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Turkey and the IMF

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Turkey: Letter of Intent and Memorandum of Economic and Financial Policies

April 26, 2005

The following item is a Letter of Intent of the government of Turkey, which describes the policies that Turkey intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Turkey, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Mr. Rodrigo de Rato Ankara, April 26, 2005
Managing Director
International Monetary Fund
Washington DC 20431
U.S.A.

Dear Mr. de Rato,

1. This letter comes after the completion of the second year of our government. In the short time since taking office, our government has decisively transformed the performance of the Turkish economy. Output has grown significantly while inflation has fallen to single digits, the best performance in more than a generation. By bringing order to economic policymaking and to the management of the public finances, the confidence of our citizens and of investors has been restored, allowing interest rates to drop to their lowest levels in decades.

2. Although the achievements of the last two years have been considerable, over the next three years we aim to build on these and provide the basis for strong and sustained growth, low inflation, and employment generation. To this end, we have developed our own comprehensive program of economic reform. These policies are aimed at fulfilling our next and most ambitious challenge—securing convergence with the economies of the European Union:

- First, the strict control of public finances and debt reduction will continue to be the cornerstone of our economic strategy. Within a debt reduction framework that seeks to reduce the net public debt ratio by about 10 percent of GNP by the end of the program period, we will continue to aim at achieving a primary surplus of 6½ percent of GNP. This should help bring the overall budget position close to balance by the end of the program period. Continued tight fiscal policy will keep the current account deficit under control, and generate the resources needed for investment and growth. Importantly, it will also help ensure that interest rates continue to fall.

- Second, with macroeconomic stability successfully established, we can now focus on improving the quality of government spending and taxation to make our fiscal adjustment sustainable and easier to implement. To achieve this, we will embark on a wide-ranging structural reform agenda to redirect resources toward more growth-enhancing public investment. We will also introduce reforms that will broaden the tax base and reduce the size of the unregistered economy, to generate sustained improvements in revenue performance.

- Third, the government and the central bank are determined to safeguard the success in reducing inflation and indeed to bring it down to the low single digits during the program period. To achieve this, we remain committed to fiscal discipline and preserving the independence of the Central Bank, in line with European Union standards, and to introducing formal inflation targeting by January 2006.

- Fourth, to maintain financial sector stability we will introduce a new Banking Law that further improves the supervisory and regulatory framework, restructure the state banks, and accelerate asset recovery.

- Fifth, we will introduce a comprehensive agenda of reform to enhance the investment climate, improve Turkey's medium-term growth prospects, and lower unemployment.

- Finally, we will continue to strengthen our international reserve position, as part of our strategy for increasing resilience to external shocks and exiting from the financial support of the Fund.

3. The attached Memorandum of Economic and Financial Policies (MEFP) presents the details of the reforms we will adopt in pursuit of these goals. To support this reform program, we request a new three-year stand-by arrangement with the Fund (May 2005–May 2008). Based on our balance of payments and financing framework, and our strengthened policies described below, we are requesting access in an amount equivalent to SDR 6,662.04 million, to be spread across 12 equally sized purchases (Annex A).

4. To smooth our debt service profile, we also request that the repurchase expectations falling due in 2006 be extended to an obligations basis. Moreover, should macroeconomic conditions prove significantly more favorable than envisaged in the macroeconomic framework underlying the request for this arrangement, we would forgo further purchases and treat any remaining access under the program as precautionary.

5. The program will be monitored through regular reviews, prior actions, quantitative performance criteria and indicative targets, and structural performance criteria and structural benchmarks. The phasing of purchases under the arrangement and the review schedule are set out in Annex A. Annex B summarizes the quantitative performance criteria and indicative targets, while Annex C lists the structural conditions and prior actions for approval of the arrangement.

6. We will enhance the transparent reporting of performance under the program described in the attached memorandum. We are committed to publishing key relevant data, all updates to the memorandum and associated Letters of Intent, as well as all staff reports for the request and reviews for this program. Accurate and timely data will be provided as required for the monitoring of the program described in the attached memorandum.

7. We believe that the policies set forth in the attached Memorandum of Economic and Financial Policies are adequate to achieve the objectives of our program, but we will take any further measures that may become appropriate for this purpose. We will consult with the

Fund on the adoption of these measures and in advance of revisions to policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

Very truly yours,

/s/	/s/
Ali Babacan	Süreyya Serdengeçti
Minister of State for Economic Affairs	Governor of the Central Bank of Turkey

Attachments

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES OF THE GOVERNMENT OF THE REPUBLIC OF TURKEY

April 26, 2005

1. **Since taking office in November 2002, our government's reform program has delivered a sustained improvement in economic performance**. Despite outside shocks, financial market confidence has strengthened. Interest rates have declined significantly and the lira has remained strong. The strength of the real economy has exceeded our projections, while, backed by prudent fiscal and monetary policies, inflation has fallen sharply to single digits. After rising significantly following the banking crisis of 2000–01, net public debt has been put on a steadily declining path, falling by some 30 percentage points to 63.5 percent of GNP at the end of 2004, which has helped address concerns over debt sustainability.

2. **Over the next three years we intend to build on this record of success and strengthen our convergence with the economies of the European Union**. To achieve these goals, we will: (i) secure further declines in government debt through continued primary surpluses, guided by a medium-term debt reduction strategy; (ii) reduce inflation to low single digits, through the introduction of formal inflation targeting, and maintaining the independence of the central bank; (iii) enhance the strength and preserve the stability of the financial system; (iv) introduce structural reforms that will put the social security system on a sound footing, reduce the size of the unregistered economy, lower unemployment, and improve the investment climate; and (v) strengthen our international reserve position to prepare for exit from Fund financial support (Annexes A–C). This memorandum outlines the reform agenda in detail.

A. Macroeconomic Framework

3. **Our macroeconomic program aims to place Turkey firmly on a path of robust growth, with a sustainable external current account and low inflation**. The recovery from the economic crisis has been very strong, with growth in 2004 exceeding program projections by a wide margin. The new economic reform program assumes that growth moderates to around 5 percent. With our tight fiscal policy, we expect growth to be led by increased investment and exports. This should lower the current account deficit to around 4½ percent of GNP in 2005 and then to 3 percent for the remainder of the program. This cooling of the economy will also help sustain our successful disinflation program, gradually reducing inflation rates further towards EU levels. The target is to reach 8 percent inflation in 2005 and to move to levels below 5 percent by the end of the program.

B. Monetary Policy

4. **The main objective of monetary policy over the course of the program will be to reduce inflation towards EU levels**. In just three years, inflation has fallen from 70 percent to less than 10 percent, well below our program targets. To reduce inflation further, we will maintain our prudent fiscal policies and protect the independence of the Central Bank of Turkey (CBT), both of which have been central to the success achieved so far. Given the recent success in reducing inflation, the strength of the Turkish lira, and the decline in inflation expectations, this year's 8 percent inflation target is clearly achievable. This will set the stage for further reductions during the new program period. In the initial stages of the transition to formal inflation targeting, we will retain the existing framework of base money targets, accompanied by indicative targets on net domestic assets (Annex D). These targets will continue to be kept under close review and modifications would be proposed if there is strong evidence of a shift in base money demand. To mark our success in disinflation and strengthened confidence in the Turkish lira, in January we introduced a new redenominated currency (dropping six zeros). The introduction of the new Turkish lira was extremely smooth, further enhancing policy credibility.

5. **The CBT has announced a detailed plan to move to formal inflation targeting by January 2006**. With inflation already in single digits, a declining public debt burden, and a strengthened financial system, we believe the right time is approaching to introduce formal inflation targeting. The first part of the plan concerns the timing of monetary policy decisions. In this respect, regular monthly meetings of the Monetary Policy Committee (MPC), which was formed in May 2001, are being held on preannounced dates of each month starting January 2005, with the MPC playing an advisory role initially. After each meeting, the CBT will explain its decision and publish a report summarizing the inflation outlook and the deliberations of the MPC. Monetary policy decisions will continue to be made according to the existing practice during the 12-month transition stage. During the year the CBT's views on the transmission mechanism will be explained and core inflation measures introduced. Marking the final stage in the transition to formal inflation targeting, the MPC will assume full responsibility for setting interest rates in early 2006 and a summary of MPC minutes will be released after each meeting. As for program conditionality, once the MPC assumes full responsibility for setting interest rates in early 2006, base money and net domestic asset targets will be replaced with an inflation consultation clause.

6. **Working within the floating exchange rate regime, the CBT plans to strengthen its net international reserves during the program** (Annex E). The CBT has restarted its daily foreign exchange purchase auctions with fixed daily minimum purchase amounts for the year 2005. Daily minimum purchase amounts have been fixed in advance at US$15 million, with winning banks given the option to sell additional foreign exchange to the CBT at the average auction price. To provide greater predictability in the auction mechanism, these daily minimum amounts will remain unchanged throughout the year, although there will be provisions to allow temporary suspension of the auctions in extreme circumstances. As shown in our response to capital inflows in January and March this year,

the CBT will also retain the option of using strictly limited discretionary intervention, outside the auction mechanism, to help prevent excessive exchange rate volatility.

C. Fiscal Policy

Program objectives

7. **Our new program remains focused on debt reduction through high primary surpluses**. High primary surpluses have helped reduce public debt and lower interest rates, and sent a clear signal of our policy determination to financial markets. We will continue this successful strategy under the new program and reduce the net debt ratio by around 10 percentage points of GNP.

8. **Our new program will also improve the composition and quality of the budget to ensure sustainability of the adjustment and an enhanced impact on the economy**. We will broaden the tax base and improve tax administration, so as to reduce our reliance on high tax rates, distortionary tax instruments, and one-off measures. We will introduce social security and civil service reforms to enhance budget flexibility, and improve the efficiency of spending on health and education. Expenditure management and fiscal policy transparency will also be advanced further.

Fiscal performance in 2004

9. **Reflecting strong growth and buoyant revenues, fiscal performance in 2004 exceeded program targets**. Expenditures were kept in line with the budget, and tax collections were robust, particularly from the corporate income tax and the VAT. Outside of the central government, fiscal performance was also strong with a minor shortfall in the position of the social security institutions (SSIs) being more than offset by the higher primary surplus of the state economic enterprises (SEEs), despite higher international oil prices and grain purchases. In sum, the primary surplus for 2004 reached close to 7 percent of GNP. Both the 6½ percent of GNP target for the consolidated public sector, and the 5 percent target for the central government were exceeded.

10. **To address the current account deficit and strengthen the revenue base for 2005, we introduced a series of targeted measures in the fourth quarter of 2004**. These include adjustments in petroleum product and natural gas prices as well as higher excises on motor vehicles. For 2005, excise taxes and SEE prices will be kept in line with 2005 program assumptions (structural benchmark).

2005 Budget framework

11. **Our 2005 budget targets a primary surplus of 6½ percent of GNP for the consolidated public sector (5 percent for central government) (Annex F)**. With interest rates declining steadily, we expect the overall public sector deficit to fall from over 6 percent of GNP in 2004 to about 4½ percent in 2005 (Annex F). The budget was approved by

parliament in December and includes a number of first steps toward improving the composition of revenues and expenditures:

- On the expenditure side, we are shifting resources toward outlays for public investment and scientific research. This not only underwrites critical progress on key infrastructure and social projects, but allow us to make greater use of bilateral and multilateral foreign financing. We will also contain social security expenditures by curbing the sharp growth of recent years in spending on pharmaceuticals and other medical supplies. Measures include lower procurement prices for drugs and medical services. To help ensure that the program's fiscal targets are met, the new program incorporates quarterly indicative targets on the combined balance of the three SSIs (Annex F).

- The budget lowers the corporate income tax rate as well as the top rate of the personal income tax. If revenues outperform projections in 2005, we will consider reducing financial intermediation taxes. This would encourage intermediation back into the domestic banking system at a modest revenue cost.

We stand ready to take additional revenue and expenditure measures, if needed, to achieve the 2005 fiscal targets, and we will continue to allow any revenue overperformance to be saved, in order to provide a cushion to help ensure that the 2005 budget targets are met, and to help contain pressures on the current account deficit.

Medium-term budgetary framework

12. **To facilitate debt and interest rate reduction we intend to retain our 6½ percent of GNP primary surplus target for the program period**. Within this envelope we seek to improve expenditure composition further in particular by rationalizing current expenditures, transfers to the SSIs, SEEs and other institutions, and subsidies. Tax policy changes will be consistent with the primary surplus target, while improved tax administration to capture Turkey's large informal economy offers prospects for revenue gains. Through these measures, we expect that the overall public sector deficit will be close to balance by 2007.

D. Structural Fiscal Reforms

13. **The new program will extend the success of our current program in implementing fiscal structural reforms**. Over the last two years we have made major improvements to budgetary transparency and the tax system, and we have initiated reforms in social security and tax administration. Continued implementation of these reforms is essential to place Turkey's public finances on a fully sustainable path and bring its fiscal institutions more into line with those in the EU.

14. **A key element in our efforts to entrench a lasting improvement of public finances is comprehensive social security reform, supplemented by short-term safeguards**. Without reform, the additional costs associated with demographic trends and

technological advances in medicine would make it very difficult to maintain prudent fiscal policies, especially in the longer run. Following an extensive consultative process, we have prepared a package of three reform laws. A draft pension and health reform law introduces parametric changes while harmonizing the pension formula across occupational groups, and establishes universal health insurance with the additional costs largely offset through measures under the health transformation program. The reform also reorganizes the fragmented system into one unified pension fund and one unified health fund. Legislation on social aid consolidates a multitude of existing programs. Finally, an administrative reform law unifies the governance structure of pensions, health and social assistance programs. With the focus of social security reform on long-run savings, we are guarding against near-term pressures by capping the overall balance (before transfers) of the three social security institutions (SSK, Bağ-Kur, and Emekli Sandigi) at 4.5 percent of GNP, the same ratio as in 2004, for the program period (indicative target).

15. **The pension reform aims to reduce the pension deficit to less than 1 percent of GNP over the long term**. Savings will come from a unified pension formula that bases all pensions on life-time earnings, modification of key pension parameters, a broadening of the contribution base, and adjustments of the statutory retirement age to lengthening life expectancy. Annual savings will build gradually over time and are expected to reach around 1 percent of GNP in ten years' time. The draft pension reform law has been submitted to Parliament (prior action). Parliamentary passage of the pension reform law is expected by end-June, a structural performance criterion under the program. The passage of the administrative reform law is also expected by end-June 2005 (structural benchmark).

16. **We intend to begin implementing universal health insurance starting from 2006**. Although there will be initial transition costs, sectoral reforms connected with universal coverage, including hospital restructuring and a refocusing on primary care, aim at reducing costs over the medium term below the pre-reform baseline trend. The measures we are taking in 2005 to reduce the growth of pharmaceutical spending will be a critical start to our efforts to defray the additional costs of universal coverage and, more generally, reduce the growth of health spending. In light of the potential additional burden of health care reforms on the budget, we stand ready to take compensatory fiscal measures, as needed. After the passage of the health reform law, we will develop a quantitative framework (benchmark for end-September, 2005) for monitoring health expenditures and assessing medium-term trends to ensure that health outlays are kept under control and in line with the baseline projected after the implementation of the reforms.

17. **We are introducing other expenditure policy reforms to reduce the rigidity of budget spending and improve the quality of public services**. This year we started work with the World Bank on a full public expenditure review (PER), to elaborate medium-term spending priorities. The PER will target efficiency gains in public employment, health, education, agriculture, and investment. Our personnel outlays absorb a much larger share of primary expenditure than in EU countries. Moreover, our public employment policies have overly complex compensation schemes, wage compression, and contracts that impede

medium-term planning. To address these problems, a comprehensive review of civil and public service wage and employment structures has been initiated, and will be completed by end-year (structural benchmark). We will also continue our policy of strictly limiting new hiring in SEEs. At most, 10 percent of those leaving through attrition will be replaced at each state enterprise, with limited exceptions for specialist positions and overperforming enterprises (structural benchmark).

18. **Further tax reforms are key to improving efficiency, reducing incentives to remain in the informal economy, and offsetting the expected structural decline in revenues, as interest rates and revenues from financial intermediation taxes decline**:

- By September 2005, we will submit to Parliament legislation to reform the **personal income tax** (PIT), with an aim to improving coverage and compliance, and enhancing revenues (structural benchmark). In particular, we intend to broaden the PIT base, combine the wage and non-wage schedules, reduce the number of brackets, and streamline the system of expenditure credits to ease the compliance burden for taxpayers and the revenue administration.

- We have introduced **VAT** coverage at reduced rates in 2005 for private health care and education services and a narrow range of food items, in line with EU directives. Beyond this, we do not intend to change the VAT rates or coverage during the program period.

- We will review the **corporate income tax** regime by September 2005, with a view to simplification, greater efficiency and base broadening. Our aim is to bring the CIT more in line with practices in the EU.

- **Financial intermediation taxes** will be phased out during the program period. We intend to eliminate the BITT by 2006 and, conditions permitting, eliminate the RUSF during the program period.

- Finally, to reduce distortions and harmonize tax treatment across financial instruments, starting from 2006 we will introduce a unified tax rate on individuals' earnings from government and other securities, bank deposits, and other financial assets.

19. **Legislation to restructure and strengthen Turkey's tax administration has been approved by parliament, a prior action under the program**. The legislation establishes the Revenue Administration (RA) under the Ministry of Finance as a semi-autonomous entity, structured along functional lines and with local tax offices directly under its control. Responsibility for tax policy will be retained by the Ministry of Finance, allowing the new RA to focus on tax administration. Additionally, RA is setting up a large taxpayers unit by end-2005 (structural benchmark) and is expected to take increasing responsibility for collecting social security contributions in 2006. We will also continue to examine the scope for improving tax audit activities. Over the medium-term we will increase the number of

auditors from 5 percent of GDR staff to the international standard of 20 percent or more. As in the previous program, we will continue to refrain from introducing **amnesties for public sector receivables** (continuous structural performance criterion).

20. **The Public Financial Management and Control Law (PFMCL) will come fully into force by 2006 and provide a framework for further improvements in expenditure management**. Two areas where implementation will be critical are medium-term and performance-based budgeting and improved financial accountability at the municipal and provincial level. Secondary legislation will be in place by end-September, 2005 (structural benchmark). To help identify key issues in these areas, as well as in audit and control, budget preparation and execution, debt and cash management, and Treasury operations and coverage, we have requested the Fund staff to prepare an updated Report on the Observance of Standards and Codes in the area of fiscal policy transparency.

21. **The government remains committed to seeking a greater degree of decentralization, within a legislative framework that promotes enhanced transparency and strict budgetary discipline**. We will submit to parliament draft legislation that will ensure that new spending mandates of the local administrations are adequately matched by local tax instruments and revenue capabilities and supported by a stable and transparent system for revenue sharing. New laws on local administrations will put in place strict borrowing and debt limits for special provincial administrations and municipalities. The debt stock of municipalities and special provincial administrations will be limited to no more than annual revenue, while the debt stock of metropolitan municipalities will be limited to 1.5 times annual revenue. New borrowing by all local administrations in excess of 10 percent of annual revenues will require central government authorization. These limits will be closely monitored during the program period and will be tightened if necessary. We will complete and publish by end-September 2005 a comprehensive report on the debt level of municipalities and metropolitan municipalities, including enterprises under their control. Arrears of municipalities and metropolitan municipalities will continue to be dealt with on a case-by-case basis, with formal settlements to be made public and guided by ability to pay. Adequate safeguards will ensure repayment through claw back of central government transfers.

22. **New legislation strengthening state enterprise governance will further improve fiscal transparency**. The governance legislation will cover performance targets, accountability and disclosure requirements, budgeting and planning arrangements, procurement requirements and provisions for external audits. The legislation is expected to be submitted to parliament by the end of September 2005 (structural benchmark).

E. Debt Management

23. **Our debt management strategy will further reduce the vulnerability of public debt (Annexes H and I)**. We plan to lower the public debt stock's roll-over risk by further lengthening the maturity of new domestic debt issues and by increasing the Treasury's cash position. In October 2004, we launched successfully a lira-denominated fixed-coupon

government bond with a maturity of three years, which is significantly longer than previous issues of this type. We followed this by issuing a five year bond in February this year. We plan similar issuances in the future as market conditions permit in order to extend the yield curve for local currency denominated government bonds and create a more liquid market for these instruments. This will not only facilitate debt management but also help foster the development of the domestic capital market, thereby enabling financial intermediaries to better manage their interest rate and liquidity exposure. Finally, we will continue our efforts to broaden the investor base for government paper, exploring avenues to raise the demand among pension and insurance funds, corporations, retail investors and foreign investors.

24. **We will also improve our contacts with markets, by strengthening our Investor Relations office in Treasury**. Such an upgraded office (supported by a dedicated website) helps enhance our dialogue and information exchange with market participants, contributing to the stability of foreign financing flows. In addition to general information on the government’s macroeconomic position, its objectives and policies (legal framework, etc.,), this office will make available updated forecasts, insight on financing plans, and other forthcoming events that are of particular interest to investors in the country's debt and equity instruments.

F. Financial Sector Reform

25. **Reforms in recent years have brought the banking regulatory framework closer to international standards**. State banks have been recapitalized and restructured, and private banks have been restored to profitability. The new program will build on these reforms by addressing the remaining vulnerabilities in the legal and supervisory regime; accelerating asset resolution; and further restructuring state banks and preparing them for eventual privatization. As input to our reform plans, we are requesting the Fund and the World Bank to initiate a Financial Sector Assessment Program in early 2006.

26. **We have submitted a new Banking Law, with the elements outlined below, to parliament (prior action), and passage is expected by end-June (structural performance criterion)**. The draft law will bring the legal framework more closely in line with EU standards. Notably, the new law will enhance banking supervision and regulation in the following areas: (i) “fit and proper” criteria for bank owners; (ii) on-site inspections (by allowing the BRSA to engage off-site supervisory personnel and bring in other experts in this process); (iii) lending to related parties (by establishing prudential safeguards such as non-preferential terms and special approval requirements); (iv) legal protection for BRSA and SDIF board members and staff for actions taken in good faith during the course of their duties; (v) delineating better the responsibilities of BRSA and SDIF and providing for their effective coordination; and (vi) granting SDIF the power to determine deposit insurance premiums in coordination with the BRSA, the CBT, and the Treasury. We are committed to maintaining the operational and financial independence of the BRSA and the SDIF in the new Banking Law and other relevant legislation. Implementing regulations will be completed by end-June 2006 (structural benchmark).

27. **We will further strengthen BRSA's supervision, bringing it closer to best international practices**. By end-September 2005, taking into account the findings of the Imar inquiry, the BRSA will publish a list of actions it will take to strengthen its organizational structure, coordinate onsite and offsite supervision, and improve the effectiveness of its staff, together with a timetable for their implementation (structural benchmark).

28. **We are planning to consolidate further the supervision of our financial markets**. Regulation and supervision of non-bank financial institutions will be transferred from the Treasury to the BRSA as soon as the new Banking Law has been passed. We will also set up a committee to assess whether integrated financial sector supervision in Turkey is warranted. The committee is expected to present its findings by end-March 2006 (structural benchmark).

29. **We are determined to bring state bank restructuring and privatization to a decisive stage over the next three years**. While substantial progress has been made in restructuring and rationalizing the state banks, their privatization has proved difficult because of their large government bond holdings and their extensive rural branch network. Bank specific strategies are being prepared and will be adopted by both the government and the boards of the state banks by end-June 2005 (structural benchmark). In this context, the government is determined to also level the playing field in the banking system to ensure efficiency and competitiveness. As part of this effort, we will adopt a timetable for phasing out special privileges and obligations of the state banks by end-June 2005 (structural benchmark).

30. **A number of intermediary steps have been taken and further actions are planned in preparation for adoption of bank specific strategies**:

- The integration of **Pamukbank** into **Halkbank** was completed on November 17, 2004.

- Effective April 12, both **Ziraat** and **Halkbank** have separate boards of directors in which a majority of the members are non-executive directors (prior action). The banks are drawing up plans for restructuring their balance sheets, including assessing the feasibility of reducing their holdings of government bonds. The timetable for implementation will be included in the strategic plans. Until the strategic plans have been adopted, these banks will not increase the size of their balance sheets and will be cautious in their lending operations.

- Our aim is to ensure that the managements of **Ziraat** and **Halkbank** have the necessary expertise, and are given the mandate and held accountable for implementation of restructuring and privatization plans.

- With regard to **Vakifbank**, on April 1, 2005 the bank's General Assembly adopted a plan for its restructuring and for increasing private participation in the bank. By end-

2005, the first IPO of Vakifbank will be launched (structural benchmark) to enhance private ownership in the bank and increase the capital base.

31. **We will accelerate the resolution of bad assets in banks previously taken over by the SDIF**. To this end, the SDIF has prepared and published a sales strategy whereby the bulk of asset recoveries will be completed before end-2007 and the government is removing legal obstacles that complicate the sale of certain assets. Publication of the strategy fulfills a prior action for the program. The SDIF estimates that it will be able to recover about US$6.2 billion. It expects to complete about 90 percent of the recoveries (US$5.5 billion) before end-2007. The strategy has the following key components:

- Protocols have already been signed with 11 former owners of failed banks on how they will settle their debts to SDIF. SDIF will immediately exercise remedies upon default.

- All cases of recalcitrant owners of failed banks will be turned over to prosecutors in 2005.

- Encouraged by the successful completion of its first loan auction, SDIF will auction off all remaining non-related party loans by end-2005 (structural benchmark). Such loans have a face value of about US$1 billion in total. SDIF has announced the details of its auction plans.

- The SDIF will dispose holdings of shares in companies and other assets taken over through competitive bidding of the assets by end-2007. The strategy will include a plan for operational restructuring of SDIF as assets are sold. The resolution of Bayindirbank will be concluded by end-2007.

- The Treasury will by end-September 2005 resolve its receivables from the SDIF that arise from the earlier costs of restructuring the banking system.

G. Enhancing the Investment Climate

32. **To further improve medium-term growth and employment prospects, we are taking a range of measures aimed at improving the investment climate and expanding foreign direct investment**. In this regard, we will continue to build on the recommendations from the Investment Advisory Council, focusing on accelerating privatization, streamlining administrative procedures, improving the efficiency of the judicial system and adopting EU standards and regulations. Various legislative changes have been made in key areas with a view to raising the efficiency and transparency of government services and rationalizing the application and processing procedures for necessary permits and approvals.

- A key achievement has been to reduce the time required to register a company to less than one week, and in many cases less than a day–well below the OECD average. We have also eliminated minimum capital requirements and drastically shortened the time needed to obtain environmental impact assessments from 6–7 months to 33 days.

- A regulation streamlining procedures for obtaining an operating license from the Ministry of Labor and Social Security has been drafted, which will reduce the number of required documents from 18 to 3, and set a maximum approval period of 30 days.

- We have prepared legislation for the creation of a "one-stop-shop" system for obtaining business permits. The new system will make procedures for start-up permits easier by enabling investors to apply through a single agency. The legislation would also eliminate duplication of documents and make more transparent the approval periods for various permits.

- We are preparing a new Commercial Code that will further align Turkey's corporate law with the EU directives.

- To reduce transaction costs for traders, customs controls and import procedures have been simplified, and the processing of customs declarations is increasingly automated. As of mid-2004, 96 percent of export and 77 percent of import declarations were processed within 24 hours.

33. **Following the good progress realized in 2004, we intend to further advance our privatization program**. A good start was made during 2004, with the privatization of over 30 companies, including a block sale of TEKEL's Alcoholic Beverages Unit and a 23 percent public offering of TURKISH AIRLINES. Looking ahead, our aim is to bring several of the larger state enterprises to the point of sale as soon as feasible, and we have set ambitious, but realistic, targets for privatization receipts under the program (indicative targets). In particular:

- The privatization process for the sale of 55 percent of TURK TELEKOM was initiated on November 25, 2004 and 13 bidders were pre-qualified during January 2005. The bidding deadline for the transaction is May 31, 2005. The privatization of TURK TELEKOM marks a milestone in our privatization program, and will contribute to further enhancing competition in the telecommunications sector, lowering costs for businesses and consumers alike.

- In March 2005, about 15 percent of TUPRAS shares were sold to investment funds through the Istanbul Stock Exchange, raising US$ 440 million dollars. We plan to sell the remaining 51 percent of shares in a block sale during 2005.

- A public offering process for 34.5 percent of PETKIM shares was completed in mid-April, raising US$288 million.

- We envisage 46 percent of ERDEMIR shares to be privatized via block sale during 2005.

- Finally, we will continue to privatize some of the smaller state-owned enterprises and the associated real estate assets. For the year as a whole, we are confident that we can comfortably surpass the level of privatization revenues achieved in 2004.

Turkey : Proposed Schedule of Purchases

Review 1/	Purchase (SDR millions)	Purchase Percent of Quota	Test Dates Quantitative PCs	Earliest Possible Purchase Date
Approval	555.17	57.59		
2005				
1st Review	555.17	57.59	May 31, 2005 2/	June 15, 2005
2nd Review	555.17	57.59	June 30, 2005	Sep. 1, 2005
3rd Review	555.17	57.59	Sep. 30, 2005	Dec. 1, 2005
2006				
4th Review	555.17	57.59	Dec. 31, 2005	Mar. 1, 2006
5th Review	555.17	57.59	Mar. 31, 2006	June 1, 2006
6th Review	555.17	57.59	June 30, 2006	Sep. 1, 2006
7th Review	555.17	57.59	Sep. 30, 2006	Dec. 1, 2006
2007				
8th Review	555.17	57.59	Dec. 31, 2006	Mar. 1, 2007
9th Review	555.17	57.59	Apr. 30, 2007	July 1, 2007
10th Review	555.17	57.59	Aug. 30, 2007	Dec. 1, 2007
2008				
11th Review	555.17	57.59	Dec. 31, 2007	Mar. 1, 2008
Total	6662.04	691.09		

1/ The frequency of reviews after the first year of the arrangement will be reassessed at the end of 2005.
2/ Fiscal PCs will be for end-April 2005.

Turkey: Quantitative Performance Criteria and Indicative Targets for 2004–05

	Target Under Old Arrangement	Outcome (Preliminary)	Ceiling / Floor	Ceiling / Floor	Ceiling / Floor	Ceiling / Floor
	Dec. 31, 2004		May 31, 2005 2/	June 30, 2005	Sep. 30, 2005	Dec. 31, 2005
I. Quantitative performance criteria 1/	(In trillions of TL for 2004 and millions of YTL for 2005, unless otherwise stated)					
1. Floor on the cumulative primary balance of the consolidated government sector	26,200	27,723	8,720	15,730	25,995	30,460
2. Floor on the cumulative primary balance of the consolidated government excluding SEEs sector	22,900	23,803	8,020	14,130	23,295	26,660
3. Ceiling on contracting or guaranteeing of new external public debt with original maturities of more than one year (in millions of US$)	17,500	8,928	7,000	10,000	13,000	16,000
4. Ceiling on the stock of external public debt with original maturities of up to and including one year (in millions of US$)	1,000	0	1,000	1,000	1,000	1,000
5. Floor on level of net international reserves of CBT and Treasury combined (in billions of US$)	-2.00	0.23 3/	2.00	2.00	2.75	3.80
6. Ceiling on base money (in quadrillions of TL for 2004 and billions of YTL for 2005)	20.9	20.2	23.6	23.6	24.7	25.0
II. Indicative targets						
1. Floor on the cumulative overall balance of the consolidated government sector	-35,440	-22,593	-8,180	-8,770	-10,205	-19,590
2. Ceiling on the stock of net domestic assets of the CBT and Treasury combined (in quadrillions of TL for 2004 and billions of YTL for 2005)	35.0	31.2 3/	37.7	37.7	37.8	36.4
3. Privatization proceeds (in millions of US$)	3,000	1,282	…	300	1,250	1,500
4. Number of employees hired at non-financial state enterprises	4,000	1,612	…	…	…	…
5. Ceiling on the cumulative overall balance (before transfers) of the social security institutions (SSK, BK, and ES)	-19,185	-19,123	-7,200	-10,500	-16,500	-21,500

1/ Cumulative targets are set from January 1, 2005. The targets through September 30, 2005 are performance criteria; the remaining targets are indicative.
2/ End-April for floor on the cumulative primary balance of the consolidated government sector and for floor on the cumulative primary balance of the consolidated government excluding SEEs, and for fiscal indicative targets (1 and 5).
3/ Outturns at new, end-September 2004 program exchange rates are US$1.29 billion for net international reserves, and TL35.5 quadrillion for net domestic assets.

Turkey: Structural Conditionality 2005 1/

Action	Timing
Prior Actions	
1. Parliamentary submission of Banking Law. (¶26)	Done.
2. Separation of board in Ziraat and Halk. (¶30)	Done.
3 Publication of SDIF's strategy to complete bulk of asset recoveries by end-2007. (¶31)	Done.
4. Parliamentary submission of pension reform legislation. (¶15)	Done.
5. Parliamentary approval of tax administration legislation. (¶19)	Done.
Fiscal Measures	
6. No new amnesties of arrears on public sector receivables as defined in Annex F (¶19)	Continuous PC.
7. At most, 10 percent of those leaving through attrition in each state enterprise will be replaced, with limited exceptions for specialist positions and overperforming enterprises with approval by the Treasury. (¶17)	BM.
8. Maintain excise taxes and SEE prices in line with 2005 program assumptions. (¶10)	BM. End-June 2005.
9. Parliamentary approval of pension reform legislation. (¶15)	PC. End-June 2005.
10. Parliamentary approval of the administrative social security reform law. (¶14)	BM. End-June 2005.
11. Put in place secondary legislation required under the Public Financial Management and Control Law. (¶20)	BM. End-September 2005.
12. Parliamentary submission of legislation strengthening state enterprise governance. (¶22)	BM. End-September 2005.
13. Develop a quantitative framework for monitoring health expenditure and assessing medium-term trends. (¶16)	BM. End-September 2005.
14. Prepare legislation to reform the personal income tax. (¶18)	BM. End-September 2005.
15. Establish a large-taxpayers unit within the Revenue Administration. (¶19)	BM. End-December 2005.
16. Complete comprehensive review of civil service wage and employment structure. (¶17)	BM. End-December 2005.
Financial Sector Measures	
17. Parliamentary approval of Banking Law. (¶26)	PC. End-June 2005.
18. Adoption of state bank specific strategies by both the government and the boards of the state banks. (¶29)	BM. End-June 2005.
19. Adopt a timetable for the phasing out of special privileges and obligations of the state banks. (¶29)	BM. End-June 2005.
20. Publication by BRSA of its planned reforms taking into account the findings of the Imar inquiry. (¶27)	BM. End-September 2005.
21. SDIF to sell all remaining non-related party loans by auction. (¶31)	BM. End-December 2005.
22. Launch of first IPO for Vakifbank. (¶30)	BM. End-December 2005.
23. Set up a committee to assess whether integrated financial sector supervision is warranted, with findings to be presented by end-March 2006. (¶28)	BM. End-March 2006.
24. Completion of implementing regulations for the Banking Law. (¶26)	BM. End-June 2006.

1/ PA=prior action, PC=structural performance criterion, BM= structural benchmark. Paragraph numbers refer to the Memorandum of Economic and Financial Policies.

MONETARY TARGETS

Table 1. Turkey: Performance Criteria and Indicative Targets for Base Money of the Central Bank of Turkey 1/

(In quadrillions of TL for 2004 and billions of YTL for 2005)

	Ceilings	Actual
Outstanding base money as of December 31, 2004		20.2 2/
May 31, 2005 (performance criterion)	23.6	
June 30, 2005 (performance criterion)	23.6	
September 30, 2005 (performance criterion)	24.7	
December 31, 2005 (indicative target)	25.0	

1/ These ceilings are based on the average of the stocks prevailing during the five working days including and immediately preceding each of these dates.
2/ Base money outturn at December 31, 2004.

1. This Annex sets out performance criteria for base money, and indicative targets for net domestic assets of the Central Bank of Turkey (CBT) and Treasury combined.

2. Base money is defined as currency issued by the CBT, plus the banking sector's deposits in Turkish lira with the CBT. The net domestic assets (NDA) of the CBT are defined as base money less net foreign assets of the CBT. The net domestic assets of the CBT and Treasury combined are defined as net domestic assets of the CBT plus (i) Treasury liabilities to the International Monetary Fund and (ii) Treasury foreign exchange denominated borrowing with an original maturity of less than one year.

3. Net foreign assets of the CBT are defined as the sum of the net international reserves of the CBT (as defined in Annex E), medium- and long-term foreign exchange credits (net), and other net foreign assets (including deposits under the Dresdner scheme of original maturity of two years or longer and the holdings in accounts of the Turkish Defense Fund, but excluding CBT's net lending to domestic banks in foreign exchange). As of December 31, 2004, net foreign assets of the CBT amounted to TL11.03 quadrillion, net domestic assets of the CBT TL9.16 quadrillion, and base money TL20.19 quadrillion.

4. Net domestic assets of the Treasury are equal to Treasury liabilities to the International Monetary Fund and Treasury foreign exchange denominated borrowing with an original maturity of less than one year. As of December 31, 2004, these amounted to US$17.59 billion, or TL26.34 quadrillion (evaluated at program exchange rates).

5. All assets and liabilities denominated in foreign currencies will be converted into Turkish lira at program exchange rates (Annex J).

6. NDA ceilings will be adjusted for any change in the definition of the aggregate to which the reserve requirement applies according to the following formula:

$$\Delta NDA = R^{*}\Delta B,$$

where: R denotes the 6 percent reserve requirement and ΔB denotes the change in base generated by a change in the definition of the reserve aggregate, or due to any change in the averaging period. Base money ceilings will also be adjusted to reflect these changes.

7. NDA ceilings will be adjusted for any change in the reserve requirement coefficient according to the following formula:

$$\Delta NDA = B * \Delta R$$

where: B is the level of the base to which the reserve requirement applies on the test date and ΔR is the change in the reserve requirement coefficient and the liquidity requirement coefficient. Base money ceilings will also be adjusted to reflect these changes.

8. The NDA and base money ceilings will be adjusted downward for any waiver of reserve requirements for any additional bank intervened by the BRSA. The adjustment will be equal to the existing reserve requirement coefficient times the amount of liabilities at these banks subject to reserve requirements.

Table 2. Turkey: Indicative Targets on the Net Domestic Assets of the Central Bank of Turkey and Treasury Combined 1/

(In quadrillions of TL for 2004 and billions of YTL for 2005)

	Ceilings	Actual
Outstanding NDA as of December 31, 2004:		35.5
May 31, 2005	37.7	
June 30, 2005	37.7	
September 30, 2005	37.8	
December 31, 2005	36.4	

1/ These targets are based on the average of the stocks prevailing during the five working days including and immediately preceding each of these dates.

TARGETS FOR NET INTERNATIONAL RESERVES

Table 1. Turkey: Performance Criteria and Indicative Floors on the Level of Net International Reserves

(In billions of U.S. dollars)

	Floor on level of NIR	Actual	Memo item: NIR of the CBT
Outstanding stock as of December 31, 2004:		1.29	18.87
May 31, 2005 (performance criterion)	2.00		…
June 30, 2005 (performance criterion)	2.00		...
September 30, 2005 (performance criterion)	2.75		...
December 31, 2005 (indicative target)	3.80		…

1/ The end-December NIR outcome (US$1,293 million) corresponds to a level of US$229 million when measured using program exchange rates under the previous arrangement.

1. For program purposes, net international reserves is defined as net international reserves of the CBT minus (i) Treasury liabilities to the International Monetary Fund and (ii) Treasury foreign exchange denominated borrowing with an original maturity of less than one year.

2. Net international reserves of the CBT comprise its gross foreign assets excluding encumbered reserves less its gross international reserve liabilities plus the net forward position of the central bank, denominated in U.S. dollars. Encumbered reserves are reserves that are not readily available.

3. For the purpose of the program, gross foreign assets are all short-term foreign (convertible) currency denominated claims on nonresidents, monetary gold valued at the September 30, 2004 average London fixing market price of US$414 per troy ounce, foreign bank notes, balances in correspondent accounts, and any reserve position in the IMF. At present encumbered reserves consist of foreign asset holdings in accounts of the Turkish Defense Fund (amounting to US$0.33 billion on December 31, 2004). Reserve assets as of December 31, 2004 amounted to US$35.08 billion (evaluated at program exchange rates).

4. Gross international reserve liabilities include all foreign currency-denominated liabilities (or TL/YTL-denominated liabilities indexed to any exchange rate) to residents and non-residents with an original maturity of up to and including one year (including reserves against foreign currency deposits of the banking sector), claims from central bank letters of credit, overdraft obligations of the central bank, and central bank liabilities arising from balance of payments support borrowing irrespective of their maturity. Government foreign

exchange deposits with the CBT are not treated as an international reserve liability. On December 31, 2004 reserve liabilities thus defined amounted to US$16.20 billion (evaluated at program exchange rates).

5. The net forward position is defined as the difference between the face value of foreign currency-denominated or indexed central bank off-balance sheet (forwards, swaps, options on foreign currency, and any future contracts) claims on nonresidents and foreign currency obligations to both residents and nonresidents. As of December 31, 2004 these amounts were zero.

6. As of December 31, 2004 the sum of: (i) Treasury liabilities to the International Monetary Fund and (ii) Treasury foreign exchange denominated borrowing with an original maturity of less than one year amounted to US$17.59 billion.

7. All assets and liabilities denominated in foreign currencies other than the U.S. dollar will be converted into U.S. dollars at the program cross exchange rates specified (Annex J).

FISCAL TARGETS

A. Primary Balance of the Consolidated Government Sector

Table 1. Turkey: Performance Criteria and Indicative Targets on the Cumulative Primary Balance of the Consolidated Government Sector and consolidated government sector excluding SEEs.

	Floor (In millions of YTL)
Cumulative primary balance from January 1, 2005, to:	
April 30, 2005 (performance criterion)	8,720
June 30, 2005 (performance criterion)	15,730
September 30, 2005 (performance criterion)	25,995
December 31, 2005 (indicative target)	30,460
Cumulative primary balance (excluding SEEs) from January 1, 2005, to:	
April 30, 2005 (performance criterion)	8,020
June 30, 2005 (performance criterion)	14,130
September 30, 2005 (performance criterion)	23,295
December 31, 2005 (indicative target)	26,660

1. The primary balance of the *consolidated government sector* (CGS), Table 1, comprises the primary balances (primary revenue minus noninterest expenditures) of the consolidated central government (consolidated budget), the 3 extra budgetary funds (EBFs) identified below, the 26 state economic enterprises (SEEs) identified below, the social security institutions (SSIs), and the unemployment insurance fund. A second set of performance criteria excludes the SEEs. The floors on the primary balance of the CGS will be monitored:

- For the central government from above the line on a modified cash basis (including both special revenues and special expenditures). In this definition, reported transfers to social security institutions are reconciled with cash transfers reported by the social security institutions.
- For the EBFs from above the line on a modified cash basis, counting non-transferred shared tax revenues, to the extent these are not already recorded as reserves by other elements of the CGS.
- For the SSIs, and the unemployment insurance fund from above the line on a cash basis;
- For the SEEs, from below the line as described in paragraph 6.

2. For the purposes of the program, the primary revenues will exclude interest receipts of the consolidated central government (including on tax arrears), SEEs, and of the unemployment insurance fund, profit transfers of the Central Bank of Turkey (CBT) and net special revenues of the Turkish mint, proceeds from the sale of assets of the CGS (privatization proceeds or transfers thereof), and state bank dividend payments. Revenues of the CGS from sales of immovables below YTL500 million will be included. Interest receipts of EBFs and SSIs will not be excluded. As well, the floor on the primary balance will be adjusted upwards for any increase in revenues arising from changes in the revenue sharing agreement between any components of the CGS and other elements of the public sector, including local authorities. For the purposes of the program, revenues of the CGS will exclude payments-in-kind and other nonmonetary forms of payments.

3. For the purposes of the program, primary expenditure of the CGS will exclude any payments related to bank recapitalization and to the restructuring of private and state banks.

4. Net lending of any component of the CGS will be considered as a non-interest expenditure item. (If this net lending is negative, it will be considered as a non-interest revenue item.) Payment of guaranteed debt by treasury on behalf of non-CGS components of the public sector will not be treated as net lending up to the baseline reported in Annex G.

Extrabudgetary funds

5. The three EBFs included in the definition of the performance criterion are the Defense Industry Support Fund, the Privatization Fund, and the Social Aid and Solidarity Incentive Fund.

State economic enterprises

6. The 26 SEEs whose primary balances will be included in the definition of the performance criterion are: TTK (coal), T. ŞEKER FAB (sugar), TMO (soil products office), TEKEL (tobacco), TCDD (railways), Türk Telekom (telecommunications), BOTAŞ (natural gas), TEDAŞ (electricity distribution), EÜAŞ (electricity generation), TETAŞ (electricity trade), TEİAŞ (electricity transmission), TPAO (petroleum exploration and extraction), ETİ Maden İŞL., MKEK, TKİ, ÇAYKUR, DHMİ, PTT, PETKİM, THY, TÜPRAŞ, TİGEM, KIYEM, TDİ, TÜGSAŞ, and DMO.

7. The primary balance of these SEEs will be monitored as the sum of net financing minus accrued interest made by the SEEs. Net financing will be monitored as: net financing from the banking system (excluding pre-export financing from Eximbank) plus net external borrowing (excluding normal trade financing), plus the change in net arrears to and net advances from the private sector and to/from the non-CGS public sector (including subsidiaries and joint ventures), plus net interest payments undertaken by the Treasury. The net change in arrears on tax liabilities will be excluded.

8. Net financing from the banking system (excluding pre-export financing from Eximbank) is defined as the change in all claims of these institutions on the SEEs listed above, including loans and capitalized interest arrears, less the change in deposits and repos of SEEs in these institutions, as reported by these SEEs. Changes in claims and deposits denominated in foreign currency will be valued at the average of the exchange rates between the Turkish lira and each corresponding currency prevailing during the quarter in question. As of December 31, 2004 the stock of net banking claims on SEEs as defined above stood at TL499 trillion, valued at the exchange rates on that day.

9. Net external borrowing is defined as the receipt of external loans (including guaranteed debt and on-lending, and excluding normal trade financing) less amortization (excluding repayments of guaranteed debt and on-lending undertaken by the Treasury), valued at the exchange rate at the time of transaction. As of December 31, 2004 the stock of external loans stood at TL8,207 trillion, valued at the exchange rates on that day.

Social security institutions

10. The three social security institutions (SSIs) included in the definition of the performance criterion are SSK, Bağ-Kur, and Emekli Sandığı. The deficits of the SSIs will be covered by transfers from the central government budget, and they are thus expected to be in primary balance.

Adjusters

11. The floor on the primary surplus of the CGS will be adjusted upwards for any increase in the expenditure arrears of the SSIs. Arrears of the SSIs are defined as the sum of (i) overdue pension payments; (ii) medicine payments overdue by more than 45 days for both imported and domestic medicine (from the date of invoice receipt); (iii) other payments overdue by more than 30 days and payments to hospitals overdue by more than 60 days (from the date of invoice receipt). In the case of Bag Kur they exclude the arrears to the common retirement fund. The stock of arrears for Bag Kur stood at TL104 trillion; for SSK stood at TL54 trillion; and for ES stood at TL0 trillion on December 31, 2004. These stocks of arrears will be used for the purpose of calculating the adjustor.

12. The floors for the primary surplus of the CGS will be adjusted upward:

- For any issue of noncash debt other than for bank recapitalization and securitization of duty losses and for the restructuring of the Agricultural Sale Cooperative Units and military foreign financed in-kind spending;
- For any off-balance sheet expenditure of any component of the CGS (excluding military foreign financed in-kind spending).
- For cumulative interest receipts of the Defense Industry Support Fund in excess of YTL 100 million.

13. The floor on the primary surplus of the CGS will be adjusted upwards (downwards) in line with the projected surplus (deficit) of the primary balance of any fund or entity that is incorporated in the CGS after January 1, 2004.

14. The floor on the primary surplus of the CGS will be adjusted by the primary balance projected at the time of approval of the program for any state economic enterprise (included in the performance criterion) when there is a change of control due to privatizations. The adjustor will be calculated as the difference between the primary surplus generated by the company while in public control and the annual projection. This adjustor does not apply to the primary surplus of the CGS excluding SEEs.

B. Overall Balance of the Consolidated Government Sector

Table 1. Turkey: Indicative Floors on the Cumulative Overall Balance of the Consolidated Government Sector

	Floor (In millions of YTL)
Cumulative overall balance from January 1, 2005 to:	
April 30, 2005	-8,180
June 30, 2005	-8,770
September 30, 2005	-10,205
December 31, 2005	-19,590

15. The overall balance of the consolidated government sector (CGS), Table 1, comprises (i) the primary balance of the CGS as previously defined in this annex, (ii) the net interest payments of the central government, the UIF, and the SEEs, (iii) the interest payments of SSIs and EBFs, (iv) transfers of profits from the CBT and net special revenues of the Turkish Mint to the consolidated central government, and (v) state bank dividends payments, expenditures under the risk account (net lending) and carry over at current expenditures.

16. The monitoring of the different components of the overall balance will be as indicated in paragraph 1 of this Annex.

17. All definitions and adjusters specified earlier in this Annex to apply to the primary balance of the CGS will also apply to the overall balance of the CGS. In particular, the overall balance will be adjusted for the overall balance of any new government funds and institutions established after January 1, 2004.

C. Overall Balance (before transfers) of the Social Security Institutions

Table 1. Turkey: Indicative Floor on the Cumulative Overall Balance (before transfers) of the Social Security Institutions

	Floor (In millions of YTL)
Cumulative overall balance (before transfers) from January 1, 2005 to:	
April 30, 2005	-7,200
June 30, 2005	-10,500
September 30, 2005	-16,500
December 31, 2005	-21,500

18. The overall balance (before transfers) of the social security institutions (SSIs), Table 1, comprises the balances of SSK, Bağ-Kur, and Emekli Sandıgı.

D. Amnesties and Public Sector Receivables

19. Amnesties will be understood as a reduction in the net present value of a public receivable, without any reference to individual ability to pay, or attempt to enforce individual payment. A public receivable will be understood as an obligation to general government (GFS definition) or to a state economic enterprise or state bank.

PROGRAM BASELINE FOR TREASURY NET LENDING

Table 1. Turkey: Program Baseline for Treasury Net Lending

	Baseline (In millions of US$)	Baseline (In millions of YTL)
Cumulative net lending from January 1, 2005 to:		
April 30, 2005	270	360
June 30, 2005	450	600
September 30, 2005	580	800
December 31, 2005	770	1,100

1. Net lending (risk account) by Treasury to other (non-CGS) components of the public sector is defined as the sum of guarantee payments made by Treasury on behalf of these entities minus repayments obtained by Treasury from them.

2. Other components of the public sector include: extrabudgetary funds not in the CGS, revolving funds, associations or foundations, state economic enterprises not in the CGS, state banks (including Eximbank and Iller bank), special provincial administrations, municipalities, municipal enterprises, build-operate-transfer projects, and build-operate projects.

3. Repayments include those obtained in cash directly from municipalities. Repayments, obtained through claw-back mechanisms, either directly, by withholding of transfers of tax shares from the MoF, or indirectly, via withholding of transfers to be made by Iller Bank, and proceeds from privatization, direct or indirect, are not included as repayments.

4. For the purposes of program monitoring, the flows in U.S. dollars will be converted at the average YTL/US$ exchange rate between test dates.

SHORT-TERM EXTERNAL DEBT CEILINGS

Table 1. Turkey: Performance Criteria and Indicative Ceilings on the Stock of Short-Term External Debt Outstanding

	Ceilings (In millions of US$)
May 31, 2005 (performance criterion)	1,000
June 30, 2005 (performance criterion)	1,000
September 30, 2005 (performance criterion)	1,000
December 31, 2005 (indicative target)	1,000

1. The limits specified in Table 1 apply to the stock of debt of original maturity of one year or less, owed or guaranteed by the consolidated government sector (as defined in Annex F). The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt or Borrowing in Fund Arrangements (Decision No. 6230-(79/140), August 3, 1979 as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85), August 24, 2000). Excluded from this performance criterion are external program financing, sales of treasury bills denominated in Turkish lira or foreign exchange to nonresidents in either the domestic primary market or the secondary market, normal import-related credits, reserve liabilities of the Central Bank of Turkey, and forward contracts, swaps, and other future market contracts. Debt falling within the limit shall be valued in U.S. dollars at the program cross exchange rates specified in (Annex J).

MEDIUM- AND LONG-TERM DEBT CEILINGS

Table 1. Turkey: Performance Criteria and Indicative Ceilings on Contracting and Guaranteeing of New External Debt

	Limits (In millions of US$)
Cumulative flows from end-December 2004	
May 31, 2005 (performance criterion)	7,000
June 30, 2005 (performance criterion)	10,000
September 30, 2005 (performance criterion)	13,000
December 31, 2005 (indicative target)	16,000

1. The limits specified in Table 1 apply to the contracting or guaranteeing by the consolidated government sector (as defined in Annex F) of new, nonconcessional external debt with an original maturity of more than one year. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (adopted by the Executive Board of the International Monetary Fund on August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received. The term "nonconcessional" means containing a grant element of less than 35 percent on the basis of the currency-specific discount rates based on the OECD commercial interest reference rates in place at the time at which the contract is entered into, or guarantee issued. Excluded from this performance criterion are credits extended by the IMF, adjustment lending from the World Bank, and other external program financing, long-term liabilities of the Central Bank of Turkey and sales of treasury bills and bonds denominated in TL/YTL or FX to nonresidents in either the domestic primary market or the secondary market. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract is entered into, or guarantee is issued.

PROGRAM EXCHANGE RATES

Table 1. Cross Exchange Rates for Program Purposes

	TL value	YTL value	U.S. dollars per currency unit
Program exchange rates			
U.S. dollar	1,497,696	1.497696	1.0000
Euro	1,845,162	1.845162	1.2320
Japanese yen	13,469	0.013469	0.0090
Swiss franc	1,186,643	1.186643	0.7936
U.K. pound	2,707,645	2.707645	1.8086

1. This table sets out the program exchange rates referred to in earlier Annexes. They shall apply to the performance criteria/indicative ceilings or floors for the period May 31, 2005–May 31, 2008. Currencies not specified here will be converted at the representative exchange rates reported to the IMF as of September 29, 2004.

2. Constituent currencies of the euro shall be converted into euro at the official European Union conversion rates and then converted into the U.S. dollar value.