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Folder ID: 1771215

ISAD(G) Reference Code: WB IBRD/IDA 03 EXC-10-4549S

Series: Contacts - Member Countries files

Sub-Fonds: Records of President Robert S. McNamara

Fonds: Records of the Office of the President

Digitized: June 28, 2013

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THE WORLD BANK
Washington, D.C.

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McNamara Papers

Contacts
Turkey (1975-1978)

The World Bank Group
Archives



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A1993-012 Other #: 18


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Contacts with member countries: Turkey - Correspondence 02

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OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

FROM: Munir P. Benjenk 

SUBJECT: TURKEY - Visit of Finance Minister
Karakaya Project

DATE: January 16, 1975

1. We have received this morning the attached letter addressed to you by Professor Bedri Gursoy, Minister of Finance of Turkey, who is scheduled to call on you this evening at 6.50 p.m.
2. The letter forwards the application for Bank financing of the Karakaya hydroelectric project on the Euphrates which we had been expecting for some time. The Turkish Government's position vis a vis the Bank's policy on projects on international waters has varied in recent months for reasons we have not elucidated yet. After an agreement of principle to entrust the Bank with a basin study for both the Euphrates and Tigris, the Government now prefers to deal directly with the other riparians before resorting to any technical assistance. Following complaints in the Turkish press that the Bank is taking the side of Syria and Iraq on this issue I recently felt the need to give to the Turkish Charge d'Affaires an Aide Memoire (copy attached) which reasserts the Bank position. Its paragraph 4 is the operative one you may want to look at.
3. The Minister's letter suggests that we should finance Karakaya without any agreement between the riparians and merely rely on Turkey's goodwill to prevent any damage to the lower riparians. In light of the difficulties experienced by Iraq during the filling of Keban and Tabqa last summer and of the large expansion of irrigation under way, I do not believe that such assurances would be sufficient. I recommend that you urge the Minister to proceed with talks with the other riparians so as to settle this issue "in the interest of the mutual interests of Turkey and her neighbors", before rather than after a Bank loan is made. Alternatively, the Bank would be prepared to ask Syria and Iraq for their comments on the project (as we did for Balikh in Syria and Lower Khalis in Iraq) but it may well happen that these countries would want specific arrangements to protect their water needs. A reservoir operation model for the Euphrates (which is nearing completion in the Bank) indicates that the solutions protecting the interest of all three riparians in connection with hydroelectric projects (as opposed to irrigation) would not impose excessive constraints on Turkey. For the longer run, a basin study is indispensable to pave the way for an agreement on water sharing. You may want to stress that the Bank has no other interest in the riparian issue but to help on the technical plane, with complete objectivity, the three riparians reach agreement on a matter they have been discussing in vain for more than a decade.
4. The Minister might also wish to raise with you questions relating to other project problems. He has asked a seven-member Government delegation to accompany him here and it would be preferable that the Region discuss these matters with them before we answer the questions the Minister may have.

Attachments

T. C.
MALIYE BAKANLIĞI
ANKARA

HAZMİT : Dünya Bankası Grubu Kredileri Şubesi

Sayı : 56908

Konu :

January 10, 1975

Mr. Robert S. McNamara
President
International Bank for Reconstruction
and Development
1818 H. Street, N.W.
Washington, D.C. 20433
U. S. A.

Re: Karakaya Hydroelectric Power
Development Project.

Dear Mr. President,

I have the honor to present herewith a copy of the "Karakaya Hydroelectric Power Development Loan Application Report."

This project, Mr. President, will be, with the total installed capacity of 1.800 MW, the biggest hydroelectric power generating scheme ever designed in my country.

When completed the dam will be the second dam on the Turkish soil regulating the Euphrates waters to bring order to the whole area, which will serve the interests both ours as well as our neighbors, Syria and Iraq.

I would like to take this opportunity to submit to your kind attention the fact that, the friendly relationship demonstrated at every occasion not only on the subject of riparian question but also on all matters concerning the related parties will be our guide in this new venture. The example set in the case of the Keban Dam Project clearly testifies our goodwill and understanding. Needless to reiterate that the same goodwill and understanding will be shown during the filling period of the Karakaya Dam, which, according to the experts, will be far more shorter than the filling period of the Keban Dam.

I firmly believe, Mr. President, that any question which may arise in relation to riparian rights, should and could be solved within the context of the mutual interests of Turkey and her neighbors.

In view of the fact that the need in Turkey for power is very urgent and that not a day should be wasted we will immediately start the construction of the dam. However, the bids will be invited in such a way as to satisfy the requirements of your institution. This will enable us to use the proceeds of an IBRD Loan if it materializes.

I am confident, Mr. President, that the International Bank for Reconstruction and Development will favorably view this formal application for a loan toward financing the foreign currency requirements of the said project.

Sincerely yours,



Prof. Dr. Bedri Gürsoy
Minister of Finance of Turkey

AIDE MEMOIRE
ON THE WORLD BANK POSITION
ON THE KARAKAYA PROJECT

1. The World Bank has consistently followed the policy that projects on international rivers for which its financing is sought should not be adversely affected by, or will not adversely affect, up stream or down stream riparian states. For that purpose, before making loans for such projects the Bank should be satisfied that the international waters aspects are covered by appropriate agreements between the borrower and other riparians, or that the other borrowers have no objection to the project, or that the project is not harmful to the interests of other riparians.

2. At the time of the financing of the Keban Dam, which the Bank helped organize without, however, lending for the dam itself, attempts were made to bring about an agreement between Turkey, Syria and Iraq. Failure of the three riparians to agree on irrigation requirements (which were needed to determine the releases to be observed from Keban during its filling) brought the lenders for the dam to accept undertakings by the Government of Turkey to maintain its best efforts with a view to establishing and maintaining coordination and cooperation on river systems with the riparian countries, preparing principles and procedures to govern water right questions on such systems and, in the absence of arrangements with Syria and Iraq concerning the initial filling of the Keban reservoir, to adhere to a program for the release of water downstream of Keban during the initial filling of the reservoir. These undertakings were set forth in various forms in Turkey's agreements with the lenders for the dam and, as regards the releases, in a letter dated August 31, 1966, from the Minister of Finance of Turkey.

3. As the completion of the Keban dam was delayed, the Bank drew the attention of the Turkish, Syrian and Iraqi Governments in January 1972 to the likelihood that the filling of the Keban and Tabqa reservoirs would overlap, thus creating a new situation for the riparian countries. The Bank suggested to the riparians a "transitional agreement" which would cover reservoir operations during and after filling, pursue the coordination and cooperation on river systems undertaken in connection with Keban and pave the way for the projects planned to be started before 1977 (especially Karakaya in Turkey and Balikh in Syria) pending a longer-term agreement. The riparians, however, proceeded after 1972 with discussions between themselves which appear not yet to have resolved the issues. In March 1974, Iraq asked the Bank "to mediate in order to achieve a just and equitable solution between the riparian countries in the division of the Euphrates waters". The Bank without accepting the functions of mediator, which would have required the request of all three parties, offered to formulate proposals and alternatives for solving both the short-term problems of the simultaneous filling of Keban and Tabqa (which had reached crisis proportions for Iraq in the summer of 1974) and of the filling of Karakaya, and the long-term problem of large-scale irrigation development in the three countries. On the basis of the agreement in principle given by the three Governments in July 1974 (including the agreement given verbally to Messrs. Bart and Fish of the Bank by H.E. Deniz Baykal on behalf of the Turkish Government) the Bank submitted to the riparians in October 1974 the

outline of a proposed work program and indicated that it would be prepared to send a technical mission to discuss it. On the express request of Turkey, the program included not only the Euphrates, but also the Tigris river. By cable dated October 22, 1974, the head of the Treasury in the Finance Ministry agreed to the mission. However, in a letter dated November 6, 1974, the Finance Minister stated that Turkey deemed it necessary to enter first into discussions with the other riparians bearing upon the political aspects of the agreement to be reached on the riparian issue, asked the Bank to encourage the other riparians to enter into such bilateral negotiations and stated that, after this bilateral direct relations mechanism has become operative, the Bank's technical help might play an important role.

4. In view of the unavailability of the members of the Government dealing with this matter, Bank representatives had discussions on November 8, 1974, in Ankara with Mr. Gogmen (Ministry of Foreign Affairs) and Mr. Yalabik (Ministry of Energy and Natural Resources). In the course of the discussions the Ministry of Energy expressed reservations on the usefulness of the above-mentioned technical mission which was therefore cancelled. The Bank representatives expressed the following points which still represent the Bank's position regarding its participation in the financing of the Karakaya dam:

(a) Nothing would please the Bank more if the three riparians could establish a bilateral direct relations mechanism and if such mechanism led to an agreement between themselves on the pending riparian issues. The inclusion of Karakaya in such agreement would enable the Bank to participate in its financing without further studies. Furthermore, an agreement encompassing the sharing of waters would pave the way for Bank participation in the financing of the Karababa and Lower Firat projects.

(b) Failing agreement on Karakaya, if the Bank were asked to finance it (no application from the Turkish authorities has been received yet), it would have to ask for the comments of the other riparians as it had consistently done for projects on international rivers.

(c) If the other riparians objected to Karakaya, it would be difficult to determine unilaterally safeguards - similar to those agreed upon in connection with Keban - in view of the substantial expansion of irrigation contemplated during and after the filling period of Karakaya (expected to start in the late 1970's); the fact that the Ministry of Foreign Affairs questioned the validity of the letter of August 31, 1966, concerning Keban would further complicate a unilateral determination of safeguards.

(d) While very much hoping that the direct political negotiations mentioned in the November 6 letter of H.E. The Minister of Finance could resolve these issues, the Bank reasserted its willingness to provide technical assistance whenever the three riparians would seek such assistance. The outline of the proposed work program could constitute the starting point for determining the technical studies needed.

(e) In order to help resolve the immediate issues of the filling of Keban, Tabqa and Karakaya the Bank would shortly provide the three riparians with a reservoir operation model for the Euphrates. The related operating procedures involve, however, irrigation requirements which the Bank was not in a position to determine. Agreement between the riparians on such operating procedures would enable the Bank to participate in the financing of Karakaya, being understood that water requirements in each country would have to be reviewed periodically and could not be assessed accurately and equitably without a study of the river development as a whole along the lines suggested by the Bank.

January 9, 1975

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OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: May 14, 1975

FROM: Adi J. Davar, ~~Division~~ Chief, EMENA CPD II, 2ASUBJECT: TURKEY: Discussions during Mr. McNamara's Visit

1. During his visit to Ankara on April 24, Mr. McNamara met with (i) Finance Minister Ergenekon, (ii) Foreign Affairs Minister Caglayangil, and (iii) Prime Minister Demirel, in that order. Mr. Bart and I joined him in these meetings. We were not present at the small private lunch which the Prime Minister hosted for him. This memorandum summarizes the discussions which took place during each of these meetings.

Discussion with the Finance Minister

2. In response to the Minister's welcome, Mr. McNamara recalled his 1968 visit and the request of Mr. Demirel, who was also Prime Minister at the time, for increased Bank assistance. The Bank's program had since been increased from a level of \$12 million to over \$200 million a year. As Turkey was now one of the Bank's major and important borrowers, he hoped that during his current visit he would be able to discuss the role Turkey wanted the Bank to play in its future development.

3. The Minister, speaking in Turkish, then briefly surveyed Turkey's economic problems and plans. According to him, the period 1965-70 witnessed the establishment of a sizeable development program and the 1970 stabilization program heralded a dramatic improvement in Turkey's balance of payments. However, internal political instability since 1971 to date, had given rise to an uneasy economic situation and a high rate of inflation, the latter undoubtedly aggravated by international price increases. As a result, domestic inflation was growing at nearly 30 percent a year and Turkey's foreign exchange reserves had declined to about \$1.3 billion. Unless corrective economic policies were urgently adopted, reserves were likely to erode to about \$0.6 billion within the next 2 years. The Demirel Government intended to adopt policies to ensure that reserves were maintained at a level of at least \$1 billion and inflationary increases in domestic prices were curbed, production stimulated and investments encouraged so that Turkey could continue to have a growth rate of about 7 to 8 percent in real terms. He allowed that Turkey was an example to the world, where with total opposition to communism and despite leftist pressures, economic development was being pursued through democratic institutions.

4. The Minister urged the World Bank (and IMF) to further support Turkey's development efforts in this framework, and not to do anything in planning and implementing projects which might jeopardise the establishment of price stability in Turkey. He proposed future support by the Bank for infrastructure projects, and particularly the Karakaya Dam project. Such assistance would supplement the help that Turkey expected to receive from its oil-producing neighbors for large projects, besides reliance by Turkey on its own foreign exchange earning capacity.

May 14, 1975

5. Mr. McNamara emphasized that he shared the Government's objective for an expanded Bank role for future Turkish development. Referring to the past and present governments' platform for accelerated rural development and correcting regional imbalances, he confirmed the Bank's interest in supporting projects in both fields. He indicated that the Bank would also very much like to assist with the Karakaya project, which involved the delicate issue of riparian rights. The method for dealing with this issue was a prerogative of Turkey's sovereignty and the Bank would hardly want to impinge in any way on it. At the same time, as an international institution of which Turkey, Syria, and Iraq were all members, the Bank would find it difficult to proceed with this project unless the three riparians were in agreement over the interim use of the Euphrates waters, or Iraq and Syria did not object to the project. He recapitulated that following the request to the Bank last year by all the three riparians, the Bank had worked out an interim study as to how reservoirs on the Euphrates could be operated during the filling-in period without detriment to any riparian, as well as a work program for a technical study of possible long-term alternatives for sharing the Euphrates waters. However, in late 1974, Turkey indicated that it did not wish to proceed on that basis, although Iraq and Syria did. Mr. McNamara stated that while he did not expect an immediate answer from the Minister, he would appreciate learning how the Government now wanted the Bank to proceed further. We had provided the interim study; should we stop there and Turkey and other riparians would take up the matter from that point onwards? Should the Bank go ahead with the long-term studies, as originally requested by the riparians, with a view to assisting them in finding mutually acceptable solutions? Or would Turkey prefer the Bank to withdraw from financing the project, and itself resolve the matter and find the necessary financing?

6. The Minister felt that this "new attitude" of the Bank, "hurt Turkey's feelings". Mr. McNamara reassured him that the Bank had no intention of hurting Turkey's feelings, or desisting from financing Karakaya. However, as an international institution a solution had to be found by Turkey which would ensure that the other riparians do not object to the project or an interim agreement between them is reached. Messrs. Bart and Davar would be available to discuss the matter and alternate approaches with the Turkish Government.

7. Mr. McNamara also pointed out that although the Bank had committed nearly \$760 million since 1970 for Turkish projects, only about \$175 million had been disbursed so far. Only 13 percent, against the projected 40 percent disbursements, had taken place in respect of public sector projects. Similarly, the Bank's biggest loan signed 10 months ago for Elbistan, was not yet effective. He clarified that he was not making these points in a spirit of criticism, but rather to highlight to a new government that substantial Bank resources were available for utilization, and at the same time, substantial efforts were needed to accelerate the implementation of on-going projects. He especially urged actions to declare Elbistan effective as soon as possible. He also pointed out that while making new loan proposals to our Board, we had to report on the progress of on-going projects; a point had now been reached, where we would begin to face difficulties in seeking the Board's approval to new loans

May 14, 1975

in view of the performance on these projects. He urged the Minister to review project implementation matters with Messrs. Bart and Davar, who would be able to advise on what could be done to improve the situation. In response to Mr. McNamara's concern at the drain on the Government's fiscal resources because of the subsidization of inefficient operations of many of the SEEs, the Minister responded that an omnibus effort to remedy this situation was not politically possible. However, the Government intended to try and cure "specific diseases in specific SEEs". Mr. McNamara felt that even that would be a great help, and ended the meeting with a further reassurance about the Bank's willingness to continue to play an expanded role in future development projects in Turkey.

Discussion with the Foreign Minister

8. This was a very brief and cordial meeting, where the Minister only wanted to meet Mr. McNamara before taking him to the Prime Minister. Mr. McNamara expressed his pleasure at renewing acquaintance with the Minister, and at revisiting Turkey. He also indicated that he would be glad to visit again after the Demirel Government had had an opportunity to firm up its policies and programs. He recalled his 1968 visit and his talks with Mr. Demirel, and how since then, the Bank's activities in Turkey had burgeoned considerably. He reconfirmed the Bank's desire to continue helping Turkey at an expanded level in the future.

9. The Minister thanked Mr. McNamara for his interest and stated that neither he nor Mr. Demirel had forgotten that Mr. McNamara had kept his 1968 promise to increase lending substantially for Turkey's development. He stressed the present government was the only one which could logically emerge under the parliament as it was composed today, and without holding new elections. He felt that this government would be able to give Turkey the political stability which it had not enjoyed these last few years, and hoped that the Bank would continue to support its economic programs.

Discussion with Prime Minister Demirel

10. Minister Caglayangil and two senior officials of his Ministry, as well as Mr. Bart and myself, attended the meeting with Mr. Demirel. In response to the Prime Minister's welcome, Mr. McNamara once again recalled his 1968 visit and Mr. Demirel's request for Bank support at the time, and mentioned the substantial increase in Bank lending to Turkey since then.

11. Mr. Demirel stated that economic developments since 1971 had taken place in a highly inflationary environment, which he felt was "no development at all". Undoubtedly, Turkey was affected, as other countries were, by international economic forces including increases in prices. However, proper economic policies could have controlled the impact of these forces within Turkey. The intention of his Government in 1970 was to give Turkey political and economic stability, but "the people" decided that they wanted another government and since then, Turkey had unfortunately suffered from some years

May 14, 1975

of instability on both counts. However, now that he had succeeded in pulling a government - the 7th in 4 years - together, under very difficult circumstances, he intended to achieve what he had wanted to do for Turkey since 1970.

12. On the economic front, the major issues which Mr. Demirel planned to tackle on a priority basis were the following: (a) fight against inflation and reduction in price levels with Turkey, at any cost; (b) removal of shortages which resulted in high prices and black-marketing, through increased industrial and agricultural production, which would also help to earn foreign exchange from exports; (c) accelerating the slowed-down pace of investments, including filling-up of a depleted public investment pipeline; (d) providing additional infrastructure needed to support increased production, particularly facilities for generating power whose short supply had led to reduced industrial production; (e) elimination of problems encountered last year in the sale/export of cotton, because of inappropriate price support policies; (f) achieving a balanced budget for the central government, which would reduce reliance on central bank borrowings and at the same time stimulate savings; and (g) policy that would allow Turkey to continue "to export its workers" to other countries while recession prevailed in Europe, so as to ensure an "adequate flowback of workers' remittances". He also recalled that during his discussion with Mr. McNamara in 1968, the latter had told him that Turkey's annual debt repayment capacity was only US\$50 million. Since then, with the help of friends - including the World Bank - Turkey's economy had achieved vitality, as a result of which it was able to service substantially large borrowings. Indeed, it now seemed that resources, not repayment capacity, was the problem. He therefore looked not merely to help from neighboring "petrodollars", but also from the Bank, to provide resources to contribute to Turkey's development projects.

13. Mr. McNamara responded by reasserting that Turkey was now one of the Bank's major borrowers, and he visualized the continuation of an expanded level of assistance to it. The Bank would like to continue to help not only with export-oriented and infrastructure projects - including projects like Karakaya - but also with those designed to correct regional imbalances and "make the poor more productive" through projects similar to the proposed rural development project in Corum and Cankiri. While showing Mr. Demirel a table illustrating commitments and disbursements in respect of on-going Bank projects, he pointed out that if the Government felt it needed resources, it already had over \$500 million of Bank monies already committed to Turkey. He stressed that up to December 1974, public sector projects had disbursed only 13 percent of the disbursements originally envisaged, while the private sector projects had succeeded in disbursing more than originally envisaged. A \$148 million loan for Elbistan, designed to overcome critical power shortages which Mr. Demirel was concerned about, was still not effective, although it was signed ten months ago. Substantial monies provided by other co-lenders for that project, were also unutilized. He therefore hoped Mr. Demirel would look into the matter to see how Elbistan could be made effective, as soon as possible. He allowed that political uncertainties within Turkey which Mr. Demirel mentioned, had probably led to a lack of coordination within various ministries and agencies, as well as to a reluctance to take critical decisions needed to implement projects effectively and on time. However, since a new government was now in office,

May 14, 1975

it would be most useful to consider if a central source in the Government, perhaps in the Prime Minister's office, could not be established to effectively coordinate the implementation of on-going Bank projects and the preparation of new ones.

14. Mr. Demirel responded that he was relieved to discover that when he thought that Turkey had a resource constraint, over \$500 million in committed Bank funds were available, besides the prospects of continuing Bank assistance at an annual level of over \$200 million. He assured Mr. McNamara that he would undertake a detailed review, in the very near future, of the present bottlenecks in the way of these projects and take remedial measures. Should he find that they were not moving because of bureaucratic problems or lack of decision-making, "dust would fly in Ankara".

15. Mr. Demirel reiterated his Government's desire to encourage rural development projects. At the same time, he felt that early elimination of power shortages was also most critical for Turkey; hence, his Government was determined to move ahead with Karakaya. He felt that by regulating the flow of the Euphrates through a power dam, which did not abstract water from the Euphrates, Turkey would be helping rather than harming Iraq and Syria. He recalled that when he was working as an engineer in Denver in the early fifties, it had taken the states of the USA over 20 years to agree to the sharing of the Colorado waters, and even now, there were disagreements between them. In view of the political relations between sovereign countries like Iraq and Syria, he could not therefore hope for an "agreement" for another 25 years. In the circumstances, and since Karakaya would not harm the interests of other riparians, he urged the Bank to assist with its financing. The Foreign Minister then handed an Aide-Memoire to Mr. McNamara, which purported to set forth Turkey's proposals for moving Karakaya forward.

16. Mr. McNamara stated that Messrs. Bart and Davar would be very glad to discuss the Aide-Memoire with the Turkish authorities during their stay. Meanwhile, he recognized that a solution might lie not merely on the basis of a technical dialogue, but of political initiatives which Turkey could take, as the upper riparian who had good relations with both Iraq and Syria. While further irrigation projects like Lower Firat which involved abstraction of waters by Turkey, would need a long-term water sharing arrangement between the three riparians, an interim agreement for regulating the river flows in Turkey for Keban and Karakaya and Taqba in Syria, or an indication of no objection to the Karakaya project by Iraq and Syria, should not be too difficult for Turkey to arrange. Such a solution, initiated by Turkey, would help the Bank in financing a portion of the cost of Karakaya. He ended with a plea, "to help us, so we can help you with this project". Mr. Demirel responded that while he could not anticipate any agreement with Iraq and Syria, he will do all he could to help.

Cleared with & cc: Mr. Bart

cc: Mr. McNamara's Office (2)
Mr. Knapp
Mr. Benjenk, Mr. Karaosmanoglu
Mr. Wapenhans

AJDavar:bb

310
Blanche
File in
Mems?
Comm. Book
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Turkey - 4/23/75 PAM Demirel Foreign Min.
France Min.

I Reparation rights

Foreign Office traditionally nationalist + awkward
Demirel has 2 reasons for being sympathetic:

- a. His general policy is to be friendly to Arabs (his coalition with the religious party) ^(consistent with)
- b. He is a hydraulic engineer & knows what we are talking about - it would be technically easy to reach agreement as shown by 12/74 consultant's report to BK

We want Turkey to:

- a. Have a short-term program securing adequate releases of water while dam is being filled
- b. A long-term program of studies of how to allocate water when both dams of the 3 countries exceed the capacity of the rivers.

Day & Syer have both agreed to the principle of the 3 parties, with BK assistance, why on the short & long-term part of Turkey wishes to proceed with the volume, go ahead.

We can't finance the Karakaya dam unless Turkey agrees to the short-term at least & with some figures as suggested in the consultant's report

Delaying TEK loan 7.5m (Feb) 75
not yet implemented
expected because agreement

II Most important subjects:

- A. Use our money better & faster - e.g. Elbestan Power approx 6/74 not yet
- B. Take actions to increase effectiveness of the main level prog:
 - imp of SEEs* ; economic restructuring; urbanization; reemployment;
 - Play off to coord. Proj & progs.

* State economic enterprises

Turkey

III Coalition Protocol states that special emphasis will be given to:
increasing incomes of the poor
reducing regional imbalance
developing the eastern and southeastern provinces
rural development

How will this be done

I when I met with PMS 7/18 I pointed out that Bk lending for previous 5 yrs ^(FY 64-68) had averaged only 140m lbs & I asked what he thought Bk's role in future should be.

We told Bk should expand its program to support Turkey's Devol Prog

We did so: lending in 5 yrs FY 67-73 average 100m + last yr (74) at 228.

My question now is: what role should Bk play in the future:

We face 3 problems:

1. Devol prog: has placed insufficient emphasis on social goals: increasing income of poor; reducing regional imbalance; rural level-
^(E & SE prov)
2. State Econ Enterprises remain highly inefficient (poorly paid* low quality staff; overstaffed; underpriced; poorly coordinated; excessive financial deficits) ^{Turkish Elec. Act 2nd 402} engine room because of low salary
3. Very weak project preparation & implementation - projects have faced long delays in moving to the Board but even more important has been the unsatisfactory record of implementation:
Of 760m of loans approved by an Bd in past 5 yrs only 190m has been disbursed: 590m is un-disbursed
Elbistan Power - approved by Bd in 6/74 not yet effective
In 71-74 disburse on public sector projects 132m vs 432m approved ^{+ 147m private}
Coordination of prep. & imple of Bk progs among gov't depts very poor - need to strengthen role of SDD or Treasury

III) Riparian Rights

Failure of Turkey to support either Bk tech. assistance to the parties, or alternatively for the parties to proceed with bi-l. negs is delaying resolution of dispute affecting Karakaya dam ^{in downstream river}. Iraq has objected to Karakaya dam until ques. of effect of filling its storage reservoir has been resolved - i. Bk cannot proceed. Turkey (Govt cabinet) asked Bk not to proceed with tech. assistance (studies etc) until bi-l. potential discussions + agree. had taken place.

Action reqd:

- a. Short-term Turkish Program: adequate release of water while Karakaya dam is being built.
- b. Long-term Turkish Program: studies of how to allocate the water when that proj. reqd. of the 3 countries + need the capacity of the reservoir.

Iraq + Syria have agreed in principle to the Bk working on the short + long range programs.

Turkey - 4/23/75. P.M. Demeril, Finance Minister, Foreign Minister.

I. Riparian rights

Foreign office traditionally nationalistic and awkward
Demeril has two reasons for being sympathetic:

- a. His general policy is to be friendly to Arabs (consistent with his coalition with the religious party);
- b. He is a hydraulic engineer and knows what we are talking about. It would be technically easy to reach agreement as shown by 12/74 consultant's report to Bank.

We want Turkey to:

- a. Have a short-term program assuring adequate releases of water while dam is being filled;
- b. A long-term program of studies of how to allocate water when total projects of the three countries exceed the capacity of the rivers. Iraq and Syria have both agreed to the principle of the three parties, with Bank assistance, working on the short and long-term approach. Or if Turkey wishes to proceed with the other two alone, go ahead.

We can't finance the Karskaya (sp?) dam unless Turkey agrees to the short-term at least and with some figures as suggested in the consultant's report.

II. Most important subjects:

- A. Use own money better and faster, e.g., Elbistan (sp?) Power approved 6/74 not yet - delaying TEK loan of \$50m for 6/75 inc. not yet implemented - is effective because agreed tariff (?).
- B. Take actions to increase effectiveness of the economic development program; management of SEE's (State economic enterprises); income distribution; urbanization; unemployment. Planning Office to coordinate projects and programs.

4/24/75

- ## III. Coalition Protocol states that special emphasis will be given to:
- increasing incomes of the poor
 - reducing regional imbalance
 - developing the eastern and southeastern provinces
 - rural development

How will this be done?

When I met with PM 7/68 I pointed out that Bank lending for previous five years (FY64-68) had averaged only \$12m p.a. and I asked what he thought Bank's role in future should be. He believed Bank should expand its program to support Turkey's Development Program. We did so: lending in 5 years FY69-73 average \$100m and last year ('74) amounted to \$228. My question now is: what role should Bank play in the future;

We face three problems:

1. Development progress has placed insufficient emphasis on social goals: increasing income of poor; reducing regional imbalance (eastern and southwestern provinces); rural development.
2. State Economic Enterprises remain highly inefficient (poorly paid low quality staff; overstuffed, underpriced, poorly coordinated; excessive financial deficits). Turkish Electric Authority had 402 engineer vacancies because of low salary.
3. Very weak project preparation and implementation - projects have faced long delays in moving to the Board but even more important has been the unsatisfactory record of implementation:
 - Of \$760m of loans approved by our Board in past 5 years only \$190m has been disbursed; \$590m is undisbursed.
 - Elbiston Power, approved by Board in 6/74 not yet effective.
 - In 71-74 disbursement rate on public sector projects 13% versus 43% _____ and 84% private sector financing.
 - Coordination of preparation and implementation of Bank projects among government departments very poor - need to strengthen role of SDO (?) or Treasury.

April 23, 1975

RMcN's own notes of meeting with Finance Minister and Foreign Minister filed in MemCon book in his office. No copies.

OFFICE MEMORANDUM

64-28 64
67-73 550
74-78 1170 -
74 228
75 258
76 248 -
77 258

TO: Mr. Robert S. McNamara

FROM: Martijn J.W.M. Paijmans *P*

SUBJECT: TURKEY: Agriculture Minister Ozal's Visit

DATE: June 11, 1976

1. Mr. Korkut Ozal, Turkey's Agriculture Minister, will be meeting you on June 15 at 6.30 p.m. Messrs. Bart and Davar will accompany him.

2. The Minister's biodata is provided in Annex I. Besides being close to Mr. Erbakan, the leader of his National Salvation Party (NSP), he was principally responsible for bringing about the present Demirel-Erbakan coalition. He is a technocrat, quite knowledgeable about Turkish problems in general and agriculture in particular. He is well-disposed towards the Bank. We understand that he helped behind the scenes, to persuade Mr. Erbakan to agree to the adjustments in power tariffs. This enabled the Government to issue the relevant decree in late May, following which the Bank declared the Elbistan loan effective on June 1. Mr. Bart also reports from the field that the Minister, although his Ministry is not directly involved, has been helpful in easing the Government towards an approach which should enable the Bank to move forward with the Karakaya project.

Background Material

3. As background for your meeting, Annex II summarizes the recent economic developments, as well as the rather difficult domestic political situation which is precluding the Government from taking essential actions on many fronts.

4. It might also be worth noting that from about \$1.2 billion lent to Turkey since 1971 through 27 projects (excepting those not yet signed nor approved), nearly \$300 million, or 25 percent, has been provided for 8 agricultural projects. In FY76, we lent \$84.5 million for the Livestock (Dairy) III and Agricultural Credit projects. Although the FY77 program does not include any agriculture project, that from FY78 onwards does. Our future plans envisage continuing in the fields of rural and livestock development and agricultural credit, besides formulating projects of the type not done previously in Turkey - such as grain storage, pest control and seed production - which would also help increase incomes or production, or earn/save foreign exchange. We propose to leave irrigation development in the immediate years ahead to other external donors, since we have done quite a few such projects, and also to avoid potential conflict with Turkey on the currently intractable question of adequate water charge recovery. We also plan on sending an agricultural sector mission this autumn, to which the Agriculture and Finance Ministries have agreed.

Topics for Discussion

5. Future Agricultural Projects: The main purpose of the Minister's visit is apparently to solicit interest in future agricultural projects based on his Ministry's view of investment that Turkey should make in the sector in the next 5 years, and to exchange views on his ideas for the sector's development. Discussions on such investments have still to take place between the Ministry and other relevant authorities like Finance and the State Planning Organization. Besides, we will already have had discussions with the Minister regarding future agriculture projects, on June 14. In the circumstances, should the Minister raise this topic with you, we would suggest that you indicate that the Bank would very much hope to continue lending in that sector for projects which meet the aforementioned criteria.

6. General Relationship with Turkey: The Minister may also bring up the general subject of Turkey-Bank relationship. In any case, it might be quite useful to use the occasion to discuss this matter, since he might be helpful in conveying the Bank's viewpoint at the highest levels in Ankara, and particularly to Erbakan who has been stalemating crucial policy decisions on most matters in Turkey. You might assure the Minister that the Bank wishes to continue helping Turkey with an annual lending program of about \$240 million, that our key objective is to help Turkey to establish or reinforce sound institutional developments or modern technical/financial practices through such projects, and you believe that with his help and understanding and that of his Cabinet colleagues, the few remaining problems in the way of ongoing Bank projects will be expeditiously resolved. You might make a point of expressing pleasure that the Government took steps which put the Bank in a position to declare the Elbistan loan effective on June 1, and your hope that this important project can now move full steam ahead. You should however be aware that there is an erroneous, although strong, feeling in Turkey that the present implementation difficulties on Bank projects, might be a reflection of Turkey's tension with the USA. Also, it is the basic plank of the philosophy of NSP, to which the Minister belongs, that Turkey should not let anyone "interfere" with any of her problems, much less tell her what to do. In this context, it might be worthwhile to request the Minister to help assuage Mr. Erbakan's concerns, if any, on these aspects and indicate that Senior Bank staff would be glad to call on and discuss with Mr. Erbakan on their future visits. You might clarify that the Bank's basic concerns on project implementation are: (a) early and timely absorption of the financing provided, to help relieve Turkey's rather tight balance of payments situation; and (b) efficient follow-up on agreed institutional and financial aspects of ongoing and future projects. Both are in Turkey's interest, and the Bank has no other objective in seeking a better project performance.

7. Quarterly Project Reviews: You might make a point that after your discussions with Mr. Demirel last year and the arrangements he made thereafter for these reviews, project performance has improved and the pace of commitments and disbursements also increased; but there is still significant room for improvements. For instance, of the \$825.3 million committed until March 31, 1975 for ongoing projects, only \$285.2 or 64 percent of what was expected to be disbursed by mid-May, has been actually disbursed. In Turkey's interest, we would like to see the pace of disbursements increasing rapidly, which would also reflect considerable acceleration of and improvements in project implementation.

Attachments

cc: Mr. J. Burke Knapp
Mr. W.A. Wapenhans (o/r)
Mr. M.P. Bart (o/r)
Mr. D. Knox

AJDavar:bb

20

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: September 12, 1975

FROM: ~~Adi J. Davar~~, Chief, Division 2A, EMENA CPD IISUBJECT: TURKEY: Mr. McNamara's Meeting with Turkish Delegation to Annual Meetings

1. Mr. McNamara, along with Messrs. Benjenk, Wapenhans, Bart and Davar met on September 5 with the Turkish Delegation, which included Finance Minister Ergenekon, Energy Minister Kilic and the Turkish Ambassador Esenbel. As it turned out, it was essentially a courtesy call.
2. Mr. McNamara expressed satisfaction that an acceptable compromise had now been worked out, which would enable Bank to proceed with the Elbistan project. The Energy Minister indicated that Prime Minister Demirel had charged him and the Finance Minister "to unblock" both Elbistan and Karakaya, and they appreciated the Bank's understanding in agreeing to their Government's proposals to advance matters on both. After adding that his Government would supply the requested technical data to enable the Bank to determine whether or not Karakaya adversely affected the interests of the two lower riparians, he hoped that Mr. McNamara would arrange to send a mission within eight to ten days to appraise the project. Mr. McNamara while appreciating the urgency of Turkey's request, doubted whether manpower planning and constraints would permit such a mission to be sent so soon. He however assured the Ministers, and requested the Region to ensure, that within a week, a communication was sent to Turkey indicating when such a mission could be sent, and how the project could be meanwhile further advanced.
3. Turning to the future, Mr. McNamara reiterated that he was convinced that Turkey needed, and he was willing to support, Bank assistance of about \$200 million a year for the country's economic development. As the Turkish authorities were aware, at the time of presenting each new project, the Board had to be informed about the progress made in implementing ongoing projects and on disbursements. A stage had been reached where the low level of disbursements and progress on implementation was such that the Board could raise serious questions. Low disbursement must also be a matter of great concern to the Finance Minister. In light of this, he had urged Prime Minister Demirel in April, to establish a focal point in Turkey for coordinating the implementation of Bank projects and periodically reviewing them. While he was aware that the first such review had taken place, he hoped that key persons in the Turkish Delegation were staying after the Annual Meetings, to hold the second review.
4. The Finance Minister indicated that the focal coordinating point, recently established by the Prime Minister, was a small ministerial committee which included the Ministers of Finance, Energy and Public Works. Any major or policy problems would be brought to their attention, and resolved. The Secretariat for this committee would be provided by the Finance Ministry; the unit in that Ministry dealing with Bank projects, was being expanded and strengthened to cope effectively with this responsibility

as well as with the day-to-day task of coordination. He hoped that Mr. McNamara would be satisfied with the progress that would be made from now on, on Bank projects. He also undertook to leave a part of his delegation to hold the second project review. The meeting ended, with mutual assurances of goodwill and continuing cooperation.

Cleared with and cc: Mr. Bart

cc: Mr. McNamara's office
Messrs. Knapp, Benjenk, Wapenhans, Pollan/Haynes/Fish, Palmer/Marto,
Finzi

AJDavar:af

Recent Political and Economic Developments

1. The four party coalition formed by Mr. Demirel in April 1975, continues. However, the minority coalition partners, in particular the National Salvation party (NSP) led by Mr. Erbakan, have considerably hardened their positions on many policy questions. This partly reflects basic differences within the coalition on the approach to both domestic and external issues, and perhaps more importantly, the increase in NSP's bargaining power. The Senate elections in November 1975 saw a significant gain for Mr. Demirel's Justice Party (JP), but this was offset by gains by Mr. Ecevit's Republican Party (RPP). The Government's parliamentary majority therefore remains very slender, and if Mr. Demirel is to remain in power till the next regular elections (which must be held in late 1977), the continued support of NSP is critical. Mr. Erbakan has used this leverage, as well as his strategic position as chairman of the Inter-Ministerial Economic Committee (which must approve all economic/financial proposals before being placed before the Cabinet), to stalemate measures which are urgently needed for the country's benefit, but which are unacceptable to NSP; he has also been able to force Mr. Demirel to replace heads of several agencies (including key SEEs) with persons of his choice, and to rule in favor of NSP ministers on major matters (e.g. the establishment of financially independent municipalities) on which the latter differed from JP ministers. The power tariff decree that was passed in late May, generated serious division between NSP and JP, and was probably passed only because of the possible eventuality that Turkey might lose the Bank and co-financiers' loans at a time when it was in a rather difficult balance of payments situation. Government officials realize the need for several crucial economic/fiscal policy decisions, but the prospect of winning NSP support before the elections, remains dim. At the same time, there is a growing polarization of views within all parties generally and this trend is manifested in a degree of violence quite without precedent in the last decade.

2. Despite difficult political circumstances, economic performance is impressive in some respects. First, Turkey achieved a real growth rate of over 8 percent in the last 2 years, when most countries have been in the grip of severe recession. Second, there are welcome signs of a slowing down in inflation: both wholesale prices and GDP deflator were substantially less in 1975 than in 1974. Third, the consolidated budget position has shown a remarkable improvement, partly because of buoyant revenues and partly on account of Government's ability to keep expenditures well below appropriations.

3. However significant weaknesses remain. The improvement in the budgetary position has been more than offset by financial performance of the SEEs, who made a net loss of TL 2.9 billion in 1975 compared to a net profit of TL 0.8 billion in 1974. With continued expansion of public investment (partly due to inventory accumulation), the SEEs and hence the

public sector as a whole, took recourse in 1975 to Central Bank borrowing on a much larger scale than in the previous year. Deterioration in the balance of payments has been particularly marked; the cumulative impact of international inflation (including oil prices), speculative imports and the additional defence requirements, taken together with the slow down of exports and workers' remittances, (both a direct consequence of the European recession), resulted in a current account deficit of \$1865 million in 1975, compared to \$719 million in 1974 and a surplus of \$485 million in 1973. Reserves have been depleted to \$1 billion, and maintained at this level only by recourse to short-term borrowings in the form of convertible lira deposits.

4. 1976 promises to be another good year in terms of growth, but the budget and balance of payments prospects are likely to be difficult. The approved consolidated budget is rather optimistic on likely revenues; the SEEs are expected, in the absence of price adjustments, to show a net loss of TL 8 billion; and yet the budget projects a 40 percent rise in expenditures (including SEE investments). The IMF mission and ours, have drawn attention to the difficulty of sustaining these without recourse to excessive Central Bank borrowing. The Government has informed the Fund, as part of the agreement on the Oil Facility, that it intends to keep expenditure growth well below projected levels, so that increase in Central Bank credit can be contained to TL 14 billion.

5. However, on the basis of the first 3 months record, favorable spring rainfall which points to another good crop, and the apparently comfortable inventory situation, the Government's expectation of a \$2.1 billion exports and \$5 billion imports in 1976 seem realistic. If workers' remittances reach expected levels (which is in some doubt), there will be a current account deficit of about \$1.5 billion, of which only \$0.7 billion is likely to be available from officials and private external sources. The Government at least hopes to bridge the rather sizeable external resource gap of \$800 million, through a scheme to tap savings of Turkish migrant workers in Germany, and possibly by further borrowings from commercial banks.

June 11, 1976

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
THRU: Mr. J. Burke Knapp
FROM: W.A. Wapenhans

DATE: May 21, 1976

SUBJECT: TURKEY: Visit of Agriculture Minister

1. Mr. Korkut Ozal, Minister of Agriculture, proposes to visit Washington DC for discussions with the Bank and the US Government, on June 14 and 15, 1976. He has specifically requested a meeting with you during his visit.

2. Mr. Ozal is a member of the National Salvation Party (which is in coalition with Mr. Demirel's Justice Party), and is very close to its leader Mr. Erbakan, besides being quite well-disposed towards the Bank. He was a member of Mr. Ecevit's coalition government, and following last year's elections, Mr. Ozal was apparently instrumental in persuading Messrs. Demirel and Erbakan into forming the present coalition.

3. In view of this background, and the internal political difficulties caused by Mr. Erbakan's approach of holding his coalition partners to ransom by stalemating critical decisions on several economic and political matters, including the question of Elbistan tariffs, it would be most helpful for the Bank to have an influential ally in Mr. Ozal, and conveying the Bank's role in Turkey's development through him to Mr. Erbakan. I would very much recommend that you accede to the Minister's request and meet him during his visit, at a time convenient to you.

cc: Messrs. Bart
Knox
Davar
Burmester

AJDavar:bb

5/24
5/27
I will see him
at 6:30 PM Tuesday 6/15
L. Brown

5/27 Informed Mr. Wapenhans' office - brief + attached.
S.

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: July 7, 1976

FROM: ^{DD for} Adi J. Davar, Division Chief, EM2DASUBJECT: TURKEY: Mr. McNamara's meeting with Agriculture Minister Ozal

1. Mr. McNamara met Turkey's Minister of Agriculture on June 15. Ambassador Essenbel, the Economic Counsellor Dr. Sadiklar, Acting Undersecretary for Agriculture Mr. Rumeli, Mr. Bart and I also attended.
2. The Minister briefly outlined the key policy outlook pertaining to agriculture that his Government had, and which he was trying to introduce in Turkey. This included measures to stimulate agricultural productivity, encourage exports, improve the incomes of small farmers and "debottle" problems in the way of ongoing investment projects in the sector where financed by the Bank, other aid donors or the Government itself. Minister Ozal elaborated that from the point of view of providing incentives for productivity and export, unlike the past policy of supporting the urban consumer at the expense of the farmers, flour prices had been fixed closely to the international prices of these commodities. Those prices were supplemented wherever necessary by provision of inputs, including interest-free short-term 3 or 4 month loans particularly to the small farmers in the depressed regions for meat production, until such time as these farmers began to contribute and could be weaned away from such Government supports. He also stressed as his Government's policy the institution in selected regions of integrated rural development, the increase in the efficiency of the Government machinery dealing with the sector through its reorganization and provision of better knowhow through training abroad. The Minister stressed that taking these factors into account his Government, and he personally, were very much looking forward to continued Bank support in the field of agricultural development. However, he regarded the Bank's financing role as only one of the reasons why Turkey wished to have such help. He believed that the Bank's international experience in dealing with the technical and institutional problems of agriculture was one of the key elements which Turkey hoped to tap for its own benefit through future agricultural projects. In these circumstances, technical advice in putting the projects together, its advice on appropriate institutional arrangements and Bank's assistance in financing training abroad would be most welcome for Turkish agricultural projects. He briefly outlined the proposed integrated rural development project in the northeast, the feasibility study of which he had provided earlier in the week to the Bank staff, and urged Mr. McNamara's strong support for such a proposal and for its early processing. He indicated that since irrigation projects were essentially long-gestative and many irrigation projects had already been done in the past in the country, he would like to look to the Bank for projects which yielded returns in a shorter period of time and also contributed to either earning or saving foreign exchange or increased productivity through projects such as seed production, grain storage, pest control, manufacture of tractors and agriculture equipment and the like. He also indicated that he would also like to develop agricultural projects which would aim at supplying neighboring

July 7, 1976

Middle Eastern markets or several European markets and in which co-financing either by foreign partners or by bilateral donors would be most welcome. Indeed, he hoped that in case of foreign partners projects could be put forward with a basic financing model in which 30 percent of the total investment could be made by foreign parties with perhaps 25-30 percent from the Government and the rest from the Turkish private sector. He hoped that even if the Bank might not ultimately finance such projects, it would help Turkey put such projects together or act as a catalyst to obtain such financing. He ended by again reaffirming that he was keen to remove the bottlenecks either on ongoing Bank projects or in the way of agricultural development in the country and he would do his best to continue this pattern of dynamism in the coming years.

3. Mr. McNamara responded that from the Minister's presentation he could appreciate that the much needed dynamic force was being marshalled in the support of agriculture and that many of the policies which the Minister had outlined would be conducive towards increased productivity and export potential of this sector in Turkey. He appreciated the Minister's role in "debottling" problems not only in the way of the Bank's agricultural projects, but also of the support he had provided in resolving the problem of Elbistan tariffs. He very much welcomed the idea of another integrated rural development project and stated that the Bank would be quite prepared to finance it if it could be shaped into a viable project. He also shared the Minister's view that the benefits which the Bank could give to Turkey were not merely financial, but also on the technical and institutional aspects gleaned from the Bank's international experience. Training was also one of the things which he would wholeheartedly support as well as some of the other projects which the Minister had mentioned. He added that although the projects to be done in FY77 did not include the proposed rural development project, Mr. Bart would see what could be done to expedite that project as early as possible. He then took the opportunity to inform the Minister about the Bank's concerns on the implementation of the Turkish program. He asserted that the Bank considered Turkey to be one of its major and important borrowers to whom the Bank would like to assist with a substantial lending program. He further pointed out that to get the approval of the Executive Directors for such a program, he had to explain to them why nearly \$900 million that had been committed to Turkey up to FY76 was not being used as fast as anticipated. While considerable progress had been achieved through the institution of the Quarterly Project Reviews, arranged following his discussions with Prime Minister Demirel last year, and the pace of commitments and disbursements had also accelerated, they were still short of the targets which had been anticipated at the time the projects had been finalized.

4. The Minister replied that he appreciated Mr. McNamara's statement of the problem and he would look into the matter. He however pointed out that some of the things which had been agreed upon in the existing loan arrangements were not the best way of approaching these issues or had been significantly overtaken by changed circumstances. Mr. McNamara stated that it was quite possible that this may have resulted because of misappreciation of the problems on the Bank's part; however he urged the Minister to bring forward such cases where a change may be necessary as soon as possible, to

July 7, 1976

discuss them with the Bank in the anticipation that if the Turkish concern turned out to be correct, he himself was prepared to agree to such changes, and that if the changes did not turn out to be necessary after such discussions, the Government would undertake to implement them. Minister Ozal responded that he would do so and solicited further constructive criticism from Mr. McNamara. Mr. McNamara responded that the point had been sufficiently made and he did not wish the Minister to have an exaggerated picture of what the Turkish problems may be, but merely to convey a flavor of his concern and to solicit his assistance as well as that of his Cabinet colleagues in resolving problems so that the Bank could continue to lend to Turkey through priority projects in the magnitude that he wished to do.

5. The meeting throughout was most cordial and ended on the note of the Minister inviting Mr. McNamara to visit Turkey soon and Mr. McNamara responding that he would like to do so and this time to stay longer in the country and to particularly see the depressed areas in the northeast where the Minister wished to have his next integrated rural development project.

Cleared with and cc: Mr. Bart

cc: Mr. McNamara's Office (2 copies)
Mr. J. Burke Knapp
Mr. Wapenhans (o/r)
Mr. Knox
Mr. Palmer
Mr. Haynes
Mr. Park

AJDavar:af

BIO-DATA

Name: Korkut Ozal - Born Malatya, eastern Turkey, 1929.

Marital Status: Married - Five children.

Career: Graduated from Istanbul Technical University as a civil engineer in 1951, joined the State Irrigation Department and later received an MA from the United States. Taught at the Middle East Technical University becoming Associate Professor in 1965. Later served as Director General of the Turkish Petroleum Co. (where he negotiated IGSAS loan with Bank), and as adviser to the Minister of Energy and National Resources before joining the private sector in 1972. Elected to Parliament in 1973. Held the post of Minister of Agriculture in the coalition Government under Prime Minister Ecevit from 1973, and in the same position under the coalition Government of Mr. Demirel from March 1975. He is a member of the National Salvation Party.

June 11, 1976

21

OFFICE MEMORANDUM

TO: Memorandum for the Record

FROM: ~~Adi J. Davar~~, Division Chief, EM2DA

SUBJECT: TURKEY: Mr. McNamara's Meeting with Finance Minister

DATE: May 3, 1977

1. Mr. McNamara met the Turkish delegation headed by Finance Minister Ergenekon and accompanied by Mr. de Groote, on April 26. Messrs. Knapp, Benjenk, Bart, Knox and I also attended.
2. After Mr. McNamara warmly reciprocated Prime Minister Demirel's felicitations conveyed by the Finance Minister, the latter indicated that he wanted to talk about economic policy matters, as well as touch broadly on the technical points pertaining to the power sector which he had discussed in considerable depth with Messrs. Knox and Bart on April 26. The Minister stressed that since Turkey was an active democracy, it was sometimes more difficult than in more regimented political systems, to take desirable but difficult actions which did not have public will or support. Nevertheless, within this constraint, his Government was determined that after elections on June 5, it would do its utmost to overcome the substantive economic problems facing Turkey. The major problem, according to the Minister, was the serious balance of payments situation, on the resolution of which the Government was currently focussing. Referring to his discussions with Mr. Bart in Ankara, he emphasized that actions on this and other economic issues to be taken after the elections, could not be implemented all at once, but gradually step by step. He hoped for Mr. McNamara's understanding on this approach. The Minister added that in December 1976, the colenders had highlighted the major difficulties hindering the implementation of the Elbistan project, but that at the ongoing colenders meeting on that project, they all agreed that Turkey had successfully solved these difficulties. Mr. McNamara should thus rest assured that just as Turkey had solved the Elbistan problems, it would and could also gradually remove grave problems facing the economy or those standing in the way of other projects.
3. Turning to his above-mentioned April 26 meeting with Messrs. Knox and Bart, the Minister stated that his Government would similarly resolve the problems affecting the power sector and especially the effectiveness of the TEK II project (the Minister appeared to constantly speak of Elbistan and TEK II, in the same breath). He stressed that under the power given to him by the 1977 budget law, he had already consolidated TEK's receivables in the first quarter of 1977. He was similarly prepared to clean up the problem of TEK's receivables upto 1976, by consolidating dues and receivables and providing the difference to TEK over a 20-year period, on lines of a consolidation legislation passed in 1975. As a result of these steps, TEK would receive TL 135 million in 1977, and he considered his proposal as having effectively solved the serious cash shortage problem of TEK. As regards the rate of return problem, once Government and the Bank agreed on what should be

May 3, 1977

TEK's asset base for the purpose of the return calculations (which he hoped could be completed by September this year), his Government would increase tariffs by January 1, 1978, to enable TEK to earn an 8 percent return on that agreed revised base. Turkey was prepared to give a commitment on this, and agree that Keban assets could be included in the asset base, to the extent it generated power in proportion to its rated capacity. The Minister also expressed his readiness to reinstate the fuel adjustment clause, and apply it when necessary. He felt that with these new undertakings, Turkey had effectively solved the major financial issues of Elbistan and TEK II projects, and asked Mr. McNamara whether he would agree to declaring TEK II effective and negotiating Karakaya.

4. Mr. McNamara assured the Minister that the Bank was always ready to continue its support to Turkey, and the high level of Bank lending in recent years, evidenced its goodwill. However, candidly, he could give no promise that the Bank would declare TEK effective and negotiate the Karakaya project in the immediate future. In fact, the Bank could continue a high level of lending to Turkey only if two conditions are met: (i) Turkey takes steps to make "structural changes" in its economy not on the basis of "unsuitable" economic actions, but "correct ones" which the Minister had stressed that the Government would take after the elections. He stressed that such actions should include correction of the current account deficits in the balance of payments, increased public savings and a balanced allocation of resources to priority projects so as to ensure high growth on a sound basis. He added that he was anxious to be clearly understood that initiation of such structural economic changes, was an essential prerequisite for continued high lending to Turkey; (ii) improvements were made in project implementation, especially those in the power sector. He appreciated that since the Joint Project Reviews were initiated, there has been a marked improvement in this direction. He however added that the Bank would find it difficult to negotiate new projects or continue with a higher level of lending, unless project implementation improved further.

5. In this background, Mr. McNamara stated that he could not give the Minister an indication, as he had been requested to do, that Karakaya could be negotiated, at least not until the present power project problems were resolved. He understood that in respect of TEK II, complicated problems needed resolution and that the Minister's proposals aimed at unknotting some of these complications. However, some actions on these complicated issues should be taken, before TEK II could be declared effective and further lending to the power sector through Karakaya would take place.

6. He then inquired as to how long the Minister would be in Washington. On being told he would be here until April 28, Mr. McNamara indicated that he would review the Minister's proposals in respect of making TEK II effective with the Region, and thereafter revert to the Minister.

May 3, 1977

7. The Minister than began recapitulating the economic measures which his Government intended to take after the elections, as he had informed Mr. Bart in Ankara last month. Mr. McNamara however, interjected that if the Government was willing, he was prepared to mount, as soon as possible after the elections, an economic mission as well as one to discuss improved project implementation, so that policy aspects on both matters could be discussed with the new government before that government shaped its program of actions. In this way, the government could be helped in quickly fulfilling the two preconditions he had mentioned earlier during the meeting, so that the Bank could continue to support Turkish development. The Minister concurred.

Cleared with & cc: Mr. Benjenk

cc: Mr. McNamara's Office (2)
Mr. Knapp
Mr. Knox

MPBart/AJDavar:bb

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

FROM: J. Burke Knapp *JBK*

SUBJECT: TURKEY

DATE: April 25, 1977

Re paragraph 8 of the attached brief for your meeting with the Turkish Minister of Finance tomorrow, I must say that the Region seems not to hear, or to want to hear, the views expressed by the Loan Committee regarding our lending to the Power Sector in Turkey. I have again reiterated this position to Messrs. Knox and Bart this morning.

The Loan Committee has held two long sessions on this matter in recent weeks. (Part of the problem may be that Mr. Benjenk was away at that time.) We felt that the "package" of conditions proposed by the Region for declaring the TEK II loan effective and for inviting negotiations on the Karakaya project was unsatisfactory. They would have us rely upon various promises for future action made by a government which has failed to fulfill earlier promises and which is on the eve of a major election. The election on June 5 may give the present Government a mandate which will permit it to come out of its recent state of "quasi-paralysis", (see paragraph 10 of the Regional memorandum), or it may cast up a new Government with ideas (for better or worse) that are its own. Or we may be back in the position of a weak and incapable coalition.

In any case, this seems a poor moment to try to engage in definitive negotiations on the tough problems of the Power Sector.* I think we should wait and try to get a better deal with the new Government or at least have a basis for assessing how reliable the Government's promises may be. In the meanwhile the TEK II project proceeds, financed by Turkey out of its own resources, and I have authorized the Region to engage in "technical discussions" to clear away any problems on the Karakaya project which do not touch upon the central issues of the organization, staffing and financing of the Power Sector.

Attachment

* Let alone make a new \$100 million commitment to a country that needs major economic reforms to maintain its creditworthiness.

JBKnapp:isk

JOINT BANK - FUND LIBRARY



Can't do much before structural readjustment and implementation of project conditions. Want to help but 2 problems stand in the way:

I. Need for restructuring the Turkish economy - domestic resource mobilization, resource allocation, BoP improvement.

II. Failure to meet covenants (?) of past loans (increase in r/r tariffs; power rates, etc.).

OFFICE MEMORANDUM

*Can't do much before structural
readjust & implementation
of project commitments*
*Want to help but
problems standing in way*

TO: Mr. Robert S. McNamara
(Through Mr. J. Burke Knapp)
FROM: Munir P. Benjenk, RVP, EMENA

DATE: April 22, 1977

*I need for restructuring
the Turkish econ*
*Don res. made
Res. also
BSP improve*

mp

SUBJECT: TURKEY - Your Meeting with Finance Minister Ergenekon on April 26

1. Mr. de Groote has arranged for Finance Minister Ergenekon (bio data attached) to meet you at 5.30 pm on April 26. I shall be away on that day but Messrs. Knox, Bart and Davar will join the meeting.

*II Failed to meet coverants
of part loan line
new rates tariffs, power
notes, etc*

Purpose of Visit

2. The Minister is visiting Washington to participate in the Group of Twenty Meetings. He is also likely to explore IMF's willingness to consider a standby arrangement (based on which Turkey believes it will be easier for it to tap foreign commercial bank borrowing), in support of the program the present Government seems to be preparing for introduction after the elections, if it comes back to power. IMF would be amenable to such arrangement, but for a small amount and with very stiff conditions. They do not see much possibility for assistance to Turkey under Mr. Witteveen's borrowing scheme (from OPEC, the US and Germany), before the Summer of 1978. Mr. Ergenekon will be meeting with Mr. Witteveen on Tuesday, April 26 at 9.30 am.

3. In his meeting with you, Mr. Ergenekon will probably want to reassert the Justice Party's intention to push ahead with a package of economic reforms - the lack of which Mr. Bart's mission in March flagged as the major constraint standing in the way of Bank lending. However, no reforms are possible before the June 5 elections, the outcome of which is open to speculation. The Minister may therefore focus on more immediate objectives, namely the resolution of problems with the Bank on the power subsector (including initiation of Karakaya negotiations), and plead once more, for the Bank's understanding of the Government's difficult situation.

Turkey-Bank Relations

4. Relations with Turkey, since your visit in April 1975, have been characterized by frank and substantive dialogue at all levels, including with senior ministers. Unfortunately, owing to differences within the coalition Government and to its tenuous margin in Parliament, there has been little progress on key economic and social policies. While growth continues unabated at 8 percent pa, unemployment and inflation remain potentially serious problems, and there was a substantial deterioration in the balance of payments. As regards the Bank's portfolio, the periodic Problem Project Reviews initiated in 1975, have helped improve project implementation to the extent where decisions could be taken at Turkish administrative levels. Major bottlenecks, where painful political decisions are essential, such as increases in railway or power tariffs, irrigation cost recovery and Government's inability to upgrade the staffing and efficiency

of SEEs, however remain unresolved. The Bank has therefore already told the Government that we could not consider new projects for irrigation (lack of cost recovery) and railways (because of little attention paid to economic justification of new lines, insufficient tariffs and inadequate management). As you also know, we are on the point of cancelling about \$8 million for a cattle fattening component under the TCZB loan, because of the issue of interest rate for such farmers. This action, of the type never before taken in Turkey and our continued urging to resolve the above bottlenecks, has, in recent weeks, made key ministers feel very crowded. A delay in negotiating the Karakaya loan, on which the Government has rested much prestige and on which it took difficult actions on riparian matters vis-a-vis Iraq and Syria on the Bank's urging and expectation of early Bank financing, would add considerable strain on a relationship which has taken considerable mutual efforts to improve in the last two years. The situation is aggravated by the fact that Turkey will possibly face a critical balance of payments squeeze in the summer and is unable to take corrective actions immediately. Meanwhile it needs whatever IMF and Bank support it can muster vis-a-vis commercial banks.

5. The coincidence of impending elections, of disagreements within the coalition partners (relating among others to Mr. Erbakan's initiative in inviting our March mission), of the possible balance of payments squeeze, of long-standing issues with the Bank coming to a head on power projects, and of IMF's wait-and-see attitude, puts the present Government in a rather difficult situation. Since we should not rule out the possibility that Demirel's Justice Party (to which the Minister belongs) might return to power after June 5, it would be advantageous to try and relieve the present strain in our relations to the maximum extent possible, specify the points on which the Bank could move provided the Minister removes the constraints, and outline the assistance Turkey could expect from the Bank in coming years, after major bottlenecks are removed. The specific points which you may want to mention are outlined below.

Points for Discussion

6. Economic and Social Policies. The present Government has lived over the past two years on the healthy reserves and fiscal situation it inherited. Except for a 27 percent successive devaluation of the Turkish lira between April 1975 and February 1977, the Government has not introduced other major and long overdue economic reforms advocated by the Bank and the IMF, admittedly for lack of sufficient support in Parliament and in public opinion. While some of the problems it is facing are not of its own making (e.g. impact of world inflation and recession in the EEC) they are reaching such proportions, that it would be impossible for any Government to delay action after the elections without undermining the confidence of external lenders. Our March mission has already gone on record with Messrs. Erbakan and Ergenekon, that action on the crucial problems of public savings, balance of payments and social equity was essential, for continued Bank assistance. You should reiterate to the Minister your concern on these three key points (which were already at the fore in your correspondence with Prime Minister Ecevit in July 1974 and in your discussions with Prime Minister Demirel in April 1975). You might add that if the essential economic and fiscal policy actions are taken by the Government after the elections, the Bank would thereafter be prepared to gradually increase the level of its lending to Turkey. You might stress the need for the continuation of the high-level dialogue on economic and related matters with the Bank, and the need for an economic mission's visit soon after the elections.

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7. Power Sector Problems. This is one issue the Minister will specifically raise. While the effectiveness conditions of the ongoing TEK II loan (\$56 million) have been met, the Government and we have so far agreed to delay effectiveness, since the Borrower and Guarantor would immediately be in default of key financial covenants. Since the Minister met you in September 1975, tariffs were raised about 30 percent. These increases have not been timely, not sufficient enough, to enable TEK to earn the agreed 6 percent and 8 percent returns in 1976 and 1977. Besides this: TEK is facing a serious cash shortage, because major municipalities are not paying TEK for their bulk power purchases. In this background, the Minister is likely to seek a dispensation for the lower 1976 and 1977 returns (4 and 5 percent) on the strength of specific undertaking to introduce remedial actions (which he may outline in the meeting we are having with him on Monday) after the elections, and on that basis request you to consider declaring TEK II effective and initiating Karakaya negotiations.] No

8. The Loan Committee has recently reviewed this matter, and we have since submitted a comprehensive package requiring that the Government cures the main defaults and commits itself to correcting the remainder before we declare TEK II effective and present Karakaya to the Board (it has had to be slipped to FY78). Although the Loan Committee has not yet ruled on these proposals, I believe we can expect action from this Government and its successor, only if we initiate simultaneous negotiations on the tariff/related issues and Karakaya.

9. The Minister may also raise the issue of the Elbistan project which was the subject of Prime Minister Demirel's letter of April 13 to you (attached). We shall have meetings starting next Monday, with a Turkish delegation and representatives of the co-lenders (European Investment Bank and KfW) to discuss this project. All co-lenders have been seriously concerned on broad issues, not details, of inefficient project management and ineffective coordination amongst government agencies, as a result of which the project has been delayed by one and a half years. Furthermore, possible faulty construction and mining procedures, could lead to loss of giantboilers and earth moving equipment, and to the stoppage of power generation from the plant. The co-lenders had previously met with the Government and solutions to these broad problems, have been agreed upon. You might hope, that with the Minister's help, the present co-lenders meeting will be able to find satisfactory solutions for the remaining problems, and that the Government will implement them.

10. Prospects. Turkey is achieving high growth now, based on economic policies that spell trouble for the future. Bank projects are being affected on key policy bottlenecks. Both stem from lack of courageous economic policy decisions in recent years. The Government cannot do much before the elections. While you should show understanding of the political circumstances which has resulted in quasi-paralysis, you should impress on the Minister that the Bank will not be able to maintain lending at the substantial level of recent years, let alone double it as requested by Mr. Erbakan, unless basic policy reforms are introduced. These reforms are widely accepted in principle. What has been absent, is the political courage to risk the Government's

Mr. Robert S. McNamara

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support in Parliament and its popularity. Any Government formed after the elections, would have to launch a stabilization program similar to the 1970 one which gave the country several years of prosperity. You should indicate that if such a program was implemented, and actions taken to cure the problems affecting our portfolio, Turkey could expect from the Bank the increased assistance, which its population (43 million) and medium-level income (\$860 GNP per capita in 1975) warrant.

Attachments

cc Messrs. Knox, Pollan, Davar, Chopra, Fish
MPBart/AJDavar:rpo

PRIME MINISTER

Ankara, April 13th, 1977

Dear Mr. Mc.Namara,

I appreciate your Excellency's deep interest and efforts to continue the friendly relations based on mutual understanding between the World Bank and the Turkish Government.

The World Bank has had a significant role in the financing of development projects of my country. It is evident that the credit relations between Turkey and the Bank has reached high levels. These contributions have played an important role in the realization of an almost 8 percent growth rate for Turkey in the recent years. It is imperative for Turkey to attain growth and therefore she should not slow down her investment efforts. The solution for Turkey's welfare and unemployment problems are closely related to the continuation of the investment level.

I am very pleased that the World Bank has participated effectively and as a leader in the financing of the Afşin-Elbistan project which is one of the principle factors in the development of Turkey. The realization of this project as soon as possible is vitally important for our energy sector in which we face particular problems.

Many significant meetings have been held concerning the management of the Afşin-Elbistan project between the Bank representatives and my Government authorities. I have been informed that there is no conflict in principle. However, the discussions have continued on subjects considered details. We can settle the details but we can not compensate for the time lost during these discussions.

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To reach this end, I request from you to use your personal influence in discouraging the insistence on details so that there will be no delay in the execution of this project, since it is certain that those details will be solved in time by paying attention to the special conditions of Turkey. In the forthcoming days, Mr. Yılmaz Ergenekon, the Minister of Finance will be paying a visit to Washington D.C., and will also discuss this matter in a broad manner. He will certainly contact your Excellency during his stay.

I would like to invite your Excellency's attention once more that the Afşin-Elbistan project is more than an investment project for Turkey and I hope that there will be no bottle-neck in the investment.

I am certain that your Excellency will find with his deep interest the same understanding as in the past between the Bank and Turkey.

I send my best wishes and sincere regards,



Süleyman Demirel

Prime Minister

Republic of Turkey

His Excellency

Robert S. Mc.Namara

President and Chairman of Executive Directors

International Bank for Reconstruction and

Development

1818 H Street, N.W.

Washington D.C., 20433

U.S.A.

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BIO-DATA OF TURKEY'S
MINISTER OF FINANCE

Minister of Finance Yilmaz Ergenekon, was born in 1929. After graduating from the Faculty of Political Science and Law, he held positions as lawyer and administrator. He was a former department head in the State Planning Organization. He is a Justice Party Deputy from Izmir and became Finance Minister in Demirel's new Government in March 1975. Speaks French, is married and has two children. The Minister is also the Governor of the Bank.

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: October 5, 1977

FROM: Adi J. Davar, Division Chief, EM2DA

SUBJECT: TURKEY: Mr. McNamara's Meeting with the Turkish Delegation
at the 1977 Annual Meetings

1. Mr. McNamara met the Turkish delegation headed by Finance Minister Bilgehan on September 29. Messrs. Knapp, Chenery, Benjenk, Bart and I also participated.
2. In response to Mr. McNamara's query as to the Government's strategy and plans to rectify the present economic situation, the Minister asserted Turkey's determination to take all possible corrective steps necessary to rectify the situation in the short-term, as well as in the medium-term to avoid repetition of the present crisis. Referring to the detailed economic measures he had outlined at the Region's meeting on September 27, he stressed that these should not be regarded as, nor were they intended to be, short-term measures. Rather, the Government's intention was to build on them for the long-term, and initiate structural changes necessary to implement them. He added that further steps both on the domestic and the external sides were needed and would be taken. He had therefore invited the IMF to send a mission in early October for Standby negotiations. IMF's support to Turkey at this stage was critical, as was the Bank's, and would provide the basis for actions on the economic front in the months ahead.
3. The Minister stressed that the Government would very much like to take into account the Bank's advice on export-oriented and socio-economic investments, as well as on the rationalization of investment priorities. The Minister felt that the question of mobilization of domestic and external resources for investment and using them in a rational way in the future, was particularly critical for Turkey's development. According to him, the increase in public sector revenues by TL 40 billion as a result of the price increases and other measures which the Government announced in early September, represented an increase of 20 percent in public sector resource mobilization and 4 percent of GDP. The Minister added that this by itself, was not enough, and additional resource mobilization measures were necessary. Besides this, by placing reasonable limitations on Central Bank borrowings and taking monetary and credit measures, the Government hoped to eliminate recourse to deficit financing. Since Turkey could benefit from Bank's advice on these economic issues, as well as on Turkey's forthcoming development plan, he hoped that Mr. Bart's mission would discuss them with the Government. He concluded that one should expect the actions initiated to show results gradually, and they were designed from that viewpoint.
4. Mr. McNamara requested the Minister to convey his good wishes to Prime Minister Demirel, as well as his assurance that the Bank would do all that it could, to help Turkey at this stage and in the future. Recapitulating his discussions with the Prime Minister in 1970, at which time the Bank's

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annual lending to Turkey amounted to only \$12 million and the substantial increase to about \$200 million achieved since then, Mr. McNamara added that the Bank wanted to go well over that level because Turkey needed such help and could absorb it. However, to enable him to provide such extended help, three problems remain to be resolved: (a) the short-term one of resolving the present financial crisis and restoring Turkey's creditworthiness in the eyes of the international financial community, which he hoped would be resolved by the Government with IMF; (b) the longer-term problems of strengthening resource mobilization and a rationalization of the investment expenditures and its priorities; he felt that Mr. Bart's forthcoming mission, which might take place in late October or early November, would look forward to discussing these long-term issues; (c) since many ongoing projects were facing problems, the defaults and deficiencies in implementation must be gradually, but expeditiously, overcome; he stressed that it would be most difficult for him to move ahead with new projects in the face of defaults on existing ones; at the same time, he appreciated that since quite a few of these problems stemmed from the above-mentioned longer-term problems, (i.e. rationalization of investment priorities and increased resource mobilization - including through adequate prices and tariffs,) discussion on these two matters were closely interlinked and Mr. Bart's mission would hope to address them.

5. Mr. McNamara concluded that assuming Turkey cleared up all three points he had mentioned and Mr. Bart's mission was able to report satisfactory progress, he would be prepared to complete the appraisal of 4 or 5 projects for lending in FY78, so that between \$200 to \$250 million of lending could be channelled to Turkey in this fiscal year.

6. The Finance Minister reassured Mr. McNamara that the Government's dialogue with the IMF would continue vigorously in October and outstanding differences would be resolved. He welcomed Bank's help to Turkey through Mr. Bart's and future missions. He was particularly hopeful that the project problems would be satisfactorily resolved, since the Prime Minister himself was personally interested in project matters. Mr. McNamara rejoined that he was not surprised at the Prime Minister's interest since he was an engineer by profession. He added that since the Prime Minister would need help to rectify project issues and have future priority projects prepared for external lending, he would recommend to the Prime Minister that he consider establishing a high powered unit in his own Office, to move all project matters along.

7. The Minister indicated that Turkey will do its utmost to cooperate with the Bank. Meanwhile, he wondered if Mr. McNamara might now be able to persuade the IMF to take a more understanding attitude to Turkey's economic problems. Mr. McNamara responded that the IMF and the Bank's

October 5, 1977

interests in Turkey were common, namely, to assist the Government in quickly overcoming the present financial crisis that it was facing, and to that extent there would be some coordination between the two institutions. The meeting ended with mutual assurances of goodwill and future cooperation.

Cleared with and cc: Mr. Bart

cc: Mr. McNamara's Office (2)
Messrs. Knapp, Benjenk, Knox, Dubey, Pollan,
Haynes, El Darwish, Chopra
Division 2A Turkish Team

AJDavar:mm

OFFICE MEMORANDUM

TO: Robert S. McNamara

FROM: Munir P. Benjenk *MB*

SUBJECT: TURKEY: Mr. Witteveen's Meeting with Finance Minister

DATE: September 29, 1977

At his meeting yesterday evening with the Finance Minister, Mr. Witteveen apparently struck a sympathetic, but very firm, note that Turkey needs to take many more steps to put the IMF in a position to release the Supplementary Compensatory Financing (about \$50 million) and enter into a Standby Arrangement thereafter. He stressed that such steps should be taken not merely because IMF financing would be facilitated but because the economic situation provides the Government with no alternative except to take them.

2. We are informed that Mr. Witteveen essentially made the following points: (a) the Minister's indication to the IMF mission in early September, that the Turkish Lira would be devalued by 10% this month (it has been) and by 10% within 6 weeks, was not enough. To correct the adverse balance of payments position and reduce the current account deficit, a larger one step jump in exchange rates (about 20%) should be taken, and the Government's reliance in export incentives and import controls to correct the adverse position, should be brought down to the very minimum.

(b) He urged that public expenditures should be cut and particularly the investments and expenditures brought under control. This had to be complemented by firm measures to generate more revenues and overall, strengthen the domestic mobilization effort.

(c) In response to the Minister's indication that measures would be taken, if and when needed, Mr. Witteveen apparently responded that that was not adequate, since substantial fiscal and balance of payments measures were needed now, in Turkey's own interests.

(d) When the Minister pleaded that he and his Government had already reached the limits of what was politically possible, the Minister was urged to phone Ankara, if necessary, to discuss what further actions Turkey could take in order to obtain the release of the Supplementary Compensatory Financing and enter into negotiations for a Standby Arrangement.

3. A meeting with the Turkish Delegation has been fixed by the IMF immediately after your meeting, to discuss matters further. The IMF is apparently interpreting that the Compensatory Financing is not automatic, and is using it as a lever to at least get the Turkish commitment to negotiate more substantial and additional fiscal and monetary measures if an IMF team is to go to Ankara next month for that purpose.

4. Meanwhile, ten commercial banks (including Morgan Guarantee and UBS) are reported to be trying to arrange a 6-month "bridge loan" of about \$350 million, to enable Turkey to pay off payments due for imports against letters of credits, etc. which commercial banks have been so far holding. The possibility is being discussed of converting the bridge loans into a loan with a larger maturity, after there is some withdrawal from an IMF tranche.

cc Messrs. Knapp, Bart
ADavar:rpo

March 29, 1978

Adi J. Davar, Division Chief, EMENA CPIIA

TURKEY: Mr. McNamara's Meeting with Finance Minister

1. Finance Minister Muezzinoglu accompanied by Mr. de Groote, Executive Director for Turkey, Mr. Bilget, Alternate Executive Director, and a Turkish Delegation, met Mr. McNamara on March 23. Messrs. Knapp, Bart and I attended.
2. The Finance Minister was in Washington to complete negotiations on the Standby Arrangements letter with IMF, which he signed just prior to his meeting with Mr. McNamara.
3. The Finance Minister, stressing his country's close relationships with both the Bank and IMF, stated that in its hour of need, Turkey hoped to receive all possible assistance from both institutions and also their help with the international financing community, so that Turkey can successfully cope with its severe economic crisis. Appreciating Mr. McNamara's continuing interest in Turkey, his Government felt that it would be mutually advantageous to have him visit Turkey. The Government was therefore pleased that he had accepted their invitation and would visit Turkey next month. Mr. McNamara stated that he was delighted at the opportunity and looked forward very much to meeting Prime Minister Ecevit, the Finance Minister and his colleagues.
4. The Minister then stated that with the signing of the Standby Arrangements letter with IMF, a path had now been opened to the Bank and the international financing community to help Turkey. The new government had inherited a chaotic economic situation. Its first task was therefore to bring order to that situation, and it had gone about seriously coping with it, although many of the actions needed, and taken, had high political costs, but were inescapable. Within a period of weeks, the government had to further devalue the Turkish Lira (which since September 1977, will now have been devalued by nearly 60 percent), frozen further increase in Convertible Lira Accounts, taken steps to enhance exports and worker remittances, introduced new taxes and increased SEE prices in order to have a balanced budget, intended to ensure that investments were kept within budgetary limits to obviate need for deficit financing and to control inflation, and planned on following a policy of improving the efficiency of the SEEs and periodically adjusting their prices so that this sector does not again lead to a repetition of the present serious economic situation. He felt that his government's task had just begun, and much remained to be done. However, with a short-term stabilization package in shape, the government now intended to turn its attention to the next critical problem of debt management, a viable policy for it and the medium-term policies for Turkey's economic development.

March 29, 1978

5. Mr. McNamara complimented the new government on tackling so much within a short time, and appreciated that medium-term policy directions were still to be formulated. He however hoped that when he visited Ankara, he might have an opportunity to discuss with the government: (a) its preliminary ideas for a viable debt management policy; (b) its strategy to stimulate exports and generate external resources to reduce future balance of payments pressures; (c) its approach towards raising domestic resources essentially through non-inflationary means; (d) its strategy to tailor investments within available resources; and (e) its basic policies for proper financing and management of the key sectors and for improving the implementation of the Bank's project portfolio. He reassured the Minister that given Turkey's immense development potential and sound economic and debt management policies which the new government appeared determined to pursue, Bank assistance could not only be renewed, but he hoped gradually increased.

6. Since the Minister had mentioned his government's wish to tap new sources of external financing, Mr. McNamara indicated that from informal discussions during his visit earlier in the year to Arab countries, he felt that Saudi Arabia, Kuwait and the Gulf Countries would like to help Turkey. He confided that the Saudis had informed him that they had so far been cool, because they felt that the previous government was not making a serious effort on restoring the economy to health. However, if approached on the basis of such a serious effort, the Saudis would help. The Kuwaitis had expressed similar sentiments, but in their case, they wanted outstanding issues affecting the Kuwaiti investment in the Mersin Fertilizer Co. to be quickly settled. The Minister thanked Mr. McNamara for this information, stated that the Mersin Fertilizer matter was being resolved, and Turkey would take suitable actions to pursue Arab interest.

7. The Minister also agreed that the topics listed by Mr. McNamara for discussions in Ankara, were indeed the right ones. He hoped that the visit would convince Mr. McNamara about the seriousness of the new government's policies. He indicated that cordial and constructive discussions had already taken place with a senior Bank mission earlier this month, and the Government had already taken, and proposed to take soon, a series of actions on sector policies, with a view to removing project implementation bottlenecks. He also stated that as agreed with the mission, the Government was also aiming at formulating and articulating a sector policy for the financing of the Power Sector by the time Mr. McNamara arrived, so that the problems with the Bank in the Energy Sector could be resolved. (Mr. Guccavas indicated later to Mr. Bart, that a decree was being signed by Ministers increasing power tariffs to close to between 80 and 90 kurus/KWh). In this connection, the Minister stressed the priority his government attached to Karakaya. He also emphasized the government's determination to improve the management and efficiency of all SEE operations.

8. The Minister then stated that while project loan financing was critical to Turkey, the more critical need in its present economic situation, was for import program assistance from the Bank, especially since there was

March 29th, 1978

substantial idle capacity. In the Istanbul Region alone, which accounted for one-quarter of Turkey's industrial production, capacity utilization was today only 52 percent. Mr. McNamara responded that the government obviously had the right approach, since it would be more effective to spend money to get production out of machines already installed, than to spend it on buying new machines. He hoped to discuss the question more fully during his visit. He however recapitulated that the Bank's Articles did not allow import financing except under exceptional circumstances, and the policy for which had evolved over the years on the basis of practices. He added that in line with this policy, Bank consideration of an import program loan would depend not only on the exceptional needs and circumstances of Turkey, but also on the short and medium-term economic policy framework evolved by the government. In this context, he hoped that such a framework could be evolved soon, and be confirmed in future through a close and continuing macro-economic and sector dialogue between Turkey and the Bank. The Minister indicated that Turkey would welcome such discussions and pursue the discussions on the need and policies for import program assistance during Mr. McNamara's visit. Mr. McNamara responded that he would look forward to discussing this and other topics he had recapitulated earlier. He reaffirmed the Bank's willingness to help Turkey to the maximum extent possible, and the meeting ended on mutual reaffirmation of goodwill and cooperation.

Cleared with and cc: Mr. Bart

cc: Mr. McNamara's office (2 copies)

cc: Messrs. Knapp, Benjenk (o/r), Paijmans, Knox (o/r), Dubey, Finzi,
El Darwish, Pollan, Haynes, Fuchs
Division 2A staff

AJDavar:mcm

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President
THROUGH: Mr. Martijn J.W.M. Paijmans, Acting RVP, EMENA
FROM: Maurice P. Bart, Director, EMENA CPII *MPB*

DATE: March 23, 1978

SUBJECT: TURKEY: Information Re IMF Assistance, for your Meeting with Finance Minister

1. You have already received the brief covering the pertinent details for your meeting this afternoon with Turkey's Finance Minister. This brief note is to provide you with the latest details of the financial assistance that Turkey could anticipate from IMF through the Standby Arrangements. The draft letter from Turkey is scheduled to be initialled by the Finance Minister later in the day.

2. The Arrangements provide for withdrawal of SDRs 74 million (about US\$88.8 million) in Export Compensatory Drawings, as soon as the Standby Arrangements are approved by the Board of the IMF and signed. It is expected to be put up for Board approval in 2 to 3 weeks time. Since the Witteveen Facility is not yet in operation, Turkey would be eligible for drawings up to 150 percent of its quota under the Exceptional Circumstances Clause, amounting to SDRs 300 million (US\$360 million). This is in addition to the Compensatory Drawings and would be available in two Tranches of SDRs 145 million (about US\$174 million) and SDRs 155 million (about US\$186 million). The first Tranche will be withdrawn as follows: SDRs 50 million in May 1978, SDRs 40 million in August, SDRs 30 million in November, and SDRs 25 million in February 1979. The IMF would review the economy and progress of the stabilization measures in January 1979. Following that, Turkey would be entitled to withdraw the second Tranche over a consecutive one-year period.

3. Thus, in calendar 1978, Turkey can withdraw a maximum of SDRs 194 million (US\$233 million), roughly one-quarter of its anticipated external financing needs during this year.

Cleared with & cc: Mr. Davar

cc: Messrs. J. Burke Knapp, V. Dubey, R. Chopra

SFaruqi:bb

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President
 THROUGH: Mr. J. Burke Knapp, Senior Vice President, Operations
 FROM: Martijn J.W.M. Paijmans, Acting RVP, EMENA

DATE: March 22, 1978

SUBJECT: TURKEY: Your Meeting with Finance Minister Muezzinoglu

1. Mr. Muezzinoglu, Finance Minister in Mr. Ecevit's 2 month old government, is in Washington this week. According to the IMF staff and the Turkish delegation which has been negotiating with them over the last two weeks, the Minister will settle a few issues which remain outstanding in the agreed stabilization program and sign, by this weekend, the Government's letter reflecting the Standby Arrangements with the IMF. He is scheduled to meet you at 3.45 p.m. on Thursday, March 23. Mr. Muezzinoglu is a firm but urbane individual who has injected a sense of balance in the fiscal and economic policies shaped by the new government. His bio-data is attached. Messrs. Bart and Davar will join you at the meeting.

Background

2. Economic Stabilization Measures: Since assuming office, the new government has been preoccupied in bringing Turkey's chaotic economic house in order, with great seriousness and determination. It introduced a new budget (approved late in February 1978), reshaped the 1978 Annual Program which will constitute the first year of the 1978-82 development plan to be finalized by October/November 1978, and forged a short-term economic stabilization program which forms the basis of the abovementioned IMF Standby Arrangements which are nearing completion. It has devalued the Turkish Lira in mid-February by 30 percent, which should have a salutary effect on Turkish exports and workers' remittances. Besides this, the new government has also (a) lifted the exchange guarantee on new Convertible Lira Accounts (CLA's), with a view to reducing new inflows of these short-term deposits; (b) increased interest rates on deposits in Turkey by its workers abroad, which should further help increase workers' remittances; (c) plans to introduce new taxes which will augment net revenues by TL 10 billion, and agreed with the IMF to increase prices of SEE products/services further in 1978 to bring in an additional TL 20 billion; (d) increased the level of interest and deposit rates (upto 20 percent on certain deposits), which should help improve resource mobilization and allocation; (e) agreed with IMF to peg 1978 imports at \$5 billion, compared to a peak of \$5.8 billion reached in 1977; (f) given priority in investments to completion of ongoing projects, and limit new 1978 investments to only a few high priority project essentially for energy, steel, fertilizers, ports and agriculture; and (g) envisages stimulating growth by utilizing substantial (about 40 percent) idle capacity and through export-oriented investments. The main point still outstanding with the IMF appears to relate to a commitment which the Fund is seeking regarding further devaluation of the Turkish lira should conditions require it.

3. The politically difficult, but courageous steps already taken, should help begin economic recovery and assist the Government in the critical follow-up tasks of: (a) converting about \$1 billion of its short-term commercial banking indebtedness due in 1978, into medium-term debt; (b) re-rolling about \$2 billion of CLA's; and (c) obtaining about \$1 billion of new additional medium- and long-term borrowings that Turkey needs in 1978. It might be noted that assuming the most optimistic terms for these, Turkey's debt service ratio (including workers' remittances) will reach close to 25 percent in 1978 from its 14 percent level in 1977; in 1980, this ratio can be expected to increase further, before stabilizing, and thereafter declining. Provided Government follows rational economic management and debt management policies, for which prospects appear to be reasonable, our preliminary projections show that the debt service ratio though high, should be manageable.

4. Because of the emergency situation it had to cope with while taking power only 8 weeks ago, the new government has really not yet had time to focus on the medium-term policies necessary to build on its short-term stabilization program. It is still in the process of deciding how it will go about obtaining the substantial and essential inputs of external financing needed in 1978 and 1979, besides forging a realistic and prudent debt management policy. These are a matter of considerable importance to the Bank, given the plea which the Minister will make to resume and increase the level of Bank lending soon, since the Bank is one of the very few sources of long-term financing available to Turkey. He apparently intends also to ask you for an early consideration of an import program loan to help use idle capacity in the economy.

Topics for Discussion

5. In this background, I would suggest that you take the following approach, during your meeting with the Minister.

6. Debt Management Policy: In view of the short-term debts due in 1978, and the need for substantial new borrowings in 1978 and 1979, you might inquire about the Minister's preliminary ideas about the debt management policy which his Government will pursue, and how it intends to go about implementing it with a view to ensuring that the debt service ratio is kept within manageable limits. ←

7. Medium-Term Economic Policy: The new government deserves to be complimented for its very serious approach to resolving Turkey's severe immediate economic problems and successfully negotiating the IMF Standby Arrangements (which will hopefully have been signed by the time of your meeting). You might then express the hope that the Government will now wish to build on this, through equally sound medium-term economic policies. You might indicate that during your forthcoming visit to Turkey, you will be looking forward to exchanging views especially on: (a) the Government's approach towards raising domestic resources,

essentially through non-inflationary means; (b) the strategy for stimulating export and generating external resources to reduce future pressure on the balance of payments; (c) tailoring its investment and growth strategy to the availability of domestic and external resources; (d) Government's basic policies towards the planning, financing and management of key sectors likely to be supported by future Bank assistance; and (e) its proposals to improve project implementation and the Turkish coordination machinery for implementing/preparing Bank projects. You might add that given Turkey's development potential and your expectation of a satisfactory resolution of the short-term debt problem (which is essential to restore Turkey's creditworthiness), and of a close and continued dialogue with the Bank on the above key macro-economic and sectoral issues, especially in connection with the new Five-Year Plan, you would be favorably disposed to considering resumption of lending in FY78 and a gradual increase in lending to a level of about \$400 million each year.

8. Regarding the import program loan, we feel that it should make eminent sense, and be a much quicker way of helping Turkey's balance of payments and need for long-term new financing in 1978, than the projects presently in the FY79 program, provided it can be dovetailed into a sound macroeconomic and sectoral framework. You might say that you would wish to reserve judgement on the import program loan until after your discussions in Ankara and a Bank economic updating mission (which could be mounted shortly) is able to review the case for such an exceptional loan.

9. Mobilization of New External Financing: The Minister might indicate that Turkey is planning on taking new long-term external financing by reactivating the OECD Consortium. You might indicate some scepticism about this approach, and recommend that Turkey may instead wish to consider convening a broader informal aid group on the Bolivian model (of which the Minister is aware), in which new potential aid donors like Japan, Saudi Arabia, Kuwait and the Gulf Countries might participate in addition to the traditional OECD donors. During Mr. Davar's recent mission to Turkey earlier this month, the Minister pursued this subject vigorously and inquired about the genuineness of Arab interest in assisting Turkey in view of the cold shoulder they gave to the representatives of the previous government. In this connection, you might like to convey to the Minister, the considerable interest expressed, especially by Saudi Arabia and Kuwait, during your visit earlier this year, in assisting Turkey. You will recall that the Saudi Finance Minister in particular indicated that his country's response to past Turkish overtures had not been enthusiastic, because "the approach of the Turkish representatives was made in a way which did not appear to be at all a serious one towards solving Turkey's economic problems". However, if the Saudi Government is persuaded of the seriousness of the Turkish Government's intentions, it would be prepared to help. A consortium, or even an informal aid group, would make Saudi participation much easier.

The Kuwait Finance Minister's and Mr. Al Hamad's comments were similar, except that the Kuwaitis felt that they could not do anything, until Turkey expeditiously first settled the question of Kuwaiti investment in the Mersin fertilizer company in Turkey. I believe that the Minister might be considerably helped, if you could convey these Arab comments candidly to him. You might also add that besides establishing direct contact with these Arab countries, Germany and USA might also be able to exert some influence in bringing them within the orbit of an informal aid group for Turkey.

10. Past Bank Operations: Mr. Davar's mission reviewed all sector policy constraints which have impeded past Bank lending to Turkey. Proposals to resolve specific project issues, especially the long-standing problem of sufficient resource generation in the power sector, may be forthcoming shortly. You should stress the importance of putting project coordination and implementation on a sounder basis, and forewarn the Minister that you hope to discuss these issues and the solutions proposed by the Government during your forthcoming visit.

11. Future Lending: We are processing for consideration by the Loan Committee in coming weeks, the four projects scheduled for FY78 (Karakaya Dam, Erdemir Steel, Livestock and Forestry). You should however encourage the Minister, as Mr. Davar's mission has already done, to proceed only with those projects for which full local and foreign currency financing can be ensured. In this endeavor, provision of between \$200 to \$250 million of Bank financing in FY78 for a maximum of 3, and not 4, projects would help. You should also encourage the Minister about the allocation of sufficient funds to past Bank projects (particularly Akdeniz), which are beset by cost overruns.

12. In conclusion, you might express appreciation for the considerable cooperation extended by the Minister and his colleagues to Mr. Davar's recent mission in undertaking a constructive dialogue on macro and sector policy matters with the Bank. You might add that you very much look forward to continuing this dialogue in some depth with Prime Minister Ecevit, the Minister and his colleagues during your visit next month to Turkey.

Cleared with & cc: Messrs. Bart, Chopra

cc: Messrs. Knapp, Benjenk (o/r), Knox (o/r), Dubey, El Darwish.

MPBart/AJDavar:bb

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: March 29, 1978

FROM: Adi J. Javar, Division Chief, EMENA CPIIA

SUBJECT: TURKEY: Mr. McNamara's Meeting with Finance Minister

1. Finance Minister Muezzinoglu accompanied by Mr. de Groote, Executive Director for Turkey, Mr. Bilget, Alternate Executive Director, and a Turkish Delegation, met Mr. McNamara on March 23. Messrs. Knapp, Bart and I attended.
2. The Finance Minister was in Washington to complete negotiations on the Standby Arrangements letter with IMF, which he signed just prior to his meeting with Mr. McNamara.
3. The Finance Minister, stressing his country's close relationships with both the Bank and IMF, stated that in its hour of need, Turkey hoped to receive all possible assistance from both institutions and also their help with the international financing community, so that Turkey can successfully cope with its severe economic crisis. Appreciating Mr. McNamara's continuing interest in Turkey, his Government felt that it would be mutually advantageous to have him visit Turkey. The Government was therefore pleased that he had accepted their invitation and would visit Turkey next month. Mr. McNamara stated that he was delighted at the opportunity and looked forward very much to meeting Prime Minister Ecevit, the Finance Minister and his colleagues.
4. The Minister then stated that with the signing of the Standby Arrangements letter with IMF, a path had now been opened to the Bank and the international financing community to help Turkey. The new government had inherited a chaotic economic situation. Its first task was therefore to bring order to that situation, and it had gone about seriously coping with it, although many of the actions needed, and taken, had high political costs, but were inescapable. Within a period of weeks, the government had to further devalue the Turkish Lira (which since September 1977, will now have been devalued by nearly 60 percent), frozen further increase in Convertible Lira Accounts, taken steps to enhance exports and worker remittances, introduced new taxes and increased SEE prices in order to have a balanced budget, intended to ensure that investments were kept within budgetary limits to obviate need for deficit financing and to control inflation, and planned on following a policy of improving the efficiency of the SEEs and periodically adjusting their prices so that this sector does not again lead to a repetition of the present serious economic situation. He felt that his government's task had just begun, and much remained to be done. However, with a short-term stabilization package in shape, the government now intended to turn its attention to the next critical problem of debt management, a viable policy for it and the medium-term policies for Turkey's economic development.

March 29, 1978

5. Mr. McNamara complimented the new government on tackling so much within a short time, and appreciated that medium-term policy directions were still to be formulated. He however hoped that when he visited Ankara, he might have an opportunity to discuss with the government: (a) its preliminary ideas for a viable debt management policy; (b) its strategy to stimulate exports and generate external resources to reduce future balance of payments pressures; (c) its approach towards raising domestic resources essentially through non-inflationary means; (d) its strategy to tailor investments within available resources; and (e) its basic policies for proper financing and management of the key sectors and for improving the implementation of the Bank's project portfolio. He reassured the Minister that given Turkey's immense development potential and sound economic and debt management policies which the new government appeared determined to pursue, Bank assistance could not only be renewed, but he hoped gradually increased.

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6. Since the Minister had mentioned his government's wish to tap new sources of external financing, Mr. McNamara indicated that from informal discussions during his visit earlier in the year to Arab countries, he felt that Saudi Arabia, Kuwait and the Gulf Countries would like to help Turkey. He confided that the Saudis had informed him that they had so far been cool, because they felt that the previous government was not making a serious effort on restoring the economy to health. However, if approached on the basis of such a serious effort, the Saudis would help. The Kuwaitis had expressed similar sentiments, but in their case, they wanted outstanding issues affecting the Kuwaiti investment in the Mersin Fertilizer Co. to be quickly settled. The Minister thanked Mr. McNamara for this information, stated that the Mersin Fertilizer matter was being resolved, and Turkey would take suitable actions to pursue Arab interest.

7. The Minister also agreed that the topics listed by Mr. McNamara for discussions in Ankara, were indeed the right ones. He hoped that the visit would convince Mr. McNamara about the seriousness of the new government's policies. He indicated that cordial and constructive discussions had already taken place with a senior Bank mission earlier this month, and the Government had already taken, and proposed to take soon, a series of actions on sector policies, with a view to removing project implementation bottlenecks. He also stated that as agreed with the mission, the Government was also aiming at formulating and articulating a sector policy for the financing of the Power Sector by the time Mr. McNamara arrived, so that the problems with the Bank in the Energy Sector could be resolved. (Mr. Gucevavas indicated later to Mr. Bart, that a decree was being signed by Ministers increasing power tariffs to close to between 80 and 90 kurus/KWh). In this connection, the Minister stressed the priority his government attached to Karakaya. He also emphasized the government's determination to improve the management and efficiency of all SEE operations.

8. The Minister then stated that while project loan financing was critical to Turkey, the more critical need in its present economic situation, was for import program assistance from the Bank, especially since there was

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substantial idle capacity. In the Istanbul Region alone, which accounted for one-quarter of Turkey's industrial production, capacity utilization was today only 52 percent. Mr. McNamara responded that the government obviously had the right approach, since it would be more effective to spend money to get production out of machines already installed, than to spend it on buying new machines. He hoped to discuss the question more fully during his visit. He however recapitulated that the Bank's Articles did not allow import financing except under exceptional circumstances, and the policy for which had evolved over the years on the basis of practices. He added that in line with this policy, Bank consideration of an import program loan would depend not only on the exceptional needs and circumstances of Turkey, but also on the short and medium-term economic policy framework evolved by the government. In this context, he hoped that such a framework could be evolved soon, and be confirmed in future through a close and continuing macro-economic and sector dialogue between Turkey and the Bank. The Minister indicated that Turkey would welcome such discussions and pursue the discussions on the need and policies for import program assistance during Mr. McNamara's visit. Mr. McNamara responded that he would look forward to discussing this and other topics he had recapitulated earlier. He reaffirmed the Bank's willingness to help Turkey to the maximum extent possible, and the meeting ended on mutual reaffirmations of goodwill and cooperation.

Cleared with and cc: Mr. Bart

cc: Mr. McNamara's office (2 copies)

cc: Messrs. Knapp, Benjenk (o/r), Paijmans, Knox (o/r), Dubey, Finzi,
El Darwish, Pollan, Haynes, Fuchs
Division 2A staff

AJDavar:mcm

BIO - DATA

of

Mr. Ziya Muezzinoglu

Minister of Finance (Republican Peoples Party)

Born in Kayseri in 1919, Mr. Muezzinoglu graduated from the Faculty of Political Science in Ankara, subsequently holding a number of posts in the Finance Ministry. He was a member of the Constituent Assembly formed in 1961 to prepare a new constitution. After 1972, he held the post of Finance Minister in the above-party-Government headed by Mr. Erim and subsequently served as a special advisor in the Foreign Affairs Ministry, holding posts as Ambassador to Bonn and for a period of time as ambassador to the Common Market. Mr. Muezzinoglu was elected to Parliament as an Republican Peoples Party Senator from Kayseri in 1975. He is married with two children and speaks German, French, and English.

OFFICE MEMORANDUM

TO: Memorandum For The Record

DATE: May 31, 1978

FROM: Adi J. Davar, Division Chief, EM2DA

SUBJECT: TURKEY: Mr. McNamara's Visit

1. Mr. McNamara visited Turkey between April 9 and 13, 1978, accompanied by Messrs. Benjenk, W. Clark, Bart, Davar, Chopra and Koch-Weser. He had several substantive meetings with Prime Minister Ecevit, Finance Minister Muezzinoglu, Economic Coordination Minister Cetin, as well as other senior ministers and officials in Ankara on April 10 and 11, and again on April 13 in Istanbul (A copy of his itinerary is provided in Attachment 1). On April 12, he visited the Antalya region, the Bank's Irrigation Rehabilitation and Tourism projects, as also the IFC/Valtur Hotel project, accompanied by Tourism Minister Çoskum. The arrangements made for the visit were excellent and the reception most cordial.

General Atmosphere

2. According to reports from senior officials in the Prime Minister's Office and the Treasury, the visit was preceded on the Turkish side by long and thorough sector by sector and project by project discussions, in two meetings stretching over several hours. The Ministers and senior officials of all ministries and agencies involved with Bank activities, as well as of SPO, participated in these meetings chaired by the Prime Minister himself. Turkey's problems with the Bank, its approach and policies, were fully vented, with arguments ranging from sympathy with to complete opposition to the Bank. Reportedly, Mr. Ecevit ultimately set the tone for meetings with Mr. McNamara and future relationship with the Bank, by asserting that: (a) there was considerable scope for a close Turkey-Bank relationship; (b) it was incumbent that the Turkish administrators accept the realities of Bank policies, just as it behoved Bank staff to do so with Turkish laws and policies; (c) substantial areas existed for such mutual accommodation within the parameters of each other's existing rules and regulations; and (d) the accent must be on improving Turkish performance and cooperating fully with the Bank.

Finance Minister's Meeting (April 10)

3. The Minister outlined the Government's stabilization package which required considerable political courage and pragmatism, and stressed that similarly, the Government was determined to forge medium-term economic policies. The work on that had begun, and by October/November, the Government hoped to have the new Fourth Plan finalized. He emphasized that the fulcrum of these policies would be balanced budgets, increased export earnings and rational income distribution. In pursuit of a balanced budget, a large new tax package, which included new municipal taxes netting nearly TL 15 billion additional to municipalities, had just been submitted to the Parliament. Recognizing the need to restructure \$5.5 billion of short-term debt, he announced his Government's decision to reactivate the OECD Consortium in order to extend the maturities of all public bilateral debt by 5 years, and

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to restructure export financing loans guaranteed by bilateral government, on a 7-year (including 3 years grace) basis, besides providing extended cover for such future financing. The Consortium may be ultimately expanded, although initially, the Government planned on seeking Arab assistance on a bilateral basis. Six leading commercial banks had been invited to undertake the rerolling and restructuring of about \$3.5 billion of CLAs and commercial arrears, at least on a 7-year basis (including 3 years grace), besides putting in \$0.5 billion of new monies in 1978. In this background, and recognizing that Turkey will itself have to make a significant effort to improve on project implementation and disbursements, he stressed that Turkey and the Bank were at a turning point in their relations. While Turkey was partly to blame for the low level of Bank assistance, a fresh start was now possible which could lead to a doubling of the annual level of Bank lending to at least \$10 per capita.

4. In response to Mr. McNamara's query as to how the Government envisaged monitoring future levels of debt, the Minister responded that the answer clearly lay in having a viable debt management policy. No more guaranteed CLAs would be entertained, acceptance credits for trade would only be for 6 months and kept within narrow limits so that their total did not exceed \$400 million in 6 months, and a ceiling of \$1 billion would be set for investment loans for SEEs. Regarding Mr. McNamara's query on resource mobilization, the Minister clarified that the Government's policy would not only be to increase tax revenues substantially, but also increase new sources of municipal revenues and periodically adjust SEE prices, so that the last two factors do not continue to be large drains on the Central Budget as had been the case so far. For instance, the present tax package included income tax adjustments as a result of which a TL 20 billion burden would shift from lower to higher income groups and still increase income taxes by nearly TL10 billion; corporate, wealth, production and import taxes had been increased to add nearly TL25 billion, to the level of 1977 tax revenues. Huge price increases in SEE products had already been announced, and increases in those of petrochemicals, textiles etc. were planned so as to bring in TL14 billion of additional revenues in 1978 from SEEs. Reduction in staffing of SEEs and improvement in their efficiency, was integral to the Government's determination to reduce SEE deficits.

5. In response to the Minister's plea that some Bank covenants were unrealistic for implementation, Mr. McNamara responded that the Government should tell the Bank what such covenants were, what it proposed in order to make them realistic and if that could be done within Bank policies, he assured the Minister that changes would be made. If such changes were not possible under Bank policies, then both sides should be prepared to cancel loans or components "without hard feelings". He also wanted the Government to determine realistic quarter by quarter disbursement targets for each loan and monitor the targets, in an effort to expeditiously use up \$700 million of available Bank monies. He stressed the need to begin effectively using these monies and implementing ongoing projects soundly, in order to enable the Bank to increase the lending program. More Turkish effort would also be needed to

prepare projects quickly, and develop a pipeline, where both sides knew there was little scope for policy conflicts. This would require increased economic and sectoral work by the Bank.

6. Mr. McNamara agreed to the Minister's request to work on an Import Program Loan, while stressing that the Bank's Articles prohibited such loans unless "exceptional circumstances" were demonstrated. Furthermore, he made it clear, as he did in several subsequent meetings (including those with the Prime Minister), that such a loan, to assist both the public and private sectors, could be presented to our Board only after: (a) a development plan or at least its outline, is available and discussed with the Bank; (b) other elements of economic restructuring, including policies to stimulate export, to obtain additional external financing required for development (the program loan should not be a substitute for other sources), and to curtail the financial drain arising from SEE losses, became apparent; (c) it was determined that a portion of the Import Program Loan could be directed towards goods that could increase Turkish exports in the short-run; and (d) there is evidence that steps are taken to spur disbursements under past Bank loans.

Working Meeting at Prime Ministry (April 10)

7. On behalf of the Turkish side, Mr. Kurus (Undersecretary, SPO) presented a lucid picture of the mismanagement and highly politicized investments by previous governments that led to Turkey's present crisis. After three years of artificial abundance, Turkey was facing now a period of artificial shortages. He recapitulated both the economic measures taken by the new government to alter this situation and its immediate priorities. He then added, that learning from past experience, his government: (a) did not view growth as a fetish to be fulfilled at all costs, but wanted a minimal high growth consistent with sound economic policies; (b) realized that growth would depend on what Turkey could earn abroad from her exports (import substitution having now come to an end), and could realistically tap in terms of external financing; (c) wanted to promote, on a viable basis, establishment of joint ventures between foreign partners and either private or public Turkish enterprises; (d) establish realistic prices in the economy, to eliminate the phenomenon of "double-pricing" that has emerged in the last one year; and (e) revamp agriculture pricing policies to avoid problems emerging from its past abuse. He also ended with a plea for an Import Program Loan and a doubling of Bank lending.

8. While indicating his willingness to consider both, Mr. McNamara reiterated the points he had made on the above requests at the Finance Minister's meeting. He particularly stressed that to enable him to pursue both requests, the Government needed to: (a) show progress on existing commitments and, for that purpose, establish a coordinating mechanism within the Government with which the Bank could work; (b) monitor disbursements quarterly; (c) identify unreasonable conditions signed in the past and if the issues cannot be resolved seek from the Bank a change in the conditions or the cancellation of the related loans; and (d) strengthen the dialogue with the Bank on basic economic policy and on sector policy.

Meeting with Energy Minister (April 10)

9. Stressing the massive energy needs of Turkey, and that one of the critical factors currently contributing to low capacity utilization in industry was power shortages, the Minister justified the new government's decision to give high priority to energy investments. However, since the investments needed were so massive, he felt even if bulk tariffs were substantially increased, they could cover only a small portion of such investments. While emphasizing that the Government fully agrees with the importance of imposing tariffs to generate user contributions to the sector's development, his view was that levy of tariffs should not be the main test for measuring the sector's efficiency, since even massive increases could cover only a small portion of investments, and much of the balance would initially have to come from the public exchequer in any case.

10. The Minister stated that he was not against power tariff increases, and indeed, an increase was currently in the mill and there would be future increases also. He however felt that Government should be at a liberty to increase charges and tariffs of other energy products or services, to make up for lower collection from bulk electricity users, so long as in totality, adequate resources were thus generated to finance a good portion of all energy investments. As a demonstration of his desire to do this, he reconfirmed his decision made known to the Bank mission in early March, to increase irrigation charges from TL11 to TL80 per decare and the recently announced increase in the average cost of lignite from TL170 to between TL800 and TL1000 per ton.

11. Mr. McNamara wondered why it was so difficult to increase power tariffs, when coal and irrigation, which equally affected all levels of the population and the economy besides increasing the cost of thermal power again, could be augmented. An unsatisfactory response was that irrigation charges were to be paid by richer farmers, and coal prices were dispersed over the whole Turkish population, while power increases affected only 24 million consumers and industry, giving impetus to inflation. The Minister stressed that he was anxious not to be misunderstood, since all he was trying to convey was the complexity of applying the principle of substantial power tariff increases immediately, while recognizing that power users must make increasing contributions to power investments. Pointing out that Turkey's need was not merely to generate more power, but to transmit it, he pressed the Bank to declare TEK II effective. He also pointed out that all major municipalities, which were retailing power, had had their tariffs increased substantially; as a result, the ultimate consumer was paying a high price for power he consumed. He also referred to the new tax legislation now before the Parliament, substantially increasing municipal tariffs. He therefore believed, they would no longer need to get financial resources by non-payment of TEK's bills as they had been doing so far. Besides, this legislation provided for the wiping out of all municipal overdues to TEK to date, and also gave power to the Treasury to pay TEK's bill from the municipalities' share or potential share of the tax receipts, if in future, some municipalities still defaulted on their payments. While appreciating the

effort made to augment municipal revenues and preclude defaults to TEK, Mr. McNamara was noncommittal on the Minister's request.

12. The Minister pressed Mr. McNamara also to initiate Karakaya negotiations, and for new future projects. As regards the latter, he urged early consideration of the Bati Rahman pilot project, followed by the main Bati Rahman Secondary Oil Recovery Project. He also wanted the Bank to develop and finance a coal/lignite mining project for domestic use (not limited to needs of generation), by providing equipment to a new authority for lignite/coal development, "which would be as efficient as DSI", and which could replace TKI, unless TKI's management and organization (as part of the project) could be thoroughly revamped and upgraded. Mr. McNamara felt that, in principle, these appeared to be projects which the Bank could help develop, and consider for financing if viable. Mr. Bart noted that the Bank had offered to mount an energy sector mission which could help provide a framework for the projects which the Minister had mentioned and help identify others in the energy sector. The Minister agreed to such a mission. (A misunderstanding on the scope of this mission seems to have developed subsequently on the Minister's part).

Meetings with Ministers of SEEs (April 10), Industry (April 11), Public Works (April 11), Agriculture (April 11) and Forestry (April 13).

13. Briefly, at all these meetings, the Government's priorities and policies in those sectors, were expounded with varying degree of detail. The Minister of SEEs outlined his plans with regard to DBY, Halkbank and DESIYAB. Mr. McNamara deplored that no commitments whatsoever had been made so far under the 1977 loan to DYB. With the Minister of Industry, Mr. McNamara stressed the need for Turkish industry to focus on exports, competitiveness and small-scale enterprises. The meeting with the Public Works Minister was brief, discussions were general, except that the Minister stressed the possibility of Bank help for a sector study for balanced development of road, rail, sea and air transport. The Agriculture Minister indicated that the Government's top-most priorities for Bank assistance after the Erzurum Rural Development project, were in the following order: Grain Storage, Fruits and Vegetable Production/Marketing and Seed Production. The Forestry Minister hoped for future Bank help on forestry development and forestry industries.

Meeting with Reconstruction Minister (April 13)

14. The meeting was essentially devoted to a detailed presentation by the Minister, of the need for a Sewerage project in Istanbul. However, the Illerbankasi had clearly influenced the Minister with its viewpoint, and the Minister tried to make a case for proceeding with a project for these facilities in 22 municipalities of the Metropolitan Area, without Istanbul City, since they were prepared to let Illerbankasi do the work for them. He also mentioned, that these municipalities had in the preceding week mentioned to the Prime Minister, their willingness to create a Union without a law, through a Protocol between themselves. The Minister was eager to use the Project Preparation Facility from this project, as previously envisaged,

after the creation of the Union. Agencies like ISI could be the authority, under the Protocol, who could own and operate the sewerage and water facilities for this ad hoc union, until BIBSKI and a Metropolitan Union were actually created by legislation (its enactment was deemed difficult). The Minister also referred to the need for improving public transport in Istanbul and the Government's desire to try and convert the existing Village and Land Mortgage Bank, into a land use development bank, and/or a low income housing mortgage bank.

Meeting with Turkish Industrialists/Businessmen (April 13)

15. At a meeting in Istanbul, arranged through TSKB, Mr. McNamara met a group of 15 selected industrialists/businessmen, including Messrs. Koc, Sabancı and Eczacıbaşı. The group confirmed that the combined shortage of raw materials, semi-finished components, spares and energy, was causing about 48 percent of installed capacity from being utilized: 39 percent of the unutilized capacity could be attributed to the first 3 factors, 30 percent to energy shortage and the balance to factors such as problems with acceptance credits, removal of export incentives, strikes, etc. Indeed, transfers pending in respect of orders placed abroad for raw materials/semi-finished components/spares, amounted to some \$2.8 billion.

16. In response to Mr. McNamara's query, the group amplified that if the shortage of raw materials/semi-finished components/spares was removed, the market was not a bottleneck. Indeed, the major problem they confessed was that the domestic market was so buoyant and lucrative that they had little incentive to export and find markets abroad. However, in view of their country's economic situation, the private sector was willing to make maximum efforts to increase exports, provided the Government offered them worthwhile incentives. The prime condition was not merely a realistic exchange rate at all times, but a floating exchange rate; the second was provision of various export incentives, including tax rebate on the goods exported, retention of 50 percent of the foreign exchange earned from exports, to enable the exporter to import necessary raw materials etc. (this benefit had apparently been partly taken away following the March 1978 devaluation). Over the longer-term, as efforts succeeded in opening markets abroad, they felt that Turkey could eventually export about \$1 billion of industrial goods. However, \$300 million of this was already in the form of textile (essentially yarn) exports, and there were market limitations in increasing this much further. Hence, the accent may have to be on other consumer goods which Turkish industry essentially manufactures, with growing attention to the middle-east markets. Winning of more construction contracts abroad by Turkish firms, was also mentioned as another possibility.

17. The group emphasized that entrepreneurs were no longer in control of their investment and production decisions. The reasons cited, besides difficulties in getting foreign exchange for capital and recurrent needs, were licensing restrictions, government's insistence on integration of product facility, delay in receiving domestically manufactured raw materials/semi-finished components (caused by delays in investment programs of the concerned SEEs), increasing costs due to failure to control inflation and wage spirals (which made exports more uncompetitive despite devaluation), shortage

of steel, petroleum and fertilizers, and bottlenecks in ports as well as road and rail transit.

18. One of the members pointed out that despite strides in spreading industrialization in Eastern Anatolia, progress was considerably hampered by the lack of infrastructure, of financing facilities and of trained workers as also management. He pleaded that Government should arrange to provide long-term financing (we mentioned TSKB's efforts in this direction), technical assistance, vocational training for workers and management training programs. He pointed out that one of his companies (cement) was owned exclusively by 17,000 Turkish workers, who had bought shares in foreign exchange equivalent to DM 50 million. He felt that if necessary facilities could be provided, there was considerable scope for developing industries in Eastern Anatolia, with share financing paid in foreign exchange by Anatolian workers working abroad.

Meetings with Prime Minister Ecevit

19. Mr. McNamara met twice with Prime Minister Ecevit in Ankara and once in Istanbul, with Mr. Benjenk accompanying him. At these meetings, apart from a general review of Turkey's relations with the Bank, three specific issues which could not be settled at the ministerial level were taken up.

20. The first concerned the "plan of action" which Turkey and the Bank would agree to pursue jointly. A first draft of such plan, prepared by the Bank team, was strenuously resisted as to its format and proposed coordination mechanism on the Turkish side, especially by SPO. Following Mr. McNamara's discussions with Mr. Ecevit, the arrangements were ultimately reflected in the form of an agreed draft letter. This has since been sent on April 18, 1978 to Mr. Muezzinoglu (Attachment 2).^{1/}

21. Regarding the major problem of the rate of return on our power loans on which no solution was proposed by the Energy and Finance Ministers, the choice for the Bank was either to let the TEK II loan lapse and be cancelled at the expiration date for declaring the loan effective (April 28), or to accept the Government's arguments that: (a) the critical power shortage was a substantial factor impeding production and growth; (b) immediate investments were needed in the energy field so that the shortage could be alleviated in the

^{1/} Discussions on this issue very much helped to catalyze a decision within Turkey, as to which Turkish agencies should be involved in continuous coordination of Bank activities, and who should assume overall charge. The responsibility has ultimately been given to Economic Coordination Minister Cetin. An inter-governmental coordination group which has now been established, includes Mr. Erder (Adviser to the Prime Minister), Mrs. Oymen (Director General of Treasury) and Mr. Haceloglu (Director of Coordination, SPO) as Secretary of the Group.

medium-term future; (c) the ultimate power consumer generally paid retail tariffs at a fairly high level; (d) those tariffs must inevitably be raised if the bulk power tariff of TEK was to be now increased to enable TEK to earn an 8 percent return in 1978; (e) to do so now, would have a very adverse impact at a time when the Government's efforts were concentrated on controlling all prices within manageable levels. Appreciating this plea, and since the Government was essentially asking for a temporary waiver of the rate of return covenant calculated on the basis set out in the loan documents, Mr. McNamara agreed that bulk power tariffs of TEK would be increased by December 31, 1979 to earn a return of 5.5 percent in 1980, and thereafter to earn the covenanted 8 percent in 1982. The discussions between Mr. McNamara and the Prime Minister on this subject and the more detailed rationale for the above decision, were reflected in a Side Letter, which has been since signed by the Government, TEK and the Bank (Attachment 3).

22. In view of Turkey's energy needs, but appreciating both the inherent political aspects for Turkey of the riparian issue with Syria and Iraq regarding Karakaya and the Bank's policy on riparian projects which had to be followed, Mr. McNamara and the Prime Minister agreed that if Turkey provided a written unilateral declaration preserving the substance of the required releases of water from the Karakaya Reservoir which the Bank could accept as a representation, then the Bank would be prepared to process the Karakaya Project for Board consideration. A draft letter was subsequently submitted for the Government's consideration (Attachment 4).

Concluding Meeting with Finance Minister (April 13)

23. Mr. McNamara first summed up the conclusions he had drawn from his visit and discussions with the Government. Turkey had made considerable progress since his first visit to the country, when the economy had essentially an inward looking character and foreign exchange receipts were very low. Since then, despite remarkable growth, major problems had developed because of the failure to adjust the exchange rate sufficiently and to expand exports, tourism and foreign exchange borrowings from new long-term sources such as Arab oil producers and the financial market. There was still some inhibition about foreign domination which was unwarranted, since the Government was too strong to be shifted from its course. Finally, the objectives retained great importance: increasing the competitiveness of industry and realizing the agricultural potential.

24. Turning to the plan agreed upon with the Government to strengthen relations with the Bank, Mr. McNamara summarized its salient points as follows:

(a) the Bank would study the proposed program loan but difficulties should not be underestimated since it had never made such a loan for a country at Turkey's stage of development; the respective roles of IMF and the Bank should be clearly differentiated, since the loan could not be justified by the foreign exchange gap but as a basis for development;

May 31, 1978

(b) the Bank was prepared to consider an enlarged lending program for Turkey based on a sectoral approach;

(c) however, to support the case for such an expanded program, there should be a clear demonstration that steps were being taken by Turkish authorities to expeditiously use up \$700 million of undisbursed Bank monies, through more efficient implementation of ongoing projects; the Government should make a thorough and quick review of what: (i) it could do - taking all constraints into account - to achieve this objective; (ii) would be the realistic disbursement targets which it could achieve, quarter by quarter, in respect of each project; and (iii) measures it could take to achieve those quarterly targets;

(d) the Turkish administration should, pari passu, also review the loan documents for each loan, determine which Bank covenant or condition could not be fulfilled in view of existing Turkish laws and practices, and propose such change to bring them into conformity with Turkish laws and practices; while reaffirming willingness to consider such proposals with considerable sympathy and amending loan documents to the extent possible, it was stressed that if Turkish proposals could not be easily accommodated within the Bank's regulations and policies, which after all must be equitably applied to all member countries, then both sides should mutually agree to cancel the loans, or components, involved.

(e) regarding Karakaya, he asked the Minister to inform the Bank whenever the Government would be ready to declare that it would take the measures required in order not to penalize the downstream riparians; he also mentioned that further financing of the project by other sources may not be forthcoming if the riparian issue was not settled.

25. Mr. Muezzinoglu expressed satisfaction that a plan of action had jointly been devised and assured Mr. McNamara that it would be strictly implemented. He would send a mission to Washington to discuss problem projects as soon as the Government had completed its review.^{2/} He hoped that export-oriented industries could have a first claim on the program loan. As to foreign sources of finance, he reiterated that the Government had no complex in having recourse to them, whether as investments or under other forms. He concluded the meeting by expressing his thanks for what had been an extremely successful visit, and indeed turning point in the relations between Turkey and the Bank as he had anticipated.

^{2/} It was subsequently agreed that a review on the above lines would be immediately initiated by the Turkish authorities, and completed by around end May. The visit of a Turkish delegation to Washington was tentatively targetted upon, for substantive discussions with the Bank on aforementioned matters, including discussions of specific changes in loan documents, which might involve amendments to and perhaps some cancellation of loans.

Attachments

May 31, 1978

cc: Mr. McNamara's Office (2)

cc Messrs. Knapp, Benjenk, Knox, Fuchs, Jaycox, Tolbert, Haynes, Pollan,
El Darwish, Howard, Elliott, Fish, Thys, ffrench-Mullen, Le Moigne,
Frank, Naylor, Stewart, Serageldin, Sekse, Cash, Nayar, Perram,
Odone, Singh, Dubey, Chopra.

MPBart/AJDavar:bb

MR. MCNAMARA'S ITINERARY

April 9, Sunday : Arrive Ankara (from Copenhagen)
22.50 on TK 906 Overnight at Büyük
Ankara Hotel, Ankara

April 10, Monday : 9.00-10.30 Meeting with Finance
Minister
Ziya Muezzinoglu
10.30-11.00 Meeting with Economic
Coordination Minister
11.00-13.00 Meeting with Prime
Minister
13.00-14.30 Working lunch with
Prime Minister
15.00-16.00 Meeting with Energy
and Natural Resources
Minister,
Deniz Baykal
16.15-17.00 Meeting with Economic
Enterprises Minister
17.15-19.30 Rest at Hotel
20.00-22.00 Reception at Büyük
Ankara hosted by Finance
Minister to meet Directors
General of SEE's and other
agencies dealing with Bank
Projects.

Overnight at Büyük Ankara Hotel, Ankara

April 11, Tuesday : 8.30- 9.30 Meeting with Industry Minister
Orhan Alp
9.45-10.45 Meeting with Agriculture Minister
Mehmet Queller
11.00-12.00 Meeting with Public Work
Minister *Serapettin Elici*
12.15-14.30 Lunch hosted by Finance
Minister to meet Deputy
Prime Ministers and Key
Ministers.
15.30- Meeting on Plan of Action with
Transport Minister
18.30- Leave for Antalya

Overnight at Hotel Antalya

April 12, Wednesday :

8.30- 9.15	Drive Antalya to Perge
9.15-10.15	Visit Perge
10.15-10.45	Drive from Perge to Aspendos
10.45-11.45	Visit Aspendos
11.45-12.45	Visit Irrigation Rehabilitation Project at Köprüçay
12.45-13.30	Drive Köprüçay for Side
13.30-15.00	Lunch at Side
15.00-16:00	Visit Side
16.00-17.30	Drive Side-Antalya Hotel
18.30-18.45	Antalya Hotel-Airport
19.30-20.20	Antalya- Istanbul

Overnight at Istanbul Hilton

April 13, Thursday :

8.00-	Breakfast at Hotel Çınar hosted by Prime Minister for Wrap-up meeting
9.30-10.30	Meeting with Reconstruction Minister at Hotel Çınar
10.45-12.15	Wrap-up meeting with Finance Minister at Hotel Çınar
12.30-14.30	Lunch with Governor and Mayor of Istanbul
15.00-17.30	Hilton Hotel for meeting with leading Turkish entrepreneurs.
18.00-	Free

April 18, 1978

His Excellency
Ziya Muezzinoglu
Minister of Finance
Ministry of Finance
Ankara, Turkey.

Dear Mr. Minister:

The discussions which my associates and I have had with yourself and members of your Government in the last few days have been extremely interesting and fruitful. I should like to thank you and, through you, each of the Ministers we met, for the time which was devoted to explaining the problems of their sectors to our delegation. It was a particular privilege to meet so extensively with the Prime Minister, to whom I am writing separately to thank him for his interest.

Our discussions covered a number of issues of mutual interest and I should like to record my understanding of the matters raised by your Government and to restate the responses which we were able to give you on behalf of the Bank.

It seems to me that, at this time the Turkish Government seeks the cooperation of the Bank on three different issues. First, you have asked that the Bank increase its lending to Turkey with a view to doubling the volume of commitments within the foreseeable future. Second, you have stressed the importance to Turkey at the present juncture of a quick-disbursing program loan to finance essential imports which the country urgently needs. Third, you have suggested that the Bank cooperate with you in finding ways to speed up the disbursements on existing loans, of which \$700 million are still undisbursed.

We were able to give you a positive reaction on each of these points, while pointing out some of the hurdles which we will jointly have to overcome on some of them, bearing in mind the Bank's Articles of Agreement and its basic procedures. Let me deal with each one of these points in turn.

We are in full agreement with the point made by the Turkish Government that the scale of World Bank loan commitments to Turkey has been relatively low, when compared to other countries of similar size, potential and development and we are prepared to work with your

His Excellency
Ziya Muezzinoglu

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April 18, 1978

competent authorities to prepare the sectoral and technical studies relating to the pipeline of new projects which will allow for an expansion of bank lending on the scale which you desire. It is my understanding that you desire an early start of such preparations and that you wish our experts to undertake the necessary work, in cooperation with the Ministry of State for Economic Coordination, the Ministry of Finance, the SPO and other Ministries, as appropriate, in accordance with the coordinating mechanism which has been outlined by you.

With regard to your request for a program loan, you are aware that the Bank's Articles prohibit such loans unless "exceptional circumstances" can be clearly demonstrated. In the light of our conversations, I believe it can be demonstrated that such "exceptional circumstances" do exist in the case of Turkey; however, for the purposes of obtaining approval of our Board for such a loan, a number of arguments would have to be made for such a case to be successful and persuasive. Invariably, Bank program loans have been predicated on the existence of a country's sound development plan. I have understood from you that it is a Turkish constitutional requirement to undertake economic and social development within the framework of long-term plans, that a new plan is under active preparation and due to be completed this fall, and that it contains the policies and measures which will pave the way for a gradual disappearance of these "exceptional circumstances". The plan will be the basis for this loan and also the basis for a general expansion of Bank lending and we should be happy to discuss it with your authorities at a time and in a manner which you deem appropriate. I was particularly sensitive to the argument that an early import loan would help to provide raw materials, without which many plants are now working below capacity. I have noted with interest your statement that such a loan would: (i) support a strong drive towards exports; (ii) supplement additional external financing; and (iii) be used both for public sector and export-oriented private enterprises. It is these points which would form the essential basis for my proposal to our Board on such a loan, and we have agreed to send an early economic and technical mission to Ankara to prepare, with the help of your authorities, the necessary data which will support the proposal.

On the third point which was raised, we agree with you on the urgency, for both sides, of examining the many projects which have been financed in the past where the loan disbursements have been slow, or there has been no disbursement. We agree with you that a suitable procedure might be for the Turkish authorities to examine urgently, each individual project where problems have arisen, to identify where the problem lies and decide on solutions to the matter. In particular, and wherever needed, a new and accelerated disbursement schedule should

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His Excellency
Ziya Muezzinoglu

- 3 -

April 18, 1978

be agreed by both sides, which can be regularly monitored subsequently. When the Turkish authorities have completed this examination, senior members of the Bank would be available to discuss with you any matters relating to possible Bank actions such as amendments or cancellations of loan agreements that may become necessary in the light of your examination. It became quite clear to me during our discussions, that the new Turkish Government is as concerned as the Bank by the continued accumulation of unspent funds, which, on the one hand, deprives your economy of badly needed foreign exchange and on the other, would make it exceedingly difficult for me, for obvious reasons, to propose the expansion of Bank commitments which we both desire and the recommendation on an import loan which is so urgent. We are therefore at your disposal for any assistance we can offer for an early solution of this problem.

During the period of expansion of our cooperation, we have noted your wish that our regular consultations should continue as before. We agree with your proposal that the Problem Projects Review, carried out twice a year since 1975, should result in conclusions at the decision-making level, so as to lead to immediate corrective actions, where needed. We also accept with pleasure your Government's expressed intention to invite Bank missions to Turkey once every year to exchange views on current and future activities and also for the purpose of updating the Bank's knowledge on the Turkish economy.

Let me, once again, Mr. Minister thank you and your colleagues and associates for the very warm hospitality which we have received during our stay in your country.

With warm regards.

Sincerely,

(Signed) R. S. McNamara
Robert S. McNamara

cc: His Excellency
Bulent Ecevit
Prime Minister
Republic of Turkey.

His Excellency
Hilmet Cetin
Minister of State for Economic Coordination
Ankara, Turkey.

cc: Messrs. Knapp, Chenery, Baum, Knox, Dubey, Bart (o/r), MPBenjenk/AJDavar:bb
Mr. McNamara's Office (2), Mr. de Lusignan. April 17, 1978

cc: Messrs. de Groote, Executive Director; Bilget, Alternate Exec. Dir.;
Guyen, Embassy of Turkey.

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World Bank / 1818 H Street, N.W., Washington, D.C. 20433, U.S.A. • Telephone: (202) 477-1234 • Cables: INTBAFRAD

April 15, 1978

Ministry of Finance
Ankara, Turkey

and

Türkiye Elektrik Kurumu (TEK)
Ankara, Turkey

Dear Sirs:

Rate of Return Under Loans Nos. : 1194-TU and 1023-TU

1. As you are aware, Loan No. 1194-TU for the Second TEK Transmission Project has not yet been declared effective since it would be in a default situation because of TEK's inability to meet the covenanted rate of return, on an asset base revalued on principles reflected in the loan documents for that project, as well as in those documents for Loan No. 1023-TU.
2. We have, moreover, been informed by the Government during Mr. McNamara's recent visit to Turkey, that at this time, TEK is not in a position to implement this covenant. To do so, we understand, the bulk tariffs for power would have to be considerably increased from their present levels, thereby giving a further impetus to the high inflation prevailing in Turkey, when the Government's economic stabilisation policies rest on the basic premise of controlling it.
3. The Government has nevertheless pointed out, that as a result of recent increases in retail power tariffs charged by several Turkish municipalities, some of them on the basis of structured progressive tariffs, the ultimate domestic and industrial user is not paying a subsidised price for power. It has also expressed its intention to encourage the introduction of such a progressive tariff structure, in the near future, in most of these municipalities. We further understand that the present level of retail power tariffs would, in some cases, enable municipalities to earn returns exceeding 8 per cent on their power distribution and related assets.
4. We have therefore reviewed these arguments in light of the following three objectives of any rate of return covenant. These are to ensure that:



- (i) scarce fiscal resources needed for investments, are not misallocated;
- (ii) users pay sufficiently for the benefits provided to them by a public utility, to avoid creating a favored group, and
- (iii) the financial viability of the concerned entity is not adversely affected by financing such investments.

5. In view of the Government's above-mentioned policies, we concur that the first two objectives are being largely met, because of the present level of retail power tariffs paid by the ultimate domestic and industrial users. To the extent a subsidy element exists, it does essentially in respect of TEK's (and DSI's) investments for the generation and transmission of bulk power, and in the transport, gas, water or sewerage operations of some Turkish municipalities. We are however pleased to learn that subject to the Parliament approving the new tax reform package it is currently considering, and which approval is likely, there will be a substantial increase in municipal tax revenues. This, combined with the Government's announced policy of making periodic adjustments in the charges for these other facilities, should ensure that municipalities do not divert revenues generated from retail power sales to meet their operating or investment costs.

6. As regards the third objective, we are informed by the Government that the above-mentioned tax legislation empowers the Finance Ministry, which is to collect and redistribute the new municipal taxes, to pay to TEK all of municipal arrears accumulated so far. It is also empowered to make similar payments promptly to TEK from the tax share of the concerned municipality, in the unlikely event that it still defaults on future payments.

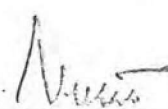
7. The Government has emphasized that it places topmost priority on power sector investments, because electricity shortages have forced industrial users to curtail production and has also affected domestic users. It has therefore stressed its intention to use on a high priority basis, central budgetary resources, in order to meet the substantial investment costs, of which TEK cannot meet a greater proportion because of the present level of bulk power tariffs. We have noted that it continues to be the Government's accepted principle that a reasonable cost of such investments should also be met by users

who purchase bulk power from TEK. We have noted that the Government wishes to defer the application of this principle until the present economic situation is restored to normalcy.

8. In this background and circumstances, the Bank accedes to the Government's request for a waiver of the rate of return covenant under both Loan Nos. 1194-TU and 1023-TU, for a duration of 18 months, i.e. until December 31, 1979, subject to the continuation of the Governmental and municipal policies summarized in para. 5 above, and on the understanding that actions would be taken by January 1, 1980 to adjust bulk power tariffs to enable TEK to earn a 5.5 per cent return in 1980, and gradually increasing them to ultimately earn an 8 per cent return in 1982. Such a return would be earned on an asset base revalued on principles reflected in the loan documents, with the cost of each new facility being revalued for inclusion in the asset base as soon as it is put into full productive use.

Very truly yours,

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT



Authorized Representative

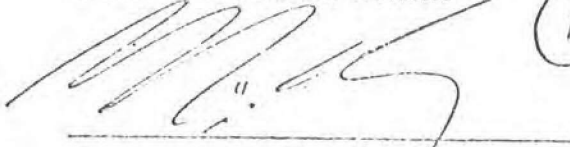
Confirmed:

REPUBLIC OF TURKEY

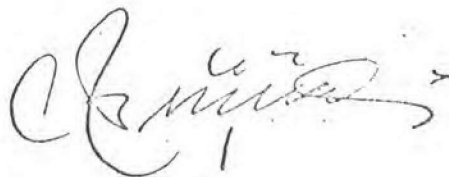


Authorized Representative

TÜRKİYE ELEKTRİK KURUMU



Authorized Representative



REPUBLIC OF TURKEY LETTERHEAD

International Bank for
Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Dear Mr. McNamara:

In connection with the proposed loan to the Republic of Turkey to assist in financing our Karakaya Hydroelectric Project, we represent that we shall ensure that the Karakaya hydroelectric facilities will be constructed and operated, and that the initial filling of the Karakaya reservoir will be conducted, in such a manner as shall cause the mean flow of the Euphrates river waters to average during each calendar month not less than 500 cubic meters of water per second as measured at or near the city of Birecik; any shortfall in such mean flow will be made up during the next following calendar month by releasing an additional volume of water over and above the volume of water needed to meet the mean flow required that month.

It is our understanding that, in making the proposed loan, the Bank intends to rely on the representation set forth in this letter

The above measures will be applied as long as Turkey has not developed a level of consumptive use of Euphrates water in its territories, which would limit their applicability.

Sincerely yours,

Minister of Finance

OFFICE MEMORANDUM

CONFIDENTIAL

TO: Files

FROM: A. David Knox, Act. RVP, EMENA *AK*

SUBJECT: TURKEY - Visit of the Minister of Finance

DATE: August 18, 1978

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The Turkish Finance Minister, Mr. Ziya Muezzinoglu, accompanied by Mr. Bilget, visited Mr. McNamara on August 17, 1978. Mr. Stern and I were also present.

The Minister began by explaining that he was in Washington briefly for a meeting with the US Government and that he was taking the opportunity to have talks with both the Fund and the Bank. As regards his talks with the Fund, he said that he had just come from a long meeting with the Acting Managing Director and that he would be meeting with him again on August 18. In reply to Mr. McNamara's questions he expressed some hope of reaching an agreement with the Fund which would permit the August 26 drawing but he was not sure that the Fund fully understood the complexities of the situation and might be asking the present government to pay for past errors which it could not do.

The Minister stressed that the stand-by agreement with the Fund and the government's stabilization program were very recent, dating only from March-April of this year. It was too early to judge the success of the program and he thought that the Fund might be looking for too quick results. His own view was that some progress had been made. He cited price and export figures. Prices had been rising at between 4% and 5% per month in the first quarter of this year, whereas in June they had gone up by only 1.8%. Exports were probably some 20% higher in July in real terms as compared with the same month last year. Moreover, it was important to realize that this export growth was mainly in agricultural products. The expansion of industrial exports had been hampered by the lack of foreign exchange to pay for inputs. This lack in turn was partly because the banking community had been very slow in arranging credits that it had promised.

Turning to another subject, Mr. McNamara said that he was pleased that efforts were being made to improve the implementation of Bank financed projects. He noted that we hoped to have project by project disbursement targets agreed with the Turkish authorities by about September. He stressed the importance for the Bank's future lending of using funds already committed to Turkey.

After some brief discussion of the status of the FY79 Lending Program, Mr. McNamara asked whether Turkey was going ahead with the Karakaya project. The Minister replied that discussions with some possible sources of finance were still under way and expressed regret that the Bank had had to withdraw since he knew the Bank's great interest in financing this project. Mr. McNamara said that it did not really matter who financed it provided it went ahead since it was so important for dealing with the problems of the Turkish power sector.

August 18, 1978

On the program loan, Mr. McNamara wanted to know the status of the medium term plan. I told him that the plan itself was not expected to be ready until probably the late fall but that our present mission was trying to see how far we could progress on the basis of a preliminary outline of the plan. The Minister told us that they were at the stage of preparing the basic strategy for the plan and that they were putting particular emphasis on the problems of the balance of payments, an emphasis which Mr. McNamara welcomed. Mr. McNamara went on to emphasize three points that were critical for a program loan:

- a) We would need a good medium term plan;
- b) the loan should be designed to assist exports; and
- c) there should be a sound stabilization program.

We would review our position in the light of the findings of our present mission, which was due back in Washington next week. In addition, Mr. Benjenk would no doubt want to have some discussions with the Turkish authorities after the mission had briefed him on its findings.

In connection with the importance of strengthening the balance of payments, Mr. McNamara asked why Turkey did not move to a crawling peg system along the Brazilian lines. He emphasized that he was asking out of interest and not in order to bring any pressure on the Turkish Government. The Minister replied that his government was moving in that direction. Having adopted the SDR as their basis, they had already made some changes against currencies other than the US dollar. The government was trying to prepare public opinion for the concept that exchange rate changes might come automatically.

At the end of the meeting the Minister made a plea for Mr. McNamara's support in Turkey's discussions with the Fund. Mr. McNamara urged the Minister to stay in town long enough to talk things out with the Fund since satisfactory arrangements with the Fund were vital to Turkey's progress.

cc: Mr. McNamara
Mr. Stern
Mr. Benjenk o/r
Mr. de Lusignan/Mr. Bart o/r

ADKnox/mv

28

CC

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
ROUGH: Mr. Ernest Stern, Vice President, Operations *es.*
FROM: A. David Knox, Acting Regional Vice President, EMENA

DATE: August 17, 1978

SUBJECT: TURKEY - Visit of the Minister of Finance

If the program loan comes up you should stress the importance of the export program as suggested in #7. I have asked the Region to focus on this with Turkey since a) it is crucial to long-term progress b) much can be done without new legislation c) the whole set of policies for the 4 year plan will not be agreed for some time in any event are too vague a basis for a program loan.

1. This is to respond to your request for a brief note before you meet today at 3.30 pm. with Minister of Finance Ziya Muezzinoglu of Turkey. We only learned yesterday that the Minister, accompanied by Undersecretary of Finance, Vural Gucsavas (bio-data at Attachment 3), was in town for a couple of days and that he had a meeting yesterday morning with Mr. de Groote at the Turkish Embassy. We presume that the unanticipated visit of the Minister to Washington is an attempt to prevent a deterioration of Turkey's relations with the IMF, and in particular to press for approval of the next drawing (SDR 40 million) due on August 26 under the Standby Agreement reached with the IMF last April. We understand the Minister also planned to talk to the U.S. Government, which is unlikely to press the Fund, other than perhaps to urge the Fund to listen to Turkey's case. The Minister is meeting with Mr. Dale at noon today.

2. As you know, discussions between Turkey and the IMF have been stalled recently as indicated to you in my memo of August 3 (at Attachment 1 for easy reference). As far as I know, the status of Turkey's relations with the Fund remains unchanged. Last Friday, I had the occasion of talking to Mr. Whittome of the Fund, who confirmed that the Fund was unlikely to agree to the August 26 drawing. The problem at this stage seems to be essentially a question of lack of confidence: the Fund concedes that Turkey's technical violations of the April agreement are minor, but is concerned lest a compromise now will lead to a trend of worsening violations in the period ahead.

3. Meanwhile, our mission mentioned in my memo of August 3 has been agreed by the Government and is presently in Ankara to discuss medium-term policy issues related to our proposed program loan. The mission is to finalize its discussions by the end of the week and before its departure from Turkey, will brief Mr. Benjenk, who is now in Istanbul. In the light of the mission's conclusions, Mr. Benjenk plans to meet with senior governmental officials in Ankara next week.

4. Under these circumstances, I believe that during your meeting with the Minister, you will only be in a position to listen to his government's views regarding present economic and financial developments and Turkey's relations with the IMF.

5. You may also wish to refer to your talks last April in Ankara with the Minister and touch on the follow-up to the three main operational points raised by the Minister: a doubling of Bank lending, a program loan, and Bank cooperation in speeding disbursements on \$700 million in outstanding loans (your letter of April 18 confirming your positive reaction as well as hurdles to overcome is at Attachment 2).

August 17, 1978

6. With regard to achieving a doubling of Bank lending, you may wish to reiterate the importance of early and well coordinated project preparation efforts, including a more systematic effort than hitherto to seek co-financing, including commercial bank funds. For FY79, assuming further effective Government efforts along these lines on the projects under discussion, we are hopeful of achieving a substantial increase over the \$205 million committed in FY78 as a step toward the new target. You might ask the Minister to elaborate on recent press reports of "constructive" initial co-lending discussions with the Kuwait Development Fund, attributed to your suggestion.

7. With respect to the program loan, you may wish to express the hope that Turkey and the IMF can reach a mutually satisfactory understanding on the continued implementation of Turkey's stabilization program. You might remind the Minister that, while short-run financial policies are the concern of IMF, the resumption of Bank lending last spring and our willingness to consider a program loan were predicated on reaching agreement on a Fund standby. As to medium-term policies, pending the return of our mission, you might ask the Minister about measures that the Government contemplates, under the 4th Plan currently being prepared, to stimulate exports and tourism in the medium-term. The Minister may possibly ask for consideration of a substantially larger program loan than the \$125-150 million we have been contemplating. We would not recommend opening the door to such a possibility.

8. As concerns speeding disbursements, you may wish to express gratification over the initial efforts made by the Government. As a result of your April talks, the new project coordination committee, led by the Prime Ministry and including the State Planning Organization and the Finance Ministry, reviewed in detail the whole Bank loan portfolio with the implementing agencies. Their findings were then candidly discussed in Washington with the Bank, and the committee undertook to send us by the end of September proposed project-by-project disbursement targets, to be jointly monitored by the Government and the Bank. As foreseen in April, the committee also agreed to pursue all major implementation bottlenecks and in particular to send their specific proposals for more flexible and realistic interpretation of certain loan covenants in light of the Washington discussions. The committee's careful preparation, frankness, cooperativeness and problem-solving approach created a favorable atmosphere not always encountered in the past. You may wish to express the hope that the Government will follow-up this new start with full support for the committee's work.

cc: Messrs. Benjenk (o/r), Bart (o/r), Davar (o/r), EMENA

GdeLusignan/RBPalmer:mcm

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

CONFIDENTIAL

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
 Through: Mr. Roger Chaufournier
 FROM: A. David Knox, Acting R.V.P., EMENA *AK*
 SUBJECT: Relations Between the IMF and Turkey

DATE: August 3, 1978

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1. During the past two days we have had discussions with IMF staff and Mr. Bilget, Alternate Executive Director, regarding the progress of discussions between the IMF and Turkey in the context of the forthcoming drawing (August 26) under the April Standby Agreement. The purpose of this note is purely to keep you informed on a potentially very difficult situation.
2. The discussions have stalled because of disagreement on the process through which additional measures that are deemed to be necessary in the present circumstances are to be negotiated between the IMF and Turkey. The situation is complicated by the fact that Turkey is in technical violation on some aspects of the Standby Agreement. Failure to reach agreement on these questions could affect the August 26 drawing and conceivably affect the rest of the Standby. If this were to happen, it would have serious consequences for our Program Loan which is in an advanced stage of processing.
3. Mr. Bilget expressed strong concern that there might be a complete breakdown of communication between the IMF and Turkey, and suggested that you should call Mr. Ecevit to convince him of the importance of keeping discussions ongoing with the IMF. I have consulted with Mr. Benjenk and we both agree that it would be undesirable for you to get involved in the discussions between the IMF and Turkey at this stage.
4. However, we recognize that it is very important that the momentum towards improved economic management in Turkey should be maintained. Therefore, Mr. Benjenk and I believe that the Bank mission planned for August 10 to Turkey to discuss medium-term policy issues with a view to completing the processing of the Program Loan should be kept on schedule, and I have asked Mr. Bilget to get the Government's agreement to the mission. Also, Mr. Benjenk plans to arrive in Turkey on August 16th on leave and is prepared to help in any manner that is considered desirable by the Turks or the IMF to keep open the discussions on further measures. The Bank mission of August 10 could provide a useful input to him in case this intermediation is needed.
5. I am keeping in touch with Mr. Whittome of the Fund and will be briefing Mr. Benjenk before he arrives in Turkey.

VDubey/ad'A

cc: Mr. Benjenk o/r,
Mr. de Lusignan, ✓
 Mr. Haynes,
 Mr. Dubey

DECLASSIFIED

JUN 19 2013

WBG ARCHIVES

Mr. Robert S. McNamara

September 25 1978

M.P. Benjenk

STRICTLY CONFIDENTIAL

TURKEY : Your meeting with the Minister of Finance

Please find below some recent information which might be useful in your meeting with the Minister of Finance.

After my recent visit to Turkey, which coincided with some very difficult Turkey-IMF negotiations, I came to the conclusion that the Bank had to take the initiative in order to break the deadlock that threatens to develop in relations between (a) the IMF and Turkey, as negotiations approach for the November drawing, during which the IMF is likely to press hard for additional major devaluation, and (b) Turkey and the commercial banks; the latter are dragging their feet in concluding the large re-scheduling agreement mentioned in your brief, which is also supposed to provide fresh loan money for Turkey. The reasons for the difficulties that have arisen are explained in my memorandum to the Director of the European Department of the IMF, which you have seen and which is attached as a reminder. For your information Mr. Stern has also sent a copy of this to Mr. Dale of the IMF.

As a result of this memorandum, meetings have been held between the IMF and ourselves and agreement has been reached to proceed along the lines advocated by us, if the Turkish Minister agrees to work with us on the lines proposed. If he agrees we would then, (a) contact the commercial banks for \$150 million of cofinancing of our program loan (also of \$150 million), (b) the IMF would support this operation, *during due* late October, notwithstanding the fact that they are likely to have a very difficult and possibly unsuccessful negotiation with Turkey in November.

If we succeed in obtaining the commercial money for cofinancing of the program loan, this would give Turkey a breathing spell, say until February, to prepare for the measures on which the IMF insists and for which Turkey may not be ready in November. During this period, the Turkish Government will have to (a) authorize the Bank to review the next Five-Year Plan, (b) to understand that the commercial banks will increasingly look to the IMF and the Bank for judgments on Turkey and that it is in the interest of Turkey to provide us with the necessary information and work closely with us, rather than in an *advisory* manner. If the few months of respite are used well by all concerned then there is a much better chance of obtaining substantial "new money" from the commercial banks simultaneously with the next IMF sponsored devaluation.

I had meetings with the Turkish Minister of Finance yesterday, who found our views somewhat gloomy but seemed in general favor of my proposal without objecting too strongly -- as I had expected him to do -- to the idea of cross-default clauses with the commercial banks in the program loan. He still has illusions about getting commercial bank money soon without strings and without the IMF's blessing. Our scenario has the virtue of carrying the IMF with us during the next few months.

On the personal side I would recommend that you show some sympathy to the Minister, whose Government in its first nine months has courageously taken a number of extremely unpopular measures but which now has to pay the price of the extreme irresponsibility of its predecessors and find, therefore, that "life is unfair". You should, however, urge him to work with us on the basis proposed so that in a few months time we can support a stronger Turkish "case" for additional funds from the commercial banks. "Courageous" measures are not enough for commercial lenders if they do not see the end of the road ahead.

Att:

cc: Mr. Stern

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: October 6, 1978

FROM: ~~Adi J. Davar~~, Acting Director, EMCPIISUBJECT: TURKEY: Annual Meetings - Mr. McNamara's and Mr. Stern's Meetings
with the Turkish Delegation

1. The Turkish delegation headed by Finance Minister Muezzinoglu, met Mr. McNamara on September 26. Messrs. Stern, Benjenk, Chenery, Bart and Davar participated.
2. After reassuring the delegation of the Bank's desire to help, Mr. McNamara asked Mr. Benjenk to summarize how the Bank might be able to help to support Turkey's need for fresh funds. Mr. Benjenk summarized: to give fluidity to the economy at this stage, an injection of fresh monies was urgently needed, before the release of the next IMF tranche in late November; one possible way of achieving this was to try and obtain commercial bank financing along with the Bank's import program loan; this was difficult in itself and unlikely to make any headway, without cross-default arrangements; since the Bank was meanwhile predicating the program loan on the Minister's letter regarding export promotion, it was important that Turkey and the Bank should agree to review export policies and performance after a few months, before additional disbursements were made; the need for a Bank review of the next 5-Year Plan soon after Parliament approved it, was also important to back the program loan as well as to facilitate Turkey's effort to obtain new commercial monies; differences with IMF should be quickly resolved during the early November discussions, since that could affect the outlook of commercial banks on rescheduling and provision of new monies.
3. Mr. McNamara assured the Minister that the Bank was dedicated to help solve Turkey's economic problems, which were difficult enough to try the political strength of any government. However, unless the painful, but essential, actions ensuring gradual restoration of economic health are taken, neither the Bank nor anyone in the international financing community could put in further monies. In the circumstances, he was not surprised that the commercial banks had still "not delivered" on proposals either for rescheduling or for new monies. Mr. McNamara stressed that irrespective of what commercial banks might have told the Minister, Turkey would be living on hope if it expected these banks to move until the economic imbalances were corrected. Responding to the Minister's query, he felt that banks expected actions on devaluation, control of inflation, expenditures and similar items of concern to IMF. It was only if IMF was satisfied on these issues, that the commercial banks would really move. He therefore urged the Minister to regard the forthcoming IMF discussions as part of the "financial package" which Turkey wanted from the international financing community, and show all possible flexibility in reaching mutually satisfactory arrangements for the end-November tranche. In response to Mr. Benjenk's suggestion, Mr. McNamara was agreeable that we should now negotiate and take the program loan to the Board, since such monies were needed to provide liquidity to the economy, and not await the IMF discussions.

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4. Mr. McNamara however added, that while he was prepared to proceed with the program loan, it would be predicated on the following specific understandings with the Minister: (a) the export program and policies mentioned in the Minister's August letter, are effectively implemented; (b) the draft 5-Year Plan is completed by late 1978 as the Minister had indicated, and the Bank would review it soon thereafter; (c) \$150 million of co-financing for the program loan is arranged with commercial banks; and (d) a constructive dialogue resolving outstanding IMF issues is completed in November.

5. The Minister responded that the Bank could review the draft Plan, and added that it was based on the balance of payments thrust and a much lower growth in the next two years, although the stated growth target figure for the Plan period, averaged 8 percent. Turkey was also ready to make changes in the stabilization program, and if necessary, make a new program; it believes that rate and other adjustments are necessary, but the difference with IMF is mainly one of timing. He also felt that IMF had not fulfilled its part of the bargain on the Standby Agreement, namely, of persuading commercial banks to quickly reschedule and provide new monies. Mr. McNamara rejoined that until Turkey developed a viable debt management plan, with which IMF and Bank could help and then support, the commercial banks would continue to be hesitant, especially about providing new monies. The Minister, while accepting the idea of co-financing for the program loan, hesitated, because he felt that banks might demand cross-default arrangements with the Bank even on their Turkish loans other than for the program loan operations. Mr. McNamara believed this fear to be unfounded, but invited the Minister to discuss the matter and the implications of a cross-default arrangement with Messrs. Stern and Benjenk.

6. At a subsequent meeting on September 29 with Messrs. Stern and Benjenk (Messrs. Bart, Hornstein and Davar also participated), the cross-default arrangements were explained and clarified. Mr. Stern also handed documents illustrating the cross-default clauses in the three large co-financing operations in Brazil (Electrosul and Varefertil and Varefertil's Supplementary), as also a list of Bank-wide operations involving commercial co-financing. It was clarified that Turkey would have to negotiate the commercial bank co-financing, and that cross-default arrangements applied only to specific Bank projects to which co-financing was tied. The Minister then confirmed Turkey's readiness to seek co-financing for the program loan, on the basis of cross-default arrangements. He however preferred it to be sought from European and US banks having little or no exposure in Turkey, rather than those already rescheduling their loans and putting in new monies. Bank of America, First National of Chicago, Continental Trust, American Express, Central Rabo of Utrecht and Bank Paris y Pays Bas were mentioned as possibilities. The Minister promised to inform Turkey's financial advisers (Lazard Freres/Kuhn Loeb) and request them to assist and coordinate contacts between potential co-financiers and the Bank.

Cleared with & cc: Mr. Benjenk
cc: Messrs. Stern (VPO), Bart (o/r)(EM2), Knox (EMP), Hornstein (VPO),
Dubey (EMNVP), Asfour (EM2)
Mr. McNamara's Office (2)
Division 2A Staff

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