REPORT ON THE 1988 CONSULTATION WITH TURKEY

1. The Committee consulted with Turkey on 4 October 1988, in accordance with its terms of reference, pursuant to Article XVIII:12(b) of the General Agreement and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held under the Chairmanship of Mr. J.-F. Boittin (France). The International Monetary Fund was invited to participate in the consultation in accordance with Article XV of the General Agreement.

2. The Committee had the following documents before it:

- Basic document by Turkey BOP/283
- Secretariat background paper BOP/W/121
- Reply by Turkey to Import Licensing Questionnaire L/5640/Add.29/Rev.3
- "Recent Economic Developments" dated 12 July 1988

Opening statement by the representative of Turkey

3. The opening statement by the representative of Turkey is attached as Annex I.

Statement by the representative of the International Monetary Fund

4. At the invitation of the Committee, the representative of the International Monetary Fund made a statement, the full text of which is reproduced in Annex II.

Balance-of-Payments position and prospects

5. Members of the Committee thanked the Turkish representative for his very complete description of the economic situation as well as the full information provided in documentation. They expressed their satisfaction with the impressive stabilization and policy reform programme undertaken by Turkey. It was evident that the change of course introduced during the 1980s had borne fruit both on the external account and in overall economic performance. Turkey had achieved a remarkably successful economic...
adjustment and transformation in a period when world economic conditions were not particularly helpful. Growth and structural change in exports, and increasing income from such items as tourism and workers' remittances, had combined to reverse adverse trends in the current-account balance and in foreign exchange reserves. Although the burden of debt had also been eased through restructuring, it was still considerable. In this context members welcomed Turkey's commitments to steady repayment of medium and long-term debt, and hoped that continued growth in foreign earnings would lead to a further reduction in the debt burden.

6. Members felt that it would be unfortunate if short term, transitory difficulties slowed or reversed the process of policy reform. It was recognized that inflation and the rapidly increasing budget deficit posed particular problems at present. In this connection, the need for prudent fiscal policies was stressed and members asked Turkey to specify its plans to reduce the overall budget deficit and improve revenue collection. Concern was also expressed concerning the partial slow-down in trade liberalization in 1987. It was felt that, for the progress achieved until now to continue, policies must be maintained in such areas as trade and investment liberalization, reduction of the fiscal deficit, structural reform in the financial sector and public-sector enterprises, and an appropriate exchange rate.

7. Members also recognized the need for Turkey to pursue its diversification of exports. Information was sought on the measures envisaged to develop new products and markets and to ensure the continuation of investment in outward-oriented sectors of the economy.

8. The representative of Turkey, in reply, said that inflation, caused largely by the high level of the public sector deficit, was the crucial issue for the economy. The main causes of the high deficit were the rapid pace of economic growth and the high level of domestic and external interest payments. He noted, in this connection, that the consolidated public sector accounts (taking central Government, State economic enterprises, municipalities and extra-budgetary funds together) would show a surplus, were it not for interest payments. Measures taken so far included the privatization of State economic enterprises (beginning with the telephone company), increase in Government revenue through improvement in the tax system, including the introduction of VAT (in this context he noted that Government revenues had risen from 18 per cent of GNP in 1983 to 25 per cent in 1987) and financing of the deficit mainly through the issue of Government bills and bonds (although he noted the possible inflationary effects of this in the medium or long term). He noted that, while the rate of inflation, on an annual basis, had risen from 35-40 per cent at the end of October 1987 to some 70 per cent in the period November 1987 - February 1988, the annualized rate for April-July 1988 had fallen to around 40 per cent. The overall targets adopted by the Government were 40 per cent for 1989 and 20 per cent in 1991.

9. Growth and diversification of exports were to be achieved through restraint in the growth of domestic demand and allocation of resources to traded sectors. An active exchange rate policy would also play a major
role. But the attitudes and protectionist policies of trading partners had also affected Turkey's trade. In this context he noted the heavy burden of restrictions, especially on trade in textiles. Foreign exchange earnings from tourism, workers' remittances and other invisibles had grown rapidly. Particular attention was now being devoted to the development of infrastructure and training of personnel in the tourist sector, which was expected to earn around US$ 2 billion in foreign exchange this year.

10. The representative of Turkey noted that following a series of foreign debt reschedulings up to 1983, no further rescheduling had been undertaken or was planned. Since 1985, Turkey had gained no further benefits from such rescheduling. Interest and amortization payments, which would stand at some $7 billion annually in the medium term, would substantially exceed expected annual capital inflows of $5 billion, of which $2 billion would come from workers' remittances and $3 billion from project credits; it was hoped that growth in current account receipts would lead to a relative decline in debt/output ratios. He noted that the policy of real exchange rate depreciation pursued by Turkey since 1980 reduced the figures for the nominal dollar or SDR value of GNP and hence inflated the apparent debt-to-GNP ratio: thus real exchange rate depreciation, while helping exports, had a contrary effect on debt ratios. Turkey hoped to maintain the present levels of debt relative to exports and GNP in nominal terms over the medium term, implying a decline in real terms. In reply to a question on investment policy, he said that there were no local content requirements. Turkey's foreign investment law was very liberal and treated local and foreign investors on an equitable footing.

System, methods and effects of restrictions

11. Members welcomed the substantial liberalization of non-tariff barriers undertaken by Turkey and the move towards greater use of tariffs and other price-based measures of protection. However, it was noted that some of the 33 categories still covered by import licensing were relatively broad. Information was sought on the value and share in total imports of products covered by licensing, and in particular on such broad categories as "other items for manufacturing industries". Questions were also asked concerning the aims expressed in paragraph 4 of Turkey's reply to the Questionnaire on Import Licensing Procedures: it was suggested that the structure of licensing in force appeared to offer protection to specific sectors, and it was recalled that protection of specific industries was not provided for under balance-of-payments provisions. The view was expressed that further liberalization of licensing restrictions should be encouraged in the light of Turkey's economic performance, and that a plan for further trade liberalization should be developed by Turkey for presentation to the Committee in the near future.

12. The number and complexity of quasi-tariff measures, including import surcharges, special fund payments, advance import guarantee deposits, VAT and stamp duties, was remarked upon. The incidence of some of these measures had increased over time. It was suggested that such measures could double or triple the effect of ordinary customs tariffs. Their combined effect on particular products could be considerable, approaching
100 per cent. The growth of such charges on imports could harm Turkey’s international competitiveness; they might also violate Turkey’s commitments under Article II:1(b) of the General Agreement. There appeared to be an inconsistency between the reductions made in non-tariff barriers and the increasing incidence of these charges. Specific questions were asked concerning Turkey’s plans for reduction or abolition of the stamp duty in the context of overall fiscal reform and of the commitments undertaken by Turkey in connection with its GATT waiver, the relationship of the Housing Fund Charge to the balance-of-payments situation, and the use of import guarantee deposits on imports financed by short-term credits. Turkey was urged to continue its liberalization of non-tariff measures, to reduce tariffs further, to roll-back quasi-tariff measures and simplify its trade régime, in order to preserve and increase the substantial progress already made.

13. In reply, the representative of Turkey said that Turkey, with a great effort, had moved from non-tariff barriers to a tariff-based system since 1980. The results were evident. Turkey had reversed 50 years of import-substitution policies. These policies would be continued in future.

14. Advance import guarantee deposits were required for all imports except those financed by foreign credits with terms of over one year, imports by some State agencies, special vehicles for handicapped persons, books and other publications, film, wheat, sugar, coal, fertilizer, vegetable oils, X-ray films and imports for the Izmir International Fair. The rate of deposit had been reduced substantially over the last seven years and now stood at 7 per cent. The deposit was refunded to the importers after goods had been cleared through Customs and the foreign supplier paid. Approximately 58 per cent of 1987 imports were free of deposits. The levying of deposits on imports financed by short-term credits was aimed at reducing short-term borrowing in favour of medium-term project investment. The deposits were regarded as a temporary measure and would be reduced and eliminated in the future.

15. The Turkish authorities were currently analyzing the possibilities of alternative measures to the stamp duty. This work was expected to take until the end of the current waiver period. Measures consistent with GATT rules and obligations would replace the stamp duty. Until now stamp duty had remained a necessary element in public finance, raising the equivalent of one-third of total customs duties in 1987. While alternative sources of revenue were being researched, so far adequate sources had not been found.

16. Extra-budgetary funds were used to discourage smuggling and to provide extra revenue from imports of goods previously subject to restrictions. They should not be regarded as a surcharge on imports. Factors such as the need to control excessive price increases, to balance domestic and external prices and to meet the relative consumption needs of Turkish citizens and foreign tourists were relevant in determining the level of such charges. Items subject to fund charges were closely monitored in the light of economic requirements. The ultimate aim was to reduce or abolish these charges.
17. The number of products covered by import licensing procedures had fallen continuously from 1,300 in 1983 to 33 in 1988. Ninety-eight per cent of the list of restricted items in 1983 had been liberalized. In 1987 only 9.8 per cent of total imports was subject to permits: during the first seven months of 1988, the level was only 6.8 per cent. By the end of 1988 the level was expected to be around 4.5 per cent and studies were under way to reduce the list still further. The categories "imports for manufacturing industries" and "imports of a specific nature", referred to imports for assembly-line industries, for which global import permits could be obtained concerning specific imports for their own needs. The share of this category was only 0.14 per cent of total imports, or $19.2 million, in 1987. Import formalities had also been considerably simplified overall.

18. The Government's aim was to implement the import régime with stability and continuity. Amendments would be issued in the longer term taking account of import and development policy needs.

19. The newly established Turkish Eximbank, operative since 1987, was aimed at providing financial credits to exports, including credits previously originating in the Central Bank. It was also planned that the Bank would implement an export credit guarantee scheme. Export tax rebates would be abolished at the end of 1988.

Conclusions

20. The Committee commended Turkey for the extensive trade liberalization undertaken in the past five years and welcomed Turkey's commitment to continue the process. The Committee recognized that the measures taken by Turkey to promote domestic economic adjustment and diversification had been an essential accompaniment to the trade liberalization process. Concern was expressed about the possible effects of inflation on the outlook for Turkey's economic policy; in this connection the Committee took note of the objectives mentioned by Turkey in paragraph 8 above. It was recognized that the level of, and means of financing, the public sector deficit were key elements in the outlook for inflation and growth. The Committee also noted the importance for Turkey of development and diversification of trade and of earnings from invisibles, and emphasized the need for stable and growing access to foreign markets.

21. The Committee welcomed the considerable movement away from physical restrictions on trade in favour of tariffs and other price-based measures since 1983. It encouraged Turkey to move further towards complete liberalization of measures maintained for balance-of-payments purposes, and to announce to the GATT, whenever practicable, a time schedule for such action. At the same time, it expressed concern about the growing number and effects of quasi-tariff measures, and the burden that these could represent for particular imports. In this connection, it looked forward to the phasing out of the stamp duty and the simplification of the tax structure applied to imports.
Mr. Chairman and the Distinguished Members of the Committee

It gives me great pleasure to address this distinguished group and to have a chance to present information on the recent developments in the Turkish economy. I hope this will enable a mutual understanding of the current economic performance of Turkey.

Starting with the recent economic developments in general, during the first half of 1980 Turkey achieved a remarkable recovery from a severe economic crisis and succeeded in reversing the unsustainable balance of payments situation. In the framework of a comprehensive adjustment program initiated in 1980, sustainable growth rate was obtained and considerable progress towards internal and external stability was achieved.

Without going into the details of the information already presented to the Committee, I feel it will be useful to point out the key policy decisions in the process of the economic recovery:

- An outward oriented growth strategy has been adopted by the Government of Turkey. Consequently the import regime has been substantially liberalized, as explained in great detail in the statement paper distributed.

- Exchange and interest rates have been used as fundamental tools of the economic policy.

- The economic functions and the operational efficiencies of the SEE's have been visibly improved and their pricing policies have been revised and based on costs.
- Important steps have been taken to improve Government finances, reduce fiscal deficits and tighten monetary control.

- Special emphasis has been given to the modernization of the tax system by the introduction of VAT and improvement of the income tax legislation.

As a result of these structural transformation process, Turkey has departed from import substitution and interventionism and has indeed become a relatively open and market oriented economy.

Over the last two years, however without derivation from the basic principles of the liberalization strategy there has been some alterations in the priorities.

Facilitated by the windfall gain in oil prices in 1986, high growth path has been pursued and the real GNP growth of the last two years has exceeded 7.5 percent, allowing a visible decline in unemployment but giving rise to inflation rate. This in turn had an increasing effect on the foreign exchange demand. Upon the effectiveness loss in the exchange rate and monetary policies, a new package of measures has been introduced in February 1988.

Let me turn to the external side. The current account deficit declined from over $ 1.5 billion in 1986 (2.6 percent of GNP), to less than one billion in 1987 (1.5 percent of GNP). This improvement was achieved by the performance of the exports in quantity, despite a 3 percent deterioration in the terms of trade, compared with an improvement of 12 percent in the previous year. The value of exports increased by almost 37 percent reflecting an increase of 4 percent in prices and a volume of 32 percent. The value of imports increased by about 28 percent in 1987 with a pick-up in prices and increase in volumes.
Summarizing the performance of the balance of payments in the first seven months of 1988, the current account deficit has decreased by 61 percent to the level at $ 322 million while it was $ 828 million in the same period of 1987.

In this period, exports excluding transit trade have increased from $ 4.9 billion in 1987 to $ 6.3 billion in 1988, representing an increase of 29 percent. Looking closer to the sectors, exports of industrial products have risen by 33 percent while mining and quarrying exports have increased by 39 percent and agricultural products have increased by 11 percent.

On the other hand, imports, excluding transit trade have increased by 16 percent reaching $ 8.3 billion in the same period.

There is one important point which needs to be underlined, that the imports of investment goods which are not financed by the project credits have increased by 29 percent. The objective of the import regime to facilitate the procurement of the investment goods and raw materials necessary for the domestic industry in order to increase its competitiveness is reflected clearly in these figures and this complements the Government's investment policy which I will briefly mention.

For a last comment on the balance of payments performance, I should point out the tourism revenues figure which has shown a jump of 50 percent reaching $ 1.041 million and this has partially compensated the interest payments which amount to $ 1.7 billion in January–July 1988 period (17 percent increase).

As regards to external debt, it rose by $ 7.1 billion in 1987 and reached $ 38.3 billion at the end of 1987, equivalent to 60 percent of GNP. The share of short-term debt increased by less than 1 percent and reached 22.7 percent level. It must be noted that one of the reasons for the increase in total external debt in 1987 was the fact that more than 60 percent of Turkey's debt is denominated in non-dollar currencies which appreciated substantially vis-a-vis the U.S. dollar. The effect of the depreciation of U.S. dollar on Turkey's external debt portfolio was estimated around $ 5 billion.
However, during the first half of 1988, total external debt has reduced by about $900 million mainly due to the appreciation of the U.S. dollar.

Touching upon the Government's public investment strategy it is clearly observed that it aims at the improvement of social and economic infrastructure by alleviating social pressures caused by demographic factors and creating an investment environment that would be conducive to a satisfactory rate of growth in private investments. The share of infrastructural investments in the total public investments has approached to 90 percent in 1987, and the composition of public investment has shifted away from sectors where it competes with private investment. In addition, export oriented manufacturing investments have been placed within the list of top priority sectors and are given incentives.

The Government of Turkey has also attached importance to the foreign investment issue and amended the related legislation.

In the present system there is practically no differentiation between the foreign and domestic capitals and the foreign investment is adequately protected.

In this connection, the improvement in performance of foreign capital after 1980 has been outstanding and considerable progress is also expected in the Build-Operate-Transfer system.

It is the medium and long-term objective of the Government to reduce Turkey's dependence on foreign borrowing which has heavy burden on the balance of payments and to increase direct foreign investment, in support of our adjustment efforts.
Upon the examination of the recent economic developments of this year it is possible to estimate that the real growth will exceed the official program target of 5 percent and will be around 6.5 percent. The problem of inflation still exists. Although some decline is expected after December, the figure based on WPI at the end of the year will be over 50 percent.

Regarding the external account, the developments so far have been quite favourable. By the end of the year exports are expected to be around the program target of $12 billion, due to good harvest and moderate domestic demand. Imports will probably remain within the target limits of $16 billion. As of end July 1988, as I have already mention, the trade figures are $6.3 billion and $8.3 billion for exports and imports respectively.

Trade figures and higher realization than the expectations regarding the tourism revenues which will offset the increase in interest payments, indicate that the current account deficit may be estimated to be around $600 million which is less than the earlier estimations.

From the general information which I presented above, it can be easily deduced that reducing inflation and maintaining export growth will be the key elements of Turkey's future economic policy. Besides, the process of fiscal adjustment needs to continue for at least another few years. It is also vitally important to follow closely the changes in the economic conjuncture. Among the issues of concern that the Government faces are:

- to maintain a satisfactory and sustainable rate of economic growth in order to solve high unemployment and social problems, constrain the speed and the intensity with which macroeconomic policies could be tightened, and
- to reduce the PSBR/GNP ratio over the next few years, which would only be compatible with a more balanced and viable growth path in the medium term. This obviously entails not only a process of fiscal retrenchment but also more efforts to improve Government revenues.

Coming to the sustainability of high export growth along a path of fiscal adjustment, I must say that this would require consistency between the macroeconomic policy stance and the regime of incentives and would have to be supported by restrained management of domestic demand. In view of the dramatic change in the composition of our exports which has shifted to manufactured goods over the last few years, one could deduce that our exports have become more price sensitive. This, in turn, implies that the continuity of a realistic exchange rate policy to offset inflation differentials between Turkey and her trading partners is indeed within the context of export promotion. In fact, the realistic exchange rate policy has, over the years, resulted in a visible improvement in the debt/export and debt/foreign exchange earnings ratios. On the other side of the coin lies, however, the relationship between the real exchange rate policy and the debt/output ratio. This implies that the macro effectiveness of the real exchange rate policy to offset any Current Account deterioration in the future would be impaired with the persistence of high inflation. Therefore, it is absolutely essential to reduce inflationary pressures to avert excessive constraints on the exchange rate policy.

Within this context, we have to give more weight to measures at the production level together with export credit and insurance schemes, to reinforce the sustainability of exports. Tax rebates on exports will be phased out by the end of the year. Other subsidies will also have to be reviewed to ascertain consistency with the macroeconomic policies. Export oriented manufacturing investments whether foreign or local will be given more weight within the incentives regime, and the system of preferential credits allocation.
But let's face it, we also need to have access to new markets. We need more encouragement from our trading partners in this context. All Turkey really wants is fair trade. Protectionist measures could seriously affect Turkey's Structural Adjustment Programme the success of which is critically dependent on export growth.

In conclusion Mr. Chairman, I hope I have been able to draw your kind attention to the fact that since 1980, Turkey has been pursuing adjustment and liberalization policies quite successfully for integrating into the world economy and I am certain that, in the coming years, the Government of Turkey will continue to effectively pursue the same policies.
During the first half of this decade, Turkey staged a remarkable turnaround from a severe economic crisis. On the basis of a comprehensive adjustment program to stabilize and liberalize the economy, it attained sustainable growth and made considerable progress toward internal and external balance. Between 1981 and 1985, real GNP growth averaged 4 1/2 percent; nonagricultural employment rose by almost 3 percent yearly; and by the end of the period the annual rate of inflation—at about 30 percent—and the external current account deficit—at below 2 percent of GNP—had been brought down to one third of the levels prevailing at the outset.

In the process, Turkey broke with more than five decades of import substitution and government intervention and became a relatively open market-oriented economy. Rigid controls over commodity prices, interest rates and the exchange rate were abolished; the import regime was liberalized significantly; reliance on export incentives was lessened; direct investment rules were liberalized; the financial sector was streamlined; State Economic Enterprises (SEEs) were exposed to greater market discipline; and the tax system was modernized through the introduction of a value added tax and a more equitable income tax.

During 1986-87, though still adhering to the basic principles of the liberalization strategy, the Turkish authorities shifted priorities. They opted for a high-growth course, and the economy expanded at a real average annual rate close to 8 percent. The destabilizing effects of this shift were not immediately apparent. In 1986, a 12 percent improvement in the terms of trade and accommodating financial policies permitted an 11 percent increase in real domestic demand without an immediate pickup in inflation. Price pressures were dampened by the fall in world oil prices and ample domestic supply due to a good harvest, high import volumes, and a drop in exports to neighboring Middle Eastern countries. But the current account deficit widened to over 2 1/2 percent of GNP (US$1.5 billion), as the combination of weak markets in these countries and strong domestic demand more than offset the terms of trade gain. In 1987, the underlying imbalance worsened. Fiscal policy became highly expansionary as the Public Sector Borrowing Requirement (PSBR) increased from 6.0 percent of GNP to 9.3 percent of GNP; the general government imparted an estimated fiscal impulse equivalent to 3 percent of GNP, compared with 1 percent in the preceding year. Monetary expansion exceeded the targets—largely on account of the sharp rise in the borrowing requirements of the public sector and the agricultural sector—and the process of currency substitution accelerated as nominal Turkish lira (TL) deposit rates did not keep pace with the rise in inflationary expectations.

In a temporary reversal of the liberalization drive, several steps were taken in 1987 to repress the imbalances. Prices on SEE products and services, which had generally been administered flexibly since 1980, were not allowed to rise. Export subsidies were raised; the import
deposit requirement was increased from 3 to 7 percent; and while the number of items subject to import licensing was reduced in early 1987, the import levy charged by the Support and Price Stabilization Fund (SPSF) was increased from 4 to 6 percent in October, and its coverage was extended substantially. In December, SEE prices were adjusted, contributing to a sharp acceleration in the rate of inflation and a speculative rise in imports at year end. But only minor impacts were evident on the average annual inflation rate—less than 2 percentage points increase in wholesale prices to 30 percent—and on the merchandise trade balance deficit—which widened by less than US$0.2 billion to US$3.2 billion. The latter, indeed, was more than offset by an improvement in invisibles so that, in fact, the current account deficit fell to 1 1/2 percent of GNP (US$1 billion) in 1987.

In early 1988, mounting inflationary expectations and the consequent rise in the demand for inflation hedges, especially foreign currency, culminated in a sharp fall in the Turkish lira on the free market in January. The authorities reacted by introducing in February a package of fast-acting measures (further SEE price adjustments, accompanied by increases in bank deposit rates, reserve and liquidity requirements, foreign exchange surrender requirements, import deposit requirements and indirect tax rates). These measures helped restore some calm to exchange and financial markets, but did not dampen the surge in inflation, which by July 1988 had accelerated to a year-on-year rate of nearly 70 percent (wholesale price index).

Besides its serious destabilizing influence in the near term, the shift in priorities has enhanced the vulnerability of the economy over the medium term. Aware of the need to adopt policies beyond those contained in the February package to address the fundamental imbalance, the authorities have prepared an economic program for 1988 within a medium-term framework, which was revised in May to take account of developments in the first quarter. The revised macroeconomic targets call for 5 percent real GNP growth, a reduction in inflation to 43 percent by the end of the year, a cut of 1/2 of 1 percent of GNP in the current account deficit to 1 percent of GNP, and the reaffirmation of the goals of domestic and external liberalization. To achieve this, the program calls for a reduction in the PSBR of nearly 3 percentage points of GNP to 6.4 percent of GNP, and sets targets for broad money expansion (45 percent for M2 and 53 percent for M2X—M2 plus resident foreign exchange deposits—at end-1988) to be accompanied by an average 4 percent real interest rate on one-year TL deposits during April-December and a 5 percent real exchange rate depreciation.

The authorities have taken a number of measures toward achieving the targets set out in their medium-term program. On the fiscal side, these include hikes in tax rates; increases in SEE prices; a hiring freeze in the public sector; the postponement or abandonment of new investment projects; and across the board cuts in central government budgetary allocations. All the same, even with these measures, the PSBR target may prove elusive. Inflationary developments in the first seven
months of 1988 will render the 43 percent target for the year as a whole very difficult to achieve, leading to higher interest payments and lower revenue collection than programmed. In addition, difficulties are likely to arise in the near term in monitoring and controlling decentralized public sector entities, especially the SEEs, which are envisaged to bear the brunt of the fiscal adjustment in 1988. Since even a slight delay in fiscal adjustment could have significantly adverse effects, the Fund has urged the authorities to consider the early implementation of additional measures.

As regards monetary policy, with the creation of an interbank money market the authorities are in a better position than before to exercise control over the money supply through reliance on indirect instruments. Yet, in view of the absence of developed financial markets and the relative attractiveness of bank intermediation in foreign currency, the effectiveness of monetary control will be seriously impaired should the authorities have to meet large borrowing needs of the public sector.

Interest rates on deposits remain negative in real terms, a situation exacerbated by cuts in deposit rates in July and August. The Fund has stressed the need to maintain interest rates at positive real levels, particularly if the recent success in curbing currency substitution is to be maintained. At the same time, interest rates on credits remain very high in real terms, and there is a need to reduce the large interest rate spread, preferably by a reduction of taxes on financial intermediation.

Given the high level of capacity utilization in the manufacturing sector, strong export growth, essential if the authorities' medium-term current account targets are to be met, can be sustained beyond the near future only with a rebound in productive fixed investment. Trade data for the first half of the year suggest that, while exports have grown by 30 percent in U.S. dollar terms compared with the same period of 1987, the level of exports has stagnated since late 1987. At the same time, imports continue to grow at a rapid rate. It is noted that some Turkish exports are affected by protectionist measures in other countries. In particular, textile exports (more than one quarter of the total) are subject to quotas in OECD countries.

In August 1988, the authorities introduced a free foreign exchange market to replace the previous managed float administered by the Central Bank. While this may assist in maintaining a competitive exchange rate, its ultimate success—and the prospects for meeting the current account target—will depend importantly on the ability of the authorities to maintain financial discipline.

The levels of Turkey's foreign debt (US$40 billion, or 60 percent of GNP at end-1987) and debt service ratio (34 percent) remain high. Short-term debt stands at US$8.7 billion; while its share in total debt did not increase in 1987, its level far exceeds the sum of official foreign exchange reserves and commercial banks' liquid foreign assets.
The Fund supports the authorities' intent to lengthen the maturity structure of the external debt, to improve the terms of borrowing, and to diversify the sources and instruments of financing, under the oversight and direction of the recently established Debt Coordination Committee. A restrained approach to borrowing, in combination with appropriate macroeconomic policies, will strengthen Turkey's credit standing in international financial markets.

The design of the authorities' 1988 program within a medium-term framework is timely. Medium-term scenario calculations under alternative policies suggest that the room for slippage has narrowed considerably in the wake of developments in the last couple of years. They point unequivocally to the pivotal role of fiscal discipline in lowering the rate of inflation. Success in pursuing prudent fiscal and monetary policies this year is the first and the most important step in a process which must be sustained for several years to come.

The Fund welcomed the renewal of trade liberalization in early 1988, undertaken within the context of the medium-term plan. Measures taken included tariff cuts on raw materials, a reduction by two thirds in the list of imports requiring prior approval, a resumption in tariff reductions on imports from the European Economic Community, and the imposition of a 50 percent ceiling on all customs duties. A cut from 6 to 4 percent in the SPSF import levy in March, however, was more than reversed in August when it was increased to 8 percent; and the import guarantee deposit rate was temporarily raised to 15 percent between March and May. The Fund has encouraged the authorities to make further progress in liberalizing their trade policies. At the conclusion of the 1988 Article IV consultation in July, the Fund welcomed a liberalization of exchange restrictions on certain invisible payments, but regretted the continued maintenance of a multiple currency practice embodied in the system of import guarantee deposits, and a bilateral payments agreement with a Fund member, which it urged Turkey to eliminate as soon as possible.