless otherwise indicated	ESA Code	2003	2004	2005	2006	2007
1. GDP Growth at Constant Prices (14+15+16)	B 1 g	5.8	9.6	4.8	5.1	5.1
2. GDP at Current Prices (Quadrillion TL)	B 1 g	360	427	482	540	592
3. Change in GDP Deflator		22.5	8.2	7.9	6.4	4.4
4. CPI Change (Annual Average)		25.3	10.7	9.6	6.1	4.5
5. Employment Growth*		-1.0	2.4	2.5	2.5	2.5
6. Labour Productivity Growth**		6.8	7.0	2.3	2.6	2.6
7. Investment Expenditures (Per cent of the GDP)		22.8	25.9	24.8	24.7	25.0
Sources of Growth: Percentage Changes at Constant Prices						
8. Private Consumption Expenditures	P3	6.6	8.6	2.5	3.7	3.9
9. Government Consumption Expenditures	P3	-2.4	2.2	1.0	1.3	1.7
10. Gross Fixed Capital Formation	P51	10.0	31.4	9.9	8.8	7.9
11. Changes in Inventories and Net Acquisition of Valuables (Per cent of the GDP)***	P52+P53	3.0	1.3	-2.4	-0.9	-0.2
12. Exports of Goods and Services	P6	16.0	16.6	14.0	12.0	10.0
13. Imports of Goods and Services	P7	27.1	20.5	6.8	9.6	9.1
Contributions to GDP Growth						
14. Final Domestic Demand		5.9	9.7	3.9	4.5	4.4
15. Changes in Inventories and Net Acquisition of Valuables	P52+P53	3.0	1.3	-2.4	-0.9	-0.2
16. External Balance of Goods and Services	B11	-3.1	-1.4	3.3	1.5	0.9
Growth of Gross Value Added						
17. Agriculture		-2.5	3.1	-1.7	2.4	2.0
18. Industry		7.8	10.8	6.5	5.9	5.8
19. Construction		-9.0	3.0	4.2	4.7	5.1
20. Services		6.7	10.3	5.3	5.2	5.3

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

Table:2- Labour Markets Developments

	2003	2004	2005	2006	2007
1.Population (Thousand Persons, Mid-year)	70,712	71,789	72,844	73,905	74,944
2.Population Growth Rate (Per cent)	1.56	1.52	1.47	1.46	1.41
3.Working Age Population (Thousand Persons)*	48,912	49,810	50,730	51,648	52,573
4.Labour-Force Participation Rate (Per cent)*	48.3	48.3	48.5	48.7	48.9
5.Employment Level (Thousand Persons)*	21,147	21,649	22,182	22,741	23,304
6. Employment Growth Rate (Per Cent)	-1.0	2.4	2.5	2.5	2.5
7. Public Sector Employment (General Government, Thousand Persons)	2,161	-	-	-	-
8. Public Sector Employment Growth Rate (Per cent)	-1.2	-	-	-	-
9.Unemployment Rate (ILO Definition, Per cent)	10.5	10.0	9.8	9.6	9.3
10. Labor Cost Growth Rate (Per cent)					
Public	1.1	-	-	-	-
Private	-2.3	-	-	-	-
11.Average Real Wage Growth Rate (Per cent)					
Public	1.3	-	-	-	-
Private	-0.4	-	-	-	-

* +15 years-old

Tablo:3- Balance of Payments

Millions of Dollars, unless otherwise indicated	2003	2004	2005	2006	2007
1. Current Account (Per cent of the GDP)	-3.2	-4.9	-3.7	-3.4	-3.0
2. Total Exports of Goods	51.2	66.2	76.0	84.7	93.9
3. Total Imports of Goods	-65.2	-88.8	-97.2	-107.0	-117.5
4. Balance on Goods	-14.0	-22.6	-21.2	-22.3	-23.6
5. Services: Credit	19.0	23.0	25.8	27.5	29.3
6. Services: Debit	8.5	10.4	10.9	11.5	12.1
7. Balance on Services	10.5	12.7	14.9	16.0	17.1
8. Net Interest Payments From Abroad	-4.0	-4.0	-4.1	-3.8	-3.5
9. Other Net Factor Income From Abroad	-0.0	-0.0	0.0	-0.3	-0.4
10. Current Transfers	1.0	1.2	1.2	1.5	1.9
11. *of which* from EU (Billion Euro)			0.3	0.5	0.5
12. Current Account Balance	-7.9	-14.6	-11.1	-10.8	-10.5
13. Foreign Direct Investment	1.1	2.0	3.7	3.8	3.9
14. Change in Official Reserves (1)	-4.0	-1.3	5.6	4.7	1.7
15. Foreign Debt (Total)	145.8	154.8	159.8	165.4	173.0
16. *of which*: Public	65.5	68.5	69.1	66.9	66.0
17. *of which*: Foreign Currency Denominated	-	-	-	-	-
18. Exchange rate vis-à-vis EURO (end-year)	1,745,072	1,898,435	-	-	-
19. Exchange rate vis-à-vis EURO (annual average)	1,685,301	1,807,502	-	-	-
Lines 20-24: Percentages of the GDP					
20. Net Foreign Saving (2)	3.3	4.6	2.7	2.4	2.3
21. Domestic Private Saving (2)	31.3	23.4	24.2	22.0	21.3
22. Domestic Private Investment (2)	11.3	13.7	14.7	15.8	16.6
23. Domestic Public Saving (2)	-11.8	-2.1	-2.1	0.3	1.4
24. Domestic Public Investment (2)	4.2	4.0	4.5	4.7	4.6

(1) Due to the fact that new Stand-By negotiations with the IMF was continuing during the preparation process of the Pre-Accession Economic Programme, the credit amount that can be utilized in the context of this agreement was not included in the balance of payments figures. However, the fall in official reserves will decrease depending on the credit utilization from the IMF.

(2) Savings-investment balance calculations are based on the GDP by expenditure figures of SIS. The public investment figures in the table also include SEEs investments in addition to general government.

Table:4- General Government Budgetary Developments

Per cent of the GDP	ESA code	2003	2004	2005	2006	2007
		Net Lending (B9) by Sub-Sectors *				
1.General Government	S13	10.1	6.3	4.4	2.1	0.5
2.Consolidated Budget	S1311	7.0	4.0	2.1	0.1	-1.5
3.Funds		0.3	0.0	-0.1	-0.3	-0.4
4.Local Government	S1312	0.5	0.1	0.1	0.1	0.1
5.Social Security Fund	S1313	3.7	3.7	3.8	3.6	3.5
6.Revolving Funds	S1314	-0.4	-0.4	-0.3	-0.3	-0.3
7.Unemployment Fund		-1.1	-1.1	-1.1	-0.9	-0.8
		General Government (S13)				
8.Total Receipts	ESA	42.7	43.4	44.5	44.1	43.7
9.Total Expenditures	ESA	52.8	49.7	48.9	46.2	44.2
10. Budget Balance*		10.1	6.3	4.4	2.1	0.5
11.Interest Payments	B9	16.8	14.1	11.9	9.3	7.5
12.Primary Balance*	D41	-6.7	-7.8	-7.5	-7.2	-7.0
		Components of Revenues				
13.Taxes	D2+D5	25.6	25.9	27.0	27.1	27.2
14.Social Funds	D61	7.4	7.9	8.1	8.0	8.0
15.Other		9.7	9.6	9.4	9.0	8.5
16.Total Receipts	ESA	42.7	43.4	44.5	44.1	43.7
		Components of Expenditures				
17.Total Consumption	P32	17.9	17.7	17.5	17.4	17.3
18.Social Security Transfers	P31	11.4	11.7	11.9	11.7	11.6
19. Interest Payments	D41	16.8	14.1	11.9	9.3	7.5
20.Subsidies (1)	D3	1.1	0.9	0.9	1.0	0.9
21.Gross Fixed Capital Formation	D51	3.7	3.4	3.9	3.9	3.9
22.Other		1.9	1.9	2.8	2.9	3.0
23.Total Expenditure	ESA	52.8	49.7	48.9	46.2	44.2

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

Table:5- General Government Debt Developments

	ESA code	2003	2004	2005	2006	2007
		Per cent of the GDP				
1. Gross Debt Level		80.2	78.4	75.3	72.2	68.3
2. *Of which*: Repayments Due		33.1	31.3	31.1	29.2	31.4
3. Change in Gross Debt		-9.3	-1.8	-3.1	-3.1	-3.9
		Contributions to Change in Gross Debt				
4. Primary Balance (Per cent)	B9	-6.7	-7.8	-7.5	-7.2	-7.0
5. Interest Payments (Per cent)	D41	16.8	14.1	11.9	9.3	7.5
6. Nominal GDP Growth (Per cent)	B1g	-24.5	-15.0	-10.1	-8.8	-6.9
7. Other Factors Influencing The Debt Ratio		5.1	6.9	2.6	3.6	2.5
8. Other Factors Influencing The Debt Ratio: Exchange Rate Change etc.		5.0	6.5	2.3	3.0	1.9
9. Other Factors Influencing The Debt Ratio: Privatization Receipts		0.1	0.4	0.3	0.6	0.6

Table:6- Divergence From Previous Update

	2003	2004	2005	2006	2007
1. GDP Growth (Per cent)					
Previous Update	5.3	5.1	5.1	5.1	-
Latest Update	5.8	9.6	4.8	5.1	5.1
Difference	0.5	4.5	-0.3	0.0	-
2. Current Account Balance (Million Euro)					
Previous Update	-6,893	-6,126	-4,651	-2,999	-
Latest Update	-6,996	-11,647	-8,946	-8,678	-8,462
Difference	-103	-5,521	-4,295	-5,679	-
3. Total Foreign Debt Level (Million Euro)					
Previous Update	129,565	136,496	135,951	135,390	-
Latest Update	129,024	123,875	128,904	133,407	139,482
Difference	-541	-12,621	-7,047	-1,983	-
4. Actual General Government Balance (Per cent of the GDP)					
Previous Update	-10.5	-9.5	-5.8	-2.5	-
Latest Update	-10.1	-6.3	-4.4	-2.1	-0.5
Difference	0.4	3.2	1.4	0.4	-
5. Actual General Government Primary Balance (Per cent of the GDP)					
Previous Update	7.2	7.1	6.4	7.2	-
Latest Update	6.7	7.8	7.5	7.2	7.0
Difference	-0.5	0.7	1.1	0.0	-
6. General Government Gross Debt Level (Per cent of the GDP)					
Previous Update*	-	-	-	-	-
Latest Update	80.2	78.4	75.3	72.2	68.3
Difference	-	-	-	-	-

*Not applicable

Table:7- Assumptions on the External Economic Environment Underlying the PEP 2004 Framework

	2003	2004	2005	2006	2007
Interest Rates (Per cent)					
Domestic Interest Rate (Treasury Bill Rate, Simple)	42.7	24.8	-	-	-
Short term Domestic Interest Rate (Treasury Bill Rate, Simple)	-	-	-	-	-
Long term Domestic Interest Rate (Treasury Bill Rate, Simple)	-	-	-	-	-
Euro Area: Short term (3-months Money Market)	2.3	2.1	2.8	-	-
Euro Area: Long term (10-years govt. bonds. lowest one prevailing in Euro area)	4.1	4.3	4.8	-	-
USA: Short term (3-months Money Market)	1.2	1.2	1.7	-	-
USA: Long term (10-years Govt. Bonds)	4.0	4.2	4.6	-	-
Exchange Rates					
Exchange Rate vis-à-vis € (TL / €)	1,685,301	1,807,502	-	-	-
Change in Annual Average ("-" depreciation)	17.9	7.3	-	-	-
Parity (USD/ €)	1.13	1.25	1.24	1.24	1.24
Percentage Change in Real Exchange Rate ("+"depreciation)	-18.6	-12.0	2.7	-0.1	-0.4
Real GDP Growth					
World (excluding EU)	4.4	5.1	4.7	-	-
USA	3.1	4.2	3.2	-	-
Japan	2.7	3.4	2.3	-	-
EU 15	0.8	2.0	2.4	2.5	2.5
World Trade (In Real Terms)					
EU Export Market (Extra-EU-15)	6.7	9.2	8.3	-	-
EU Imports (Excluding intra-EU-15)	8.0	10.1	7.3	-	-
World Import (Excluding EU-15)	7.3	9.7	8.5	-	-
International Prices					
World Import Prices (Percentage Change)	8.8	6.4	0.7	1.0	1.0
Non-oil Commodity Prices	6.6	15.6	-2.6	-	-
Oil Prices (USD per Barrel)	27.0	36.0	40.0	-	-

Table:8- Cyclical Developments *

	2003	2004	2005	2006	2007
1. Real GDP Growth	5.8	9.6	4.8	5.1	5.1
2. Actual Balance	7.0	4.0	2.1	0.1	-1.5
3. Net Interest Payments	16.3	13.7	11.7	9.1	7.3
4. Potential GDP Growth	4.6	7.2	6.4	5.6	5.3
5. Output Gap (percentage difference from the potential)	-0.3	1.9	0.4	-0.1	-0.3
6. Cyclical Budget Component	-0.1	0.8	0.2	0.0	-0.1
7. Cyclically Adjusted Balance	10.6	8.9	6.3	3.9	2.1
8. Cyclically Adjusted Primary Balance	-5.0	-5.0	-5.6	-5.4	-5.4

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

Table:9- Structural Reform Agenda and Developments

Measures Taken in Last Year's PEP	Realization Status (Y/N)	Date[6]	Comments
Privatization			
Areas from which the State is foreseen to withdraw completely:			
Textile	Y	2003-2004	Almost all companies belonging to Sümer Holding have been sold or liquidated.
Paper	Y	2003-2004	Almost all companies belonging to SEKA have been sold or liquidated.
Fertilizers	Y	2004	Sale/transfer procedures of İGSAŞ and Kütahya Gübre were completed. Sale contract of Samsun Gübre is at the signing stage.
Petrochemical	N	--	The tender for privatization of PETKİM was cancelled due to failure of the highest bidder entity to fulfill its obligations. Selling the shares of PETKİM through public offering is planned.
Tobacco	N	--	The tender for privatization of TEKEL Sigara Sanayii İşletmeleri ve Ticareti A.Ş. (Tobacco Company) was cancelled, as the bid amounting to 1.1 billion dollars was considered as insufficient. Anew tender is expected to be held before the end of 2004.
Alcohol	Y	2004	TEKEL Alkollü İçkiler Sanayii ve Ticareti A.Ş. (Alcoholic Beverages Company) was sold at a price of 292 million dollars.
Crude oil processing	N	--	The contract award process for privatization of TÜPRAŞ has been cancelled as a result of the lawsuit filed by Petrol-İş Labour Union.
Areas from which the State is foreseen to withdraw partially:			
Mining	Y	2004	Sale/transfer process of ETİ Bakır (Copper Mines), DİV-HAN, KBI Samsun Copper Works and ETİ Gümüş (Silver) were completed. Sale procedures of ETİ Elektrometalurji (Metallurgy Company) were completed. Sale contracts of ETİ Krom (Chromium Mines) and Çayeli Bakır (Copper Companies) are at the signing stage.

[6] The date or foreseen date of realization.

Sugar	Y	2004	Sale/transfer contracts of Kütahya Şeker (Sugar) and Amasya Şeker (Sugar) are at the signing stage.
Port management	Y	2003-2004	Almost all ports belonging to TDİ have been privatized through transfer of operational rights.
Natural gas distribution	Y	2004	ESGAZ and BURSAGAZ have been privatized with a total price of 163 million dollars.
Banking	N	--	In line with the Strategy of Restructuring and Privatization of the State Banks, privatizing of Ziraat Bank and Halk Bank through public offering and other methods is planned. Attempts for privatization of Vakıfbank will continue in 2005.
Competition Law and Policies			
Amendment to the Law No.4054 on Protection of Competition	Y	2003	An amendment to the Law No.4054 was made in 2003, to ensure effective enforcement of fines and to eliminate the problems encountered in request for information and on side examination.
The Communiqué on Group Exemptions with respect to Research and Development Agreements.	Y	2003	A Communiqué on group exemptions for the R&D agreements was published in the Official Gazette No. 25212 in 27 March 2003. The Communiqué aims to protect the competition effectively on the one hand, and to grant group exemptions to enterprises cooperating in certain subjects at the stage of R&D activities on the other.
Works aiming to alignment of Communiqué No. 1998/3 on Group Exemption regarding Distribution and Servicing Agreements to the Categories of Vertical Agreements and Concerted Practices in the Motor Vehicles Sector with the Commission Regulation (EC) No.1400/2002.	N	--	Draft Communiqué has been submitted to relevant agencies for their opinions.
The works towards setting up of an operationally independent state aid supervision and monitoring body within the SPO.	N	--	Draft Law has been submitted to the Prime Ministry.
Improvement of the Investment Environment			
Works on legislation aiming at improving the institutional capacity and infrastructure of the Turkish Patent Institute.	Y	2003	The Law No.5000 on the Establishment and Duties of the Turkish Patent Institute (TPI) was put into force 06 November 2003. Strengthening the institutional capacity of the TPI carries importance from the standpoint of protection of intellectual property rights.

SME Strategy and Action Plan	Y	2003	The Plan has been prepared with the objectives of ensuring implementation of the policies formed at national level for SMEs and enhancing competitiveness of SMEs in the process of alignment with the EU.
Investment Promotion Agency	N	--	It is foreseen that the activities geared towards improving Turkey's image as an investment environment, increasing foreign investments and expanding current investments be carried out by a unit to be established within the General Directorate of Foreign Investment of the Undersecretariat of Treasury.
Mining Law	Y	2004	The Law No.5177, Amending the Mining Law and some other Laws was put into force in 26 May 2004. Arrangements have been introduced with this Law in order to include the raw materials governed by the Regulation on Quarries in the Mining Law, ensure the unification of the legislation of the mining sector and security of mining licenses, remove preliminary operating license period and the obstacles and restrictions introduced by the Laws and Regulations issued after the Mining Law No.3213. A revitalization is expected in mining activities with the implementation of the arrangements stated in the new Mining Law. With a regulation that will be issued by the Council of Ministers, the Ministry of Energy and Natural Resources will be authorized as the single authority for many permissions and certifications.
Financial Sector			
Removal of the application of full guarantee on deposits and limiting the amount of saving deposit subject to deposit insurance to 50 billion Turkish lira.	Y	2004	--
Reduction of intermediation costs	Y	2004	The Resource Utilization Support Fund levy charged on commercial credits and stamp tax were removed in 2004. Works aiming to reduce intermediation costs will be continued in the next period as well.
Privatization of the State Banks	N	--	According to the results of the strategy studies carried out with the objective of determining privatization road maps, it has been concluded that it would be appropriate to privatize Halk Bank and Ziraat Bank through public offerings and other methods when the market conditions become favorable. Works aiming to privatize

			these banks and Vakıfbank will continue in 2005.
Accelerate solution of problematic claims in the banking sector	Y	2004	With the Law No.5020 that has been enacted, arrangements have been realized for acceleration of collection of claims in the banks transferred to SDIF. Furthermore, with this Law SDIF separated from the body of BRSA, thus supervision and regulation of banks separated from resolution of problematic banks and follow up and collection of claims from such banks. The strategy related to resolution of SDIF assets is announced in June 2004.
Strengthen regulatory and supervisory structure and prevent systemic risk in financial sector.	N	2005	With the prepared Draft Law on Credit Institutions, it is aimed to enhance the surveillance and supervision framework, to make financial markets more competitive, to build an effective and transparent financial system and to align further the banking system with the EU applications and international principles and standards. Opinions of relevant agencies have been taken for the Draft Law and it is planned to be enacted by the early 2005. Furthermore, the Draft Law on Bank Cards and Credit Cards has been prepared with a view to regulating the matters related with use of credit cards and establishment principles of card issuer institutions The Draft Law is planned to come into force in January 2005.
Enhance supervision of Special Finance Institutions (SFI) and their role in the financial system	E	--	The Regulation on Amending Establishment and Activities of SFIs was issued on 22 April 2004. Furthermore, it has been decided that SFIs apply the Regulation on Accounting Practices in compliance with international accounting standards as of January 2005 in order to make them operate under same conditions with the banks by increasing the auditing in the sector.
Draft Law on Micro Finance Organizations	N	--	The Draft Law is at the stage of submission to the Council of Ministers.
Complete the formation of legal infrastructure, the processes of establishment and surveillance system concerning Individual Retirement Funds	Y	2003	The first Private Pension System started to be presented to the participants as of 27 October 2003. The infrastructure of monitoring and surveillance system has been built in electronic environment.
Complete the preparations required for making the Futures and Options Exchange and the market for SMEs operational.	N	2005	The Regulation on the principles of transactions and clearing of Future and Options Exchange Corp. was put into force on 27 March 2004. The Futures

			and Options Exchange Corp., which was planned to become operational in Autumn 2004 is planned to become operational in 2005 due to the infrastructure preparations related with YTL (new Turkish lira).
Publish the Communiqué on Accounting Standards in full harmony with the EU legislation and International Accounting Standards	Y	2003	The Communiqué on Accounting Standards in the Capital Market has put into force and promotional programs have been initiated and will continue in the next period as well.
Complete the software development and e-identity/smart card management and training activities in 2003, and complete the installation and test process in 2004 of the project being executed jointly with ISE in order to transmit the information of the intermediary institutions and joint stock companies quoted in ISE via Internet, by using electronic signature.	Y	2003-2004	The project is continuing as planned. All companies covered by the project have started to use the system. Testing and debugging activities are continuing. Opening of the system to the public is planned in June 2005.
Regulate the matters related with offering financial services through remote access within the framework of EU legislation.	N	2005	By examining country experiences in this matter and carrying out other activities in this scope in 2004, it is planned to prepare drafts in September 2005 and put into effect in December 2005.
Complete the works towards aligning of the legislation regarding capital markets with the EU legislation in the period 2003-2005 in line with the Turkey's National Programme For the Adoption of the Acquis.	Y	2004	A project proposal has been prepared under 2004 Turkey-EU Financial Cooperation Programming in order to support the activities concerning the alignment with the EU legislation. It is foreseen to launch the activities related to the project at the end of 2004.
Issuing a Communiqué on ensuring price stability after public offerings by taking the EU legislation into account as well.	Y	2003	The Communiqué on ensuring price stability after public offerings was put into force on 17 December 2003.
Carry out works by taking into account of the relevant EU regulations in order to prepare a guidebook on manipulative transactions	Y	2003	The guidebook has been prepared and published in the web site of CMB.
Enact a Law on Regulation and Supervision of Insurance Activities.	N	2005	Preparatory works related with the Law have been completed and brought to the signing stage at the Treasury. It is expected that the Law will be put into force in the first quarter of 2005.
Realize a project to be financed by the EU for ensuring alignment with the EU Acquis on insurance and strengthening the necessary administrative structure for the effective implementation of the legislation.	N	--	Consulting service has been procured under short term technical assistance in 2003 in connection with the project. It is necessary to enact a framework law on insurance for strengthening the institutional structures of the General Directorate of Insurance and of the Insurance Supervision Board for the realization of the project.

Labour Market

The preparation of draft regulations in the field of occupational health and safety in line with the EU Acquis.	Y	2003-2004	These regulations have been issued.
Works to provide the Economic and Social Council with a more functional structure	Y	2004	Draft Law prepared to provide the Economic and Social Council with a more functional structure has been submitted to the Prime Ministry.
Amending the Law No.4688 on Civil Servants' Trade Unions in order to provide coherence with the EU standards and eliminate deficiencies	Y	2004	The Law No.5198, which amends the Law on Civil Servants' Trade Unions, has been issued with the objective of eliminating the deficiencies of the Law and of abolishing the arrangements that restrict the syndical activities of public employees.
The works on legal regulations regarding the employment of children under 18 years old	Y	2004	The Regulation on Principles and Procedures of Employment of Children and Young Workers has been issued and put into force.
Active Labor Market Programs Project	Y	2003	The project was launched in September 2003 and its implementation is continuing.

Administrative Reform

Public Administration Law	N	--	The Law No.5227 on Fundamental Principles and Restructuring of Public Administration was ratified by the TGNA and submitted to the President. 22 articles of the Law were vetoed by the President and returned to the TGNA to be discussed again.
Functional Review of the Government	Y	2004	The work on Functional Review of the Government has been carried out by the SPO and a draft report has been prepared.
Civil Service Reform	N	--	A draft law for civil service has been prepared by the State Personnel Administration. Works on the draft law are continuing.
Local Administrations Reform	N	--	The Law No.5216 dated 2004 on Greater- Municipalities, prepared under the reform, has been published in the Official Gazette. The Law No.5197 on Provincial Special Administrations and the Law No.5215 on Municipalities, which were ratified by the TGNA have been vetoed by the President and returned to the TGNA to be discussed again.
Right of Access to Information	Y	2004	The Law No.4982 on Right of Access to Information was put into force in 09 October 2003.
Ethical Code of Conduct in the public sector	Y	2004	The Law No.5176 on Establishment of

			Ethics Board for Civil Servants and on Amendment of certain Laws was put into effect in May 2004.
Public Financial Management and Control Law	Y	2003	The Law No.5018 on Public Financial Management and Control was approved by the TGNA on 10 December 2003 and published in the Official Gazette. The Law will enter into force as of January 2005. However, a transition period has been foreseen for some provisions until 2007.
Implementation of the analytical budget code system in 2004 in all institutions under the consolidated budget and in all agencies and institutions included in the definition of General Government in 2005	Y	2004-2005	2004 budgets of the administrations under the general and annexed budget has been prepared and started to be implemented line with the Analytical Budget Classification created on the basis of the Government Financial Statistics (GFS) within the context of restructuring of the public financial management. Works aiming to implement the new budget code structure in all agencies and institutions included in the definition of General Government are continuing.
Strengthening the governance in SEEs	Y	2004	A commission for the preparation of SEEs' governance strategy has been established. A Strategy Paper has been prepared by the commission. Necessary legal arrangements will be made in line with the Strategy
		Agriculture	
Draft Law on Insurance of Agricultural Products	N	2004	Drafting a Law on Insurance of Agricultural Products, aiming to eliminate the risks arising from climatic conditions, are being continued.
Draft Law on Seed Growing	N	2005	The Law No.308 on Registration, Control and Certification of Seeds, has been redrafted as a Draft Law on Seed Growing by taking into consideration the international seed growing systems and technological advances within the framework of alignment with the EU legislation, and submitted to the TGNA.
Draft Law on Protection of Growers' Rights on New Plant Varieties	Y	2004	The Law No.5042 on Protection of Growers' Rights on New Plant Varieties has entered into force in January 2004, with the objective of fulfilling international obligations and encouraging cultivation of new varieties and protecting new varieties and growers' rights. Preparation of implementing regulations of this law is under way.

Draft Law on Producers' Unions	Y	2004	The Law No.5200 on Producers' Unions, which allows producers to establish their unions based on a certain type of crop or a crop category, was put into force in July 2004, in order to ensure that production is planned according to demand, quality of products is improved, supply responds to market needs and measures improving marketing are taken.
	Education		
Basic Education Project, Phase II	Y	2004	Second phase of the Basic Education Project, which aims to increase the schooling rate in primary education and to develop the quality and infrastructure of the education, has been launched in 2004.
Modernization of Vocational Technical Education Institutes Project under MEDA	Y	2004	Project implementation has started in 2004. The Project aims to determine the training standards, and to support in-service and pre-service teacher training and selected schools to this end.
Strengthening Vocational Education System Project under MEDA	Y	2004	The project aims to strengthen the link between working life and education and it started to be implemented in 2004.
	Regional Development		
Draft Law on Establishment, Coordination and Duties of Regional Development Agencies	N	2005	The Draft Law has been submitted to the Prime Ministry, and is foreseen to be enacted in 2005.
Twinning Project for Improving the Institutional and Administrative Capacity of the General Directorate of Regional Development and Structural Adjustment of SPO.	N	--	The forth Draft of the Twinning Project Agreement was sent to the EC Turkey Delegation in October 2004.
Eastern Anatolia Development Programme	Y	2004	The Technical Assistance Team and Programme Coordination Unit started to work in the region in February 2004.
Regional Development in TR82, TR83 and TRA1 NUTS II Regions Programme	N	2005	Due to the delay experienced in signing of 2003 Financing Memorandum, the Technical Assistance (TA) Tender Procedure for the Programme started only in January 2004. It is expected that the TA Contract will be signed in December 2004 and implementation of the Programme will be initiated in January 2005.
Turkey-Bulgaria Cross Border Cooperation Programme/Joint Small Projects Fund	N	2004-2005	Call for Proposals has been launched in October 2004.

Social Security			
Unification of social security institutions under a single body; separation of long term from short term insurance programs and establishment of a general health insurance system.	N	2005	In this context, the Ministry of Labor and Social Security has launched works for restructuring of the social security system, and the White Paper prepared by the Ministry has been submitted to social parties for their opinions on 29 July 2004. Draft Law on General Health Insurance was submitted to the Prime Ministry. Works on pension, social security and social aid laws are about to be completed.
Health			
Shifting to Family Medicine implementation	N	2005	Pilot implementation of Family Medicine will be launched in 2005.
Establishing Health Information System	N	2004-2005	Works for establishing a standard information system at reimbursing institutions was launched with priority in 2004 and planned to be completed in 2005. The works on infrastructure and training activities required for the uniform standards are continuing.
Information and Communication Technologies			
e-Transformation Turkey Project Short Term Action Plan	Y	2003	It has been put into effect through Circular No. 2003/48 of the Prime Ministry.
The Law on Electronic Signature	Y	2004	The Law No.5070 was put into effect on 23 July 2004.
The Law on the Right of Access to Information	Y	2003-2004	The Law No.4982 was put into effect on 24 April 2004.
Amendment of the Law on Intellectual And Artistic Works	Y	2004	The Law No.5101 has introduced new arrangements for the protection of intellectual properties in the electronic medium. The Law No.5194 has introduced new legislation concerning the functioning of the judicial bodies regarding the intellectual properties and the related sanctions to be imposed.
Draft Law on Protection of Personal Data	N	2005	The Draft Law was sent to public institutions to obtain their opinions in July 2004.
Arrangement on cyber crimes in the Turkish Criminal Code	Y	2004-2005	The Law No.5237, which includes arrangements on cyber crimes as well, will enter into effect on 1 April 2005.

Strategy for privatization of Turk Telecom	Y	2004	With the Cabinet Decree No. 2004/7931, it has been decided to have a block sale of 55 per cent of the Turk Telecom's shares and to initiate the invitation to bidding for the block sale until 31 December 2004. As of 25 November 2004, the tender was undertaken by Privatization Administration.
A new framework law in the telecommunication field	N	2005	Draft Law on Electronic Telecommunications has been formulated in cooperation with all the relevant parties and presented to public opinion as of September 2004.
Communiqué on Regulation on Licensing Concerning Telecommunication Services and Infrastructures	Y	2004	It was put into effect in 2004.
Enactment of the Access and Interconnection Regulation	Y	2004-2005	Pursuant to the Decision No.2004/73 of the Telecommunications Board, the principles and procedures related with Separation of Accounts and Cost Accounting have been put into effect on the date of publication there of. The Communiqué on principles and Procedures Concerning Unbundled Access to the Local Loop will enter into force on 1 July 2005.
Regulation on Installation and use of Short Distance Radio Equipments	Y	2004	It was put into effect in 2004.
Regulation on Numbering	Y	2004	It was put into effect in 2004. The National Numbering Plan was also published under the same regulation.
Regulation on Certified Bodies	Y	2004	It has been prepared under the Regulation on Radio and Telecommunication Terminal Equipment (R&TTE), and was put into effect in 2004.
Regulation on Market Surveillance and Monitoring	Y	2004	It has been prepared under the R&TTE Regulation, and was put into effect on 11 May 2004.
Regulation on Personal Data Processing and Protection of Privacy in Telecommunications Sector	Y	2004	It has been prepared in line with the EU Directives No.2002/58/EC and 2002/21/EC.
Communiqué on Principles and Procedures on Common Location and Facility Sharing	Y	2003	It has been prepared for the purpose of adaptation to Directive No. 97/33/EC.
Legislation on Right of Way	N	--	Works on adaptation to Perfect Competition Directive No.96/19/EC are continuing.
Fixed Wireless Access Systems	Y	2004	It is planned to complete authorization activities at the end of 2004.

Long Distance Operation and Voice Transmission over Internet Protocol	Y	2004	After full liberalization, 40 operators have been licensed for long-distance telephone service as of September 2004.
Project for Increasing Institutional Capacity of Telecommunications Authority	Y	2004	The participation amount of 40,000 euro as regards the project has been paid by Turkey. The process of contract award concerning the first stage of purchase of service under the project is still ongoing and foreseen to be implemented by the end of 2004.
Project for Strengthening Physical Infrastructure of Telecommunications Authority	N	2006	Since works related with pre conditions are continuing, the participation amounts to be paid by Turkey have been postponed by one year.
Transportation			
Reorganization of the Turkish State Railways (TCDD)	N	--	A Twinning project was initiated in 2003 in order to align the Turkish railway legislation with the EU directives under Turkey-EU Financial Cooperation Program. The contract tender process for the project has been completed and the German Railways has been selected as the contractor. The contract containing the conditions for the twinning project as well has been prepared by TCDD. However, the process of evaluation of the contract by the EU is still continuing.
Energy			
Activities for privatization of electricity sector	N	2004-2008	The Strategy Document covering the implementation process of liberalization of the electricity sector and privatization of power generation and distribution assets was accepted in March 2004. TEDAŞ has been included in the privatization program. However, privatizations could not yet commence due to various technical reasons, like cost segregation and determination of performances for zones. According to the Strategy Document, privatizations are expected to commence in 2005 and to be completed in 2006. Other privatizations are foreseen to be completed by 2008.
Regulatory Board Information System Project	N	--	The Project has been approved by the Commission.
Twinning Project for Enhancement of the Institutional Capacity of EMRA	Y	2004	The project was launched in July 2004.