McNamara Papers

Contacts
Turkey (1979-1981)

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

CONFIDENTIAL

TO: Memorandum for the Record

DATE: April 13, 1979

FROM: Maurice P. Bart, Director, EMENA CPII

SUBJECT: TURKEY - Mr. McNamara's Meeting with Minister Leisler Kiep

1. Mr. McNamara met on March 30 with Mr. Walther Leisler Kiep, Minister of Finance in Hannover, to discuss his forthcoming trip to Turkey to pursue the program of assistance initiated at the Guadeloupe conference. Mr. Leisler Kiep was accompanied by Messrs. Kurth (ED), Rode (German Foreign office) and Luetzen Kirchen (Finance Ministry of Lower Saxony). Mr. Benjenk and I were present.

2. After a private meeting between Mr. McNamara and Mr. Leisler Kiep, a general discussion on Turkey's economic position and on the Bank's posture took place. Mr. McNamara indicated that the Bank was mostly concerned by the medium term policies which could correct the present situation; following its program loan it had made last November, it was processing many large loans which could be presented to the Executive Directors after agreement had been reached between Turkey and the IMF.

3. Mr. Benjenk expanded on the Bank's three key objectives. First, an economic mission was currently in Turkey to review the 5-year Plan, which assumed unrealistic levels of available resources and growth. While the Plan was unlikely to be revised, it had to be discounted as a chiefly political document. The Bank considered as one of its primary tasks the nudging of the Government towards realistic policies. Second, while sectoral policies had improved under the Ecevit Government institutional reform remained insufficient, disbursements slow, domestic and foreign resources insufficient. In sectoral policies, the Bank faced a problem of sensitivity and resistance to advice, in particular in the energy sector, which showed the least improvement; we were not sure whether cooperation with the responsible minister was possible. Third, we were working on a large pipeline of high priority projects which the Bank could not finance alone.

4. Mr. McNamara added that Mr. Ecevit faced a political problem; he was captive of his own left and had to contend with xenophobia. In contrast, the economic issues were clear: there was no way out without a devaluation or multiple exchange rates. Mr. Leisler Kiep interjected that the latter would be an administrative nightmare. Mr. Benjenk commented that Mr. Ecevit's program was attempting to do in an awkward way what devaluation would do naturally, i.e. force the private sector to export. Recent measures were all in the right direction: e.g. the increase in the prices of oil products and staples, the emphasis on exports, the reliance on Turkey's own resources, but the general thrust of the policy was democratic without being backed by the administration which this type of program required. Furthermore, Turkey could not end its predicament alone, except by defaulting on its debts.

CONFIDENTIAL

5. Mr. McNamara recalled that Mr. Ecevit had told him that if he failed, this would mean the end of democracy in Turkey and a military government. In order not to fail, difficult measures were inescapable: reform of the SEEs, increase in exports. And there was no substitute for an agreement with the IMF which was a necessary condition for the commercial banks to reschedule and give fresh money, and for the Bank to resume lending.

6. In reply to a query from Mr. Leisler Kiep, Mr. Benjenk said that Turkey a year ago considered Germany its best friend and the USA less friendly. In recent months, however, the situation had become reversed owing to the lifting of the US embargo what the Turkish government considered as Germany's rather restrictive economic attitude towards Turkey in a number of bilateral and multilateral discussions. Mr. Leisler Kiep concluded that Turkey's problem was essentially political. It was extremely important for the West to adopt the right approach from the start in order to find a common ground between the necessary reforms, the need for aid, and the political constraints.

7. At a subsequent meeting in Mr. Benjenk's office, Mr. Leisler Kiep was provided with a detailed account of the political situation, the problems into which the stabilization program--and consequently, the IMF had run into--and of prospects for official and commercial aid to Turkey.

cc: Mr. McNamara's office
Mr. Stern

cleared with and cc: Mr. Benjenk

MPBart/bp

OFFICE OF THE PRESIDENT

Meeting with Minister Walther Leisler-Kiep, March 30, 1979

Present: Messrs. McNamara, Kiep, Rhode, Luetzenkirchen, Kurth, Benjenk, Bart

Messrs. McNamara and Benjenk reported on the Bank's program in Turkey, particularly the second program loan which was scheduled for FY81 but could be brought forward to FY80, and the package of loans under preparation whose approval was contingent upon the Government's reaching agreement with the IMF. Mr. Benjenk said that the Government's Five-Year Plan was now being assessed by a Bank team; the Plan seemed to be highly unrealistic as to the availability of foreign and local resources and its projection of an average growth rate of 8% over five years. The Plan would have to be discounted because its revision at this point in time would be politically impossible. The Bank faced problems of slow disbursement of its $1.5 billion commitments in many sectors; however, its relationship in most sectors was better with the present Government than it had been with the former Government, except for the energy sector. Current projects in the areas of ports, storage, fertilizer, and private sector industry were all geared towards promoting exports or substituting for imports. In summing up, he said that the two major obstacles in the Bank's work with Turkey were the existence of an unrealistic plan and the political resistance to external advice.

Mr. McNamara said that Mr. Ecevit was a captive of his own Left which was led by the dynamic but xenophobic energy minister and which controlled about 30%-40% of the party. Turkey's present serious problems were mainly political because the economic measures to be taken were clear. There was no way for the economy to survive without a major devaluation but there was also no way to have such a devaluation accepted politically. Therefore, multiple exchange rates might be the solution for a transition period, though they would be an administrative nightmare.

Mr. Benjenk said that Mr. Ecevit's latest program, released last week, seemed to be courageous and designed to have the effects which a devaluation would produce more simply. The numerous regulations proposed instead of a devaluation could easily become a straghtjacket for the economy because of the Government bureaucracy's inability to administer them. In his speech, Mr. Ecevit had emphasized that the country should not count on outside help. However, without an IMF agreement, the country would default on its external debt and would be unable to obtain further external financing.

Mr. McNamara said that Mr. Ecevit had told him last year that, if he failed, this would be the end of democracy in Turkey. Although the Government's recent measures pointed in the right direction, they were not a substitute for an IMF agreement.

Mr. Kiep enquired about the Turkish Government's feelings about the role of Germany. Mr. Benjenk said that, in late 1978 (i.e., before the Guadeloupe meeting) Mr. Ecevit had told him that, when he came to power, he had considered Germany to be Turkey's "best friend" and the U.S. to be "the bad guy"; however, now it seemed at times to be the reverse.

CKW
April 9, 1979

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President DATE: March 28, 1979

FROM: Munir P. Benjenk, Regional Vice President, EMENA

SUBJECT: TURKEY: Your Meeting with Minister Leisler Kiep of Germany

1. Minister Leisler Kiep, Regional (Lower Saxony District) Finance Minister, who is co-ordinating the economic assistance effort with Turkey and OECD Secretary-General van Lennep on behalf of the four powers who met at Guadeloupe, is meeting you at 10.30 a.m. on Friday, March 30.

2. I would anticipate that Minister Kiep will wish to explore the Bank's posture on Turkey regarding: (i) the economic situation and policy actions which Turkey needs to take to emerge from the present crisis; and (ii) the coordination between the various economic assistance efforts under way. He will be also meeting Mr. de Larosiere on Friday.

Economic Situation and New Policy Measures

3. There have been no major developments since we briefed you on Turkey, before your visit to Bonn. The stabilization measures agreed by the Ecevit government under the IMF Standby Arrangements in April 1978, have achieved mixed results. While many of the economic comparators in 1978 show significant improvement over 1977, inflation appears to have stabilized at a high level of 50%, the operating losses of the SEEs rose by about TL 30 billion over the 1977 level despite substantial price increases over the last 15 months, and exports as well as remittances have not responded as much as anticipated by the March 1978 devaluation. On the other hand, compared to a current account deficit of $3.5 million in 1977 and $1.8 billion envisaged under the Standby, the deficit was about $1.64 billion in 1978. This was however achieved by curbing imports further to only $4.6 billion, compared to $5 billion envisaged under the Standby and the $5.8 billion peak reached in 1978. On the external front, despite completion of negotiations with all OECD countries on the rescheduling of $1.2 billion of debt service on guaranteed bilateral debts and securing of commitments totalling $1.3 billion from a variety of new sources, external financing continued to be extremely tight in 1978. Arrangements to finalize the rescheduling of commercial bank debts of about $3 billion and the securing of fresh loans of about $400 million from them, are pending the completion of the renegotiations of the Standby with IMF. These and other recent economic developments are summarized in Annex I.

4. The discussions with the IMF, were begun in December. Despite a further exploration of views with IMF earlier this month, by the Turkish delegation to the Interim Committee meetings, differences persist. IMF believes, and we concur, that what is required now are: realistic adjustments in credit ceilings, effective restraints on wage increases, stronger measures to reduce SEE losses and a major devaluation. The devaluation issue seems to be taking an increasing political weight and Mr. Ecevit has publicly stated on several occasions - the last time when announcing a new Austerity Program to his party last week - that he is adamantly opposed to a new devaluation.

5. Not all the details of the Austerity Program have yet been made public, or conveyed to IMF. The announced measures appear to go in the right direction. For example, to improve the financial situation of the SEEs, prices of gasoline, petroleum products, iron, steel, cement, sugar and tobacco have been substantially raised to yield an anticipated TL 80 billion in the 1979 fiscal year (March 1979-February 1980). A multiple exchange rate system providing a more favorable rate only for remittances, foreign tourists and selected exports, has been mentioned to the IMF but has not yet been announced as part of the package. Similarly, an increase by a few percentage points in the interest rate on government bonds with corresponding increases in those of lending to various sectors, has been mentioned, but not yet announced.

6. Even if these short-term measures, including the multiple exchange rate system, are modified following discussions with the IMF, they would merely be palliative unless accompanied by medium-term policies attacking the structural roots of Turkey's problems. These policies, outlined in your November 21, 1978 letter to Prime Minister Ecevit (in Annex 2, with his reply), include: (a) an export and tourism drive, for which a further devaluation or adequate multiple rates are a key prerequisite; (b) measures to curb inflation, including effective demand management, restraints on investment and consumption (public and private), and increases in public sector revenues; (c) measures to increase productivity, especially in the public sector; and (d) a reorientation of the structure of production to alleviate the serious unemployment problem.

7. Although the new 5-Year Plan, approved in November, aims at correcting the structural weaknesses in Turkey's balance of payments through emphasis on exports, a major shift away from Turkey's traditional import substitution strategy and growth policies is not apparent in that document. It is, therefore, essential that despite what is stated in the Plan (essentially a political document) the Government should pragmatically tailor development targets and objectives to the availability of resources, through the mechanism of Annual Programs approved each year by Parliament. The Bank economic mission visiting Turkey in April, will focus more on medium-term strategies and policies in the context of the new Plan, and discussing these issues.

OECD Assistance Plan

8. In this background, the direction and outcome of the economic assistance effort entrusted to Mr. van Lennep and being coordinated with Turkey by Minister Kiep, becomes quite critical for Turkey. The Bank has provided the requested data and analytical input requested by OECD and agreed to participate in future meetings. Meanwhile, Turkey has made it clear to Mr. van Lennep that it does not agree with the concept of having "wise men" to review and advise on policy matters as part of the OECD's economic assistance efforts, and that it prefers to rely on the IMF and the Bank for discussions of short and medium-term policies respectively. We are therefore not quite clear on the next steps that OECD and the Guadaloupe powers now propose taking. You will wish to ascertain this from Minister Kiep.

9. Besides this, it would be useful to convey the Bank's preliminary views on this effort, to supplement what you must have conveyed to the Germans during your Bonn meeting last month. Clearly, Turkey is expecting too much

in money terms from the exercise and is apparently linking it to the sizeable gap of nearly $15 billion needed to implement the new Plan. On the other hand, OECD countries are in no position to come anywhere close to providing this. Besides a $400 million Eurodollar loan that OECD is talking about (presumably the fresh monies agreed to in principle by the commercial banks), the US has included only $100 million in the FY80 AID appropriation bill for Turkey (although last week President Carter has approved in principle, a request for an increase to $200 million); Germany is talking of upping its 1978 commitment level by between $100 million to $150 million; and the Saudi Fund is prepared to give $200 million of project aid over three years, outside the OECD framework. Furthermore, it appears that Mr. van Lennep still plans to include, in addition to IMF's requirements, a set of medium-term policies upon which the aid package would be contingent, but which could support a continued aid program on the part of the OECD countries.

10. In this context and considering the limited familiarity of the OECD staff with Turkey's economic and political problems and negotiating tactics, it appears advisable that: (a) the policy package to be included in the plan of assistance be consonant, to the maximum extent possible, with the positions taken by the IMF and the Bank; (b) the van Lennep exercise be delinked from the needs of the new Plan and the assistance in 1979 be designed to help Turkey to bridge the minimum foreign exchange gap of about $1.3 to $1.5 billion (para. 8 of Annex 1); and (c) all donors do not make their contributions available at once, but while committing a sum, release it in installments during 1979 to permit Turkey to follow the lines of the revised IMF Standby Agreement. The German Government, which is one of the closest to Turkey's preoccupations, may lend a sympathetic ear to advice along the above lines. The crux of the message is that, while the rescue operation should be predicated on policy changes, it should not be expected to resolve overnight Turkey's long-standing problems which, like its short-term debt, may take a decade to cure.

11. Finally, it might be useful to mention that, anticipating that project implementation will improve gradually and the revision of the IMF Standby will be satisfactorily completed in the coming months, we are continuing to process the FY79 and 80 pipeline. In FY79 we have already provided $152.5 million (Program Loan and Bati Raman Engineering). Negotiations of Ports Rehabilitation ($75 million) have been completed and those for Grain Storage ($85 million) and TSKB XIII are scheduled for late April and early May, on the understanding that all would be submitted to the Board, only after Turkey and IMF agree on the revised Standby. Subject to this, Bank lending in FY79 should total about $352 million. Should the medium-term policy outlook emerging from our April economic mission and the van Lennep exercise appear conducive to sustained improvement in the economic situation, and should the review of export performance (scheduled for April) under our present Program Loan indicate that they are benefitting from the present export drive, I would consider that we should bring the second program loan, currently programmed for FY81S, forward into early FY80. Such a loan should command a high priority in our lending.

12. Should Mr. Kiep wish to pursue the discussion on the above or related points after your meeting, I would be glad to meet with him, or to arrange for senior EMENA staff to stopover in Germany when the need arises.

Attachments

cc: Mr. McNamara's Office (2)
cc: Messrs. Stern (VPO), Knox (EMP), Dubey (EMNVP), Faruqi/Wood (EM2)

AJDavar/MPBart:hr

Annex 1

Recent Economic Developments

1. Government estimates suggest that real GDP increased by about 3 percent in 1978, with a good harvest compensating for a reduced growth of manufacturing output. The consolidated budget deficit was TL 33.8 billion in the current fiscal year, compared with TL 47.7 billion in the corresponding period last year. But the operating losses of the State Economic Enterprises (SEEs),despite a succession of massive price increases in 1978, are estimated to have risen from about TL 20 billion in calendar 1977 to about TL 50 billion in calendar 1978. Nonetheless, Central Bank credit to the public sector increased by only 26 percent in the first 10 months of 1978, compared to 87 percent in the corresponding period of 1977. Over the same period of 1978, Central Bank credit to the private sector increased by 5 percent, compared to 23 percent in the corresponding period of 1977.

2. Merchandise exports in 1978, were $2.3 billion, a 30 percent increase in value over 1977, and marginally lower than $2.4 billion predicted under the April 1978 IMF Standby Arrangement. It might however be noted that the value of industrial exports declined. Merchandise imports declined from $5.8 billion in 1977 to $4.6 billion in 1978 (as compared with $5 billion envisaged under the Standby Arrangement). Worker remittances totalled $1 billion, the same as in 1977, but less than the $1.3 billion predicted under the Standby. Despite the OECD rescheduling exercise, net interest payments on external debt increased substantially. However, the current account deficit is provisionally estimated to have declined from $3.6 billion in 1977, to $1.6 billion in 1978. This is lower than the $1.9 billion predicted under the Standby.

3. Negotiations with all countries to reschedule more than $1 billion of short and medium-term bilateral debt, under the aegis of the May 1978 OECD Consortium agreement, are now complete. Moreover, acceptances of the Government's proposals to consolidate about $3 billion of commercial bank short-term debt have been received from over 90 percent of the 220 banks concerned; some of these banks have agreed to commit about $400 million in new monies. However, the finalization of both arrangements has been delayed, because the banks will not proceed until the ongoing Turkey-IMF discussions on the revision of the April Standby Arrangement are completed (para 5).

4. The new Fourth (1979-83) Plan was approved in November 1978. It envisages an average 18 percent annual growth in the volume of exports and an average annual real GDP growth rate of 8 percent, with real fixed investment growing at an average annual rate of 12 percent; the latter is to be financed through a marginal domestic savings rate of 35 percent and a balance of payments current account deficit averaging about $1.5 billion per annum. The Bank mission to review the Government's medium-term policies in the context of the Plan, most of whose targets appear overoptimistic in light of the current economic situation, is scheduled for early April. The 1979 Annual Program, now being discussed in the Parliament, again optimistically envisages a 6% real GDP growth and a decline in inflation to 20 percent. A 20 percent increase in the value of exports, with a 9 percent increase in that of imports, is expected to keep the current account deficit at around $1.5 billion. The 1979 Consolidated Budget, being considered at the same time together with the much-delayed tax reform bill, envisages a 35 percent increase in revenues and a 28 percent increase in expenditures, to reduce the fiscal deficit.

5. Discussions with IMF on the revision of the Standby, were adjourned in late December. IMF however submitted an Article IV Consultation Report on the economy

to its Board this week. IMF feels a revision of the Standy would require: a further major devaluation, strong measures to reduce SEE losses, more effective restraint of money wage increases, and adjustments of the credit ceilings of the April 1978 Standby arrangement to be complied without "window-dressing". IMF will release the late Nov. 78 and Jan. 79 tranches of the Standby Credit, only after the Standby is satisfactorily revised. By contrast, the Government's position is that "legally" the provisions of the Standby have been met, and the tranches should be released. Meanwhile the Government has prepared a new Austerity Program of stabilization measures, apparently reflecting some of IMF's concerns and announced some of the measures included thereon, e.g. substantial increases in SEE prices to bring in some TL 62 billion in the new Turkish fiscal year. While multiple exchange rate proposals and an increase in interest rates by a few percentage points are believed to be in the package, the details have not yet been made public or conveyed to IMF.

6. Turkey's strenuous effort in 1978 to secure external assistance was notable, more for the variety of sources tapped than for the sums secured (about $700 million in bilateral program/oil credits, $250 million in bilateral project credits and trade agreements, together with $350 million in Bank project and program loans and the IMF Standby).

7. In early 1979, however, the following four significant developments should help bolster Turkey's need for external resources:

(i) The Third EEC Protocol has been at last ratified. The Fourth Protocol and a promised Emergency Fund, could bring the total to over $1 billion in soft project loans during the Fourth Plan period (average of $200 million a year); besides, EEC might agree that Turkey's obligations to reduce tariffs under the terms of the Association Agreement be suspended for 5 years, while EEC will continue to reduce its tariffs on Turkish exports.

(ii) Mobilization of OPEC assistance, is being coordinated by President Quaddafi, following Mr. Ecevit's visit last month to Libya. Negotiations for assistance from Kuwait ($25 million) and Saudi Arabia ($250 million over 3 years) are well advanced.

(iii) The Witteveen facility, which should shortly come into operation, could increase the availability of IMF resources to Turkey, provided that the present disagreements are resolved. The amounts under the rules of the Facility are not large (Turkey's total net access to IMF resources under a normal standby arrangement, would be increased by $135 million). But the rules also contain an Exceptional Circumstances Clause, permitting larger sums (there is no formal limit on the amount) in cases of special need. IMF staff however emphasize that any such special supplement would, in practice, be quite tightly constrained by the overall availability of IMF resources.

(iv) Following Guadeloupe, the 4 powers requested OECD Secretary General van Lennep to prepare a "joint solidarity assistance action" by OECD member countries.

8. Taking into account only a 4 percent growth in the volume of imports over the 1978 levels and cautiously optimistic assumptions of export and worker remittances, besides the increased level of official aid agreed to in 1978, the foreign

exchange gap in 1979 is tentatively estimated at $1.3 billion and $1.7 billion in 1980. The details of the gap to be therefore covered by new and additional commitments of assistance, including the van Lennep exercise, are tentatively summarized in the Balance of Payments Table below:

	($ billions)		
	Estimate	Projected	
	1978	1979	1980
Exports of Goods and NFS	3.2	3.5	4.3
of which: Goods	2.3	2.5	3.0
Imports of Goods and NFS	-5.1	-5.4	-6.2
of which: Goods	-4.6	-4.9	-5.5
Workers' Remittances	1.0	1.1	1.3
Others (net)	-0.7	-1.1	-1.2
Current Account Balance	-1.6	-1.9	-1.8
Foreign Medium and Long-Term Debt Repayments (net of relief)	-0.4	-0.7 1/	-1.1 1/
Private Foreign Capital 2/	0.1	0.3	0.4
Public Medium and Long-term Borrowing (gross)	0.8	1.0 3/	0.8 3/
Other, mainly Short-term (net)	1.1 4/	-	-
Residual Foreign Exchange Gap 5/	-	1.3	1.7

Sources: 1978 -- Turkish Government and IMF Staff estimates.
1979 and 1980 -- Program Loan President's Report and Bank Debtor Reporting Service estimates.

1/ Estimated amortization of MLT debt incurred up to end 1978.
2/ Direct investment, imports with waiver, and private MLT borrowing.
3/ Estimated disbursements from increased MLT commitments up to end 1978.
4/ Mainly acceptance credits, IMF, Dresdner scheme, and arrears.
5/ Could be financed through new public MLT commitments, or net new short-term borrowings.

Annex 2

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

Office of the President

November 21 1978

Dear Mr. Prime Minister:

Earlier this month the Executive Directors of the Bank approved my recommendation for a \$150 million program loan to Turkey. This loan has since been signed and became effective last week. This action, together with the approval and signing of three project loans for \$205 million last June, and the strengthening of our projects pipeline in the last few months to meet with your request for higher World Bank lending to Turkey in the future, brings to a conclusion a first phase of the understanding we reached last April when I visited Turkey at your invitation. I am glad that in just a few months the World Bank was able to respond promptly, and in a variety of ways, to the growing needs of your country.

I felt the need to write to you today for two reasons; first, because we are now embarking on the next phase of our cooperation, which I consider of the highest importance if the cooperative path on which we jointly embarked last spring is to bring fruitful results in the medium and long run. You will remember my telling you, and I also stated this in my letter of April 18, 1978, to His Excellency the Minister of Finance, that a World Bank program of the magnitude you desire and, more specifically, the granting of a program loan, must necessarily be based on the existence of a solid development plan, which the Bank management can fully endorse when making recommendations for this level of lending. In view of the delays in finalizing the Plan and in order to meet Turkey's urgent need for fresh funds I agreed to my staff's recommendation that we should go forward with the program loan before being fully apprised of the new Plan and only on the basis of the Plan Outline, which had been made available to our economic mission. This decision, which was an act of faith justified by the courageous decisions on economic policy already made by your Government, in no way detracts from the need to proceed, as the next step, with an open dialogue between your Government and the Bank on the new Five Year Plan now that it has been approved by the Government and presented to Parliament. Such a review is particularly necessary, if we are to justify to our Board a greatly augmented lending program which you have requested from the Bank and for which we are making all the necessary technical preparations.

I am also writing this personal letter with a second and more immediate purpose in mind; I have to report to you, confidentially, that we had a great deal of difficulty getting the program loan through our Board. Many country representatives criticized us for presenting this loan before the successful conclusion of the forthcoming negotiations between Turkey and the IMF. Mr. Benjenk and his colleagues at the Board meeting finally convinced the Executive Directors that the unpopular decisions taken by your Government in its first few months in power, were a guarantee that future difficult decisions would also be made as required. The general consensus that emerged during the discussions was that the Turkish Government was certainly to be commended for having reversed the very dangerous trends in the economy that threatened Turkey late last year but also that additional difficult decisions needed to be taken in order to ensure that Turkey becomes the self-reliant, outward-looking country which I have heard you say you wish it to become in the next few years. In such a difficult period the Bank is anxious to help you not only with funds, as it has done in recent months, but also to contribute the experience in economic policy formulation which the Bank has acquired through its relationship with so many countries in the last three decades. I have therefore asked some of our leading economists in the Bank to prepare a paper containing our views of some of the immediate issues facing Turkey. It is brief and I am taking the opportunity of sending it to you with this letter.

I am sure it is as obvious to you as it is to us in the Bank that the main obstacle to a vigorous export and tourism drive which alone can redress Turkey's balance of payments gap, is an unrealistic exchange rate. However, further realignment of the exchange rate will be of little value, as the experience of the last few months shows, if the advantages gained thereby are more than wiped out by the progress of inflation. Equally, it is obvious to us from our own experience in many countries that the battle against inflation is a long one and cannot be won in a few weeks or months. What is therefore necessary for the next two or three years ahead, as the attached paper implies, is a foreign exchange system which gives export activities all the advantages of a new and favorable exchange rate and does not allow that to be lost when inflation catches up with it. Such a system would also go a long way towards attracting Turkish workers' remittances and savings, much of which now seem to be diverted towards financing unofficial imports of a non-priority nature. Similarly, tourism, to which you rightly attach great importance, would be furthered as there is evidence that tourists now prefer the less expensive facilities offered by countries such as Yugoslavia, Greece and Egypt. I hope that you will give this matter your most earnest consideration.

In writing the above I am sure I am right in assuming that it is the aim of your Government that Turkey should be an outward-looking country able to achieve growth by means of its own resources, and such reasonable inflows as are made available by friendly countries and international organizations, as well as some prudent borrowing from commercial banks. With regard to the latter, we have in recent weeks done our utmost to convince these banks that Turkey's potential represents a good risk for the future, in spite of present difficulties. But, it is quite obvious to me that these inflows will largely depend on the extent to which Turkey's economy can be diverted from what you once referred to as its "claustrophobia". You may be surprised to see from the attached memorandum that the Turkish economy is more closed to the outside world than any other we are familiar with, either capitalist or socialist. Surely it would be the greatest achievement of your Government if this trend were reversed and self-sustaining growth were achieved on the basis of Turkey's own dynamism and potential.

With a view to discussing these points, and other matters, with your authorities I am sending to Turkey a mission composed of senior Bank officials, headed by Mr. Maurice Bart, Director of Programs in the Europe, Middle East and North Africa Region, whom I am asking to deliver this letter to you. I hope you may have time to receive Mr. Bart during his stay in Ankara.

I have written this letter to you as a good friend of your country and drawing encouragement from the frankness and sincerity with which you spoke to me during my visit last spring. I wish you every success for the future.

Sincerely,

Robert S. McNamara

Robert S. McNamara

Att:

His Excellency
Bulent Ecevit
Prime Minister
The Republic of Turkey
Ankara, Turkey

November 21, 1978

TURKEY--SOME ECONOMIC POLICY ELEMENTS

Introduction

1. When it assumed office at the beginning of 1978, Mr. Ecevit's Government faced exceptionally severe economic problems. These have been tackled rapidly and with great political courage. Stabilization measures have been implemented; and a new Five Year Plan, which could redress some of the long-standing structural weaknesses of the economy, has been prepared. But the economic situation remains far from satisfactory. The purpose of this Note is thus to analyse some of the options which currently confront Turkish policy makers, and to outline policies which could ease certain outstanding economic problems within the framework of the Government's program of national objectives.

Crisis Management and Exports

2. To overcome the immediate threat of internal economic dislocation and to permit the gradual resumption of a rapid pace of growth and development, it will be necessary progressively to restore a sound balance of payments position. This will require a successful rescheduling of the bulk of the short-term debt built up over the past few years. The Government has already taken some effective steps in this direction. More importantly, it will require very careful demand management, since the trade balance is fundamentally determined by the balance between domestic demand (consumption plus investment) and domestic output. It is vital therefore that the Government should pursue fiscal and monetary policies consistent with maintaining the trade deficit at a level that can be financed through workers' remittances and external borrowing on sound terms. In the short run, when output and capacity use are constrained by a severe foreign exchange shortage, this must involve continued tight restraints on investment and consumption, both public and private. This restraint of demand, however, should have a beneficial effect on inflation and would thus complement the Government's direct efforts to reduce cost-push pressures on wages and prices.

3. But reducing the trade deficit to manageable proportions through disinflationary policies is only one part of the solution. It is also vital, in order to increase capacity utilization (thus easing the degree of demand restraint required) and ultimately to allow for further increases of capacity, first to maintain and then to raise the level of imports. Given the need to reduce the trade deficit, there is only one way in which an increase in imports can be achieved, and that is by raising the level and the rate of growth of exports.

4. To bring about a major increase in exports (which, incidentally, would permit an increase in imports also through raising Turkey's external borrowing capacity) would require some basic changes in the direction of Turkey's economic policy. Since the Second World War, Turkey's industrialization has been based principally on import substitution. This, especially in its early phases, was entirely appropriate and accelerated the process of modernization. But the experience of other countries indicates that import-substitution becomes progressively more difficult and costly, especially since it requires ever-increasing imports of capital and intermediate goods, but does not contribute to earning the foreign exchange needed to pay for them. Thus in Turkey, exports have lagged further and further behind imports; around 1970, Turkish exports paid for about three-quarters of Turkish imports; by 1977, this ratio was down to 40 percent. Moreover, the current ratio of exports to Gross Domestic Product (GDP) in Turkey is only 5 percent, which is extremely low by international standards: in Brazil the ratio is about 10 percent, and in Romania and Yugoslavia about 25 percent. Only in China, perhaps, among the major countries of the world, is the ratio of exports to GDP lower than in Turkey.

5. The need to promote Turkish exports, as the Government has publicly recognized, is thus of paramount importance, both to make rapid growth consistent with balance of payments equilibrium, and to encourage Turkish producers to achieve international standards of efficiency and quality (thus also benefiting domestic consumers). It is vital to consider how this might be achieved. The main contribution to a major and sustained growth of exports must come from manufactured products, and this will require a considerable re-orientation of industry away from the domestic market. At present, Turkish price and exchange policies confer a premium on imports, and thus favor importers and manufacturers supplying the protected domestic market. Thus a re-orientation towards exports can be brought about only if the Government takes steps to make Turkish producers competitive on world markets, and to make exporting at least as profitable, if not more so, as selling in the domestic market. There are various ways in which this could be done. One would be to reduce tariffs and relax quotas, which, by lessening the present high protection of the domestic market, would reduce the profit margins on production for domestic use. But this tactic, though highly desirable in the medium to long term, could not be undertaken in the short term because of the difficult balance of payments situation. Another set of tactics for increasing the profitability of exporting involves various forms of direct and indirect subsidy to exporters, of the sort which the Government has already implemented. These are extremely useful, but beyond a certain level would invite foreign retaliation, especially since the rates of subsidy that would be required to bring about the growth rate of exports envisaged in the Fourth Plan outline strategy would be extremely high. The third, the simplest, and in many ways the best, tactic for increasing the profitability of exporting is through exchange rate adjustment.

6. Exchange rate depreciation is of particular relevance in the Turkish context at the present time, since repeated past devaluations have regularly tended to lag behind rises in domestic costs and prices. As a result, the competitiveness of Turkish exports has deteriorated markedly since 1970, to the point where, for example, wages in the Turkish automotive industry are at the present exchange rate nearly as high as in the United Kingdom, resulting in substantially higher costs per unit of output. The fact that inflation has in the past been allowed to overtake devaluation also suggests that it would be desirable for Turkey to introduce a fairly automatic mechanism for making repeated small adjustments in response to divergences between inflation rates in Turkey and in her main trading partners--perhaps a "crawling peg" mechanism along the lines adopted by Brazil. This type of mechanism, whose implementation would have to be preceded by an initial devaluation of appropriate magnitude, would not only ease the political tensions that accompany devaluation both in Turkey and elsewhere; it would also provide Turkish producers with an assurance of continuing profit from exporting, which is essential if the necessary redirection of investment is to be accomplished. This redirection, moreover, would not be confined to manufacturing. The benefits of a more competitive exchange rate would be felt also in an increase of foreign exchange earnings from tourism, international transportation, and contracts for construction abroad. In addition, there is considerable scope for increasing agricultural exports, provided that the prices and other incentives with which farmers are confronted are such as to induce them to increase their production of commodities that can be profitably exported.

7. There are three possible objections to immediate implementation of a devaluation strategy in Turkey.

(1) The first is that an increase in exports would not result because domestic production capacity is too constrained by shortages of foreign exchange to permit any increase in exports. This objection is misconceived. To increase exports it is not necessary to raise the overall level of domestic production; it would be sufficient to divert some existing production away from the domestic market (as would happen if the relative profitability of exporting were to be increased). Such a diversion need not be large: a 2 percent increase in the share of industrial output exported (from its present level of 7 percent) would cause a 30 percent increase in industrial exports. Moreover, insofar as production of certain commodities for export is constrained by foreign exchange shortages, some diversion of production of other commodities from domestic use is essential if the vicious low-exports-low-imports-low exports circle is to be broken.

(2) Another possible objection to devaluation is that it would increase the cost of external debt service in terms of Turkish lira (though not in terms of foreign currency), and would thus strain the public finances. This objection is in principle correct, but it overlooks the fact that devaluation, by increasing exports and permitting faster growth, would have a beneficial effect on public revenues.

(3) A third possible objection to devaluation is that it would worsen inflation. This is to some degree correct, in that devaluation would elevate the domestic prices of some imported goods (the effect in other cases would simply be a reduction of importers' profit margins). But it is easy to exaggerate the effect of devaluation on domestic prices: since the ratio of imports to aggregate Turkish demand is small (around 12 percent in 1977), each 10 percent rise in import prices would directly raise domestic costs by only 1 or 2 percent. Moreover, there are other policies for reducing inflation, particularly demand management and direct control of cost-push pressures; a devaluation strategy would simply require that these be applied somewhat more stringently than would otherwise be necessary. This relatively minor cost should be set against the immense benefits that Turkey could derive from sustained expansion of exports, not least through enabling the balance between the demand and supply of resources to be struck at a level of income high enough to be socially and politically feasible.

From Crisis Management to Development

8. If, and probably only if, a rapid growth of exports over the medium term is achieved, will Turkey be able to resume and surpass the impressively high growth rates achieved over the past two decades. But this, in conjunction with the greater justice in the distribution of the costs and benefits of development which the present Government so rightly emphasizes, will require appropriate economic and social policies, as well as a number of structural reforms.

9. The measures necessary to increase exports have been outlined above, and these in themselves will necessarily bring about some significant changes in the structure of the economy, especially in the private sector. But rapid growth would also require a high level of investment, and this in turn could be reconciled with a manageable trade deficit only through a commensurate increase in domestic savings, which have stagnated at about 16 percent of GDP during the last seven years, largely because of the poor performance of public savings. [illegible], as the Government has [illegible], a sustained increase in public sector (including SEE) revenues, [illegible] public sector consumption, is required, whose implementation will require political skill and determination of the highest order. In addition, an interest rate structure that gave greater encouragement to saving, and less encouragement to capital-intensive investment, would help improve the balance between savings and investment in the private sector.

10. Enterprises in the Turkish economy must also learn to make more sparing and more efficient use of imported inputs, both in response to a competitive exchange rate and through direct Governmental encouragement, particularly in public sector enterprises. More generally, it is worth emphasizing that SEEs should play a driving role in all the various aspects of structural change outlined above. The complacency with which they have been managed in recent years has surely had a deleterious effect on Turkey's economic fabric, both through draining the exchequer and through the poor example, in terms of inadequate exports, excessive imports, and low productive efficiency, that they have provided to the private sector. Reforms are needed to upgrade their institutional structure and objectives, their management capability, and their project selection processes.

11. In the field of social justice, the Turkish Republic has successfully made a major effort to ensure that basic needs (nutrition, shelter, health and education) are largely met. But although further progress on these fronts is very desirable, the single most important social issue, both at the present time and in the foreseeable future, is unemployment. The labor force is increasing rapidly, and could continue to do so for decades unless population growth is restrained, while opportunities for working abroad are likely to remain limited. Thus to reduce unemployment, it is essential to increase the rate at which jobs are created in Turkey. One way to do this would be to maintain as high a growth rate as possible, and for this reason, if for no other, a drive to increase exports seems imperative. Another way would be to reorient the structure of production in such a way as to generate more jobs at any given growth rate. Here again, an export drive would be beneficial, since it would give an especially large stimulus to industries whose employment potential is relatively great. But a re-orientation of agricultural policies, and of policies which affect the techniques of production chosen in non-exporting industrial sectors, would also be needed.

12. To reduce unemployment, or at any rate to prevent it increasing further, would improve the distribution of income. But in this area also, other policies are needed, including tax reform, the curbing of speculation in land, and measures to raise agricultural productivity and incomes in relation to productivity and incomes in the non-agricultural sector. Within the agricultural sector itself, increased equality of incomes would require, among other things, land reform, although in practice this must probably be regarded as a longer-term objective.

13. All of the above problems and issues as the Fourth Plan outline reveals, are at the forefront of the minds of Turkish policy makers. Their successful resolution will require a consistent, comprehensive and, above all, realistic program. It is hoped that the new Plan (which we have not yet seen) will constitute such a program.

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President

DATE: March 29, 1979

FROM: Munir P. Benjenk, Regional Vice President, EMENA

SUBJECT: TURKEY: Your Meeting on March 30 with Minister Liesler Kiep of Germany

1. Further to my memorandum of March 28 providing a brief for your above-mentioned meeting, I understand that Minister Kiep may wish to exchange views on the implementation of the Elbistan Power Project, for which Germany is a major lender.

2. This project, jointly financed by Germany, EIB and the Bank, is still facing implementation problems. Because of past delays, the four power-generating units are now expected to be commissioned only in 1981, some 2-1/2 years behind schedule. However, following the co-lenders' mission in May 1978 and a detailed review of the bottlenecks, several remedial actions have been taken. Consequently, some improvements have been registered in project management and coordination and, thereby, in the physical aspects of project execution. Despite attempts to recruit personnel on significantly improved contract terms, adequate site staffing still remains a problem. So is inadequate financing, both domestic and foreign. Since 1978, despite interim arrangements made by the Treasury to cope with the problem, it is not foreign exchange, but rather the availability of local currency, that has become the immediate serious constraint on physical construction advancing at an adequate pace. Shortage of foreign exchange for the project, which has been a matter of greater concern for the Germans, will begin to loom large only in the near-term future. Against the currently estimated foreign exchange cost of $925 million, Turkey has mobilized only $710 million (almost all committed). It must find the balance of $215 million. Germany and EIB appear to be rather responsive to the Turkish proposal to provide supplementary financing. In this background, the German delegation, during its meeting with Mr. Stern at the bi-annual Bank-German meeting in October 1978, pressed the Bank to consider supplementary financing, to which a cautious response was given in view of our current policy on such financing. What is more important at this stage is to continue to press the Government - as we have done - to take the steps required to straighten out implementation before the next construction season in the spring. Failing such steps, it would be difficult for the Bank to continue to be associated to the project.

3. During my discussions this month with the EEC and the Saudi Fund, they were encouraged to consider providing some help to meet Elbistan's financing problems. EEC wishes to channel some $100 million (in addition to what the European Investment Bank would be providing) in a form which Turkey can quickly absorb, including local currency financing. They therefore seem willing to consider providing some of this money, to cover a portion of the local currency needs for Elbistan, which are so critical. The Saudi Fund might be prepared to provide some foreign exchange for Elbistan as part of their financial package for Turkey.

cc: Messrs. Stern (VPO), Knox (EMP), Bart (EM2)(o/r), Dubey (EMNVP), Palmer (EM2).

AJDavar:hr

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

March 23, 1979

URGENT

Mr. McNamara:

1. Chancellor Schmidt gave Mr. Kiep the minutes of your talk with the Chancellor to read.

2. Mr. Kiep will also see General Haig for a briefing.

3. Mr. Kiep said he was anxious to see you if and when you come through Europe next. He usually has a German airforce jet at his disposal and could go anywhere unless he happens to be in Turkey (or campaigning for his party in Northern Germany).

RBS

Rainer B. Steckhan

Att.
RS:mcl

Form No. 57 **INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT**

OFFICE MEMORANDUM

TO: Mr. Munir P. Benjenk, EMNVP

DATE: March 23, 1979

FROM: Rainer B. Steckhan, EUR Steckhan

SUBJECT: TURKEY -- Special Aid

URGENT

1. Today I saw Mr. Leisler Kiep, CDU Minister of Finance of the State of Lower Saxony and now Special Envoy of Federal Chancellor Schmidt as far as special aid to Turkey is concerned. Mr. Kiep had just met the Secretary General of the OECD. He said they both see their roles as complementary and that his job was to assist -- on behalf of Chancellor Schmidt -- the OECD Secretary General in the special aid effort.

2. Mr. Kiep explained that his first task would be to persuade the Turkish Government to seek agreement with the IMF on a program of financial rehabilitation which would not include politically unfeasible measures. In this respect, Mr. Kiep felt that the longer an agreement is delayed, the narrower Mr. Ecevit's room for maneuver will become and the less likely he will be to react rationally.

3. In addition, Mr. Kiep considered it imperative to line up substantial emergency funds for Turkey from the Big Five. In this context, he emphasized that Britain and France should put up more money than they had so far announced (he mentioned no figures). Without this, he was doubtful whether Japan would come forward with a substantial sum.

4. His next step will be to visit Washington for briefings from March 28 to 30. The German Embassy in Washington will prepare his program and unless they have already contacted your or Maurice Bart's office it might be wise to give them a call. I said you or -- in your absence -- Maurice Bart would be delighted to meet with him and to assist him in any way you can. By the way, Mr. Kiep is likely to be accompanied by Mr. Rode of the Foreign Office. In our conversation, Mr. Rode felt that devaluation in Turkey at this stage was not the right move to improve the balance of payments since for every dollar of exports, \$0.7 or 0.8 of imports would be required. I have given Mr. Kiep on a strictly personal and confidential basis some of the briefings which you prepared for Mr. McNamara's Bonn visit, and you may in your talks next week particularly insist on this aspect.

5. Mr. Kiep is planning to visit Turkey for about a week starting around April 5.

cc: Mr. Maurice Bart
RS:mcl

TU P/M

PRIME MINISTER

Ankara, 13th December 1978

Dear Mr. President,

Allow me to thank you for your kind letter of November 21 and for all that you have been doing to support our Government's efforts to revitalize Turkey's economy and to base our development efforts on a sounder course.

The understanding and constructive way in which the World Bank has approached our problems, under your wise guidance, during this period of economic crisis has been, in my eyes, an encouraging sign of international solidarity.

My Government appreciates the initiative that you have taken, together with your associates, in providing a $ 150 million programme loan to Turkey recently--this has given us a timely relief.

We shall appreciate the continuation of your constructive and inspiring efforts to make other financial institutions and organizations to approach the problems and to evaluate the potentials of Turkey in a more understanding and realistic way.

We would certainly be willing to consider such measures as would both facilitate your efforts to this end and to inspire a better understanding on the part of such organizations, although I am sure you would appreciate that we have been rather discouraged by the long delays in their functioning which rendered ineffective to a large extent most of the risky and difficult decisions we took earlier in the year. I cannot help fearing that the same disillusioning experiment may be repeated.

I have explained my views in this respect to your colleague Mr. Maurice Bart, who knows Turkey and our problems so well.

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Our Fourth Five-Year Development Plan has recently been adopted by the Parliament. Our experts will be glad to discuss its details with the World Bank experts.

In the meantime my colleagues are studying your remarks and suggestions as well as the report attached to your letter. We shall respond to them soon in detail.

We are now working on policies and institutions that should ease and shorten our way out of the crisis while enabling us to re-structure our economy on a long-term basis, within the framework of the Development Plan. We shall inform you, in due course, also on the results of these preparations.

I would like to thank you and your associates again, Mr. President, and allow me to take this opportunity to wish you a Merry Christmas and many happy years.

Sincerely,

Bülent Ecevit

His Excellency Robert S. McNamara
President
The World Bank
Washington D.C. 20433
U.S.A.

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Memorandum for the Record October 4, 1979

Maurice P. Bart, Director, CPII, EMENA MPB

Belgrade's Annual Meetings - Mr. McNamara's meeting with the Turkish Delegation.

1. Mr. McNamara met with Finance Minister Muezzinoglu on October 3, 1979.

Turkish Delegation	Bank
Messrs. Gucsavas	Messrs. Stern
Gunay	Benjenk
Ms. Oymen	Chenery
	Koch-Weser
	Bart

2. Mr. McNamara open the meeting by enquiring about the status of the Second Program Loan. Mr. Muezzinoglu indicated that, as far as Turkey was concerned, all preparations were completed and turned to Mr. Bart who said that the main issue outstanding related to the conditions to be negotiated by the end of October. Mr. McNamara underlined the importance of agreeing on measures which would bridge the present transitional period and pave the way for structural changes, to wit: a sound exchange rate, domestic savings, export orientation, employment generation and debt management.

10/19

3. Turning to the Karakaya project, Mr. McNamara said that unless the Government increased tariffs to enable TEK to earn a 5.5% rate of return in 1980, and established a satisfactory financial structure, it would not be possible to go to the Board, let alone get Board approval, for Karakaya or the supplemental loan for Elbistan. Mr. Muezzinoglu mentioned that the devaluation had complicated TEK's financial situation and that it would take longer than expected to clarify it. Mr. Gucsavas interjected that the Government hoped to discuss a cash generation covenant in the course of the reappraisal of Karakaya. Mr. McNamara saw no problem in this as long as the tariff increase was maintained; there would be no point in going ahead with the reappraisal if there was no agreement on this point.

4. Regarding the pipeline of projects, Mr. McNamara said that it was much too thin to enable the Bank to expand its assistance to Turkey. Turkey and the Bank should overplan to achieve their objectives. It was noted that while coordination was good between the Bank and the Treasury, it was not working properly within the Government. (Subsequently, Mr. Bart stressed to Mr. Gucsavas the need to entrust Bank matters to a high ranking and efficient official in the Treasury since present arrangements were not effective).

5. Mr. Muezzinoglu concluded the meeting with a brief overview of the general situation. A difficult political and economic situation lied ahead despite improvements in the economy over the past months. Workers' remittances had reached $1.3 billion since the beginning of the year against $0.5 billion in the same period in 1978. The Government had

achieved better demand management but inflation remained high, and a most complicated issue to resolve. For instance, the oil bill forecast for 1980 was $3.2 billion, or as much as exports. Hence the need to use other energy sources, such as Elbistan and Karakaya, and perhaps cooperate with the Bank in oil exploration. Mr. McNamara summed up the meeting by saying that the Bank would not be serving Turkey if it did not help her resolve the issues which had been discussed.

cc Messrs. Stern, Benjenk, Dubey, Davar

MPBart:rpo

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OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: December 26, 1979

FROM: Maurice P. Bart, Acting Regional Vice President, EMENA

SUBJECT: TURKEY - Mr. Esenbel's Meeting with Mr. McNamara

1. Mr. Esenbel, former Turkish Ambassador to Washington, called on Mr. McNamara on December 18. Mr. Koch-Weser and I were present.

2. Mr. Esenbel explained that, while he was making a personal visit to the USA, he had been asked by Prime Minister Demirel to call on Congress, the State Department and the Bank to relay the Government's determination to retain strong ties with its Western allies and to stress the economic difficulties it is facing. The external payments situation continues to be critical, oil shortages are widespread, and prompt external assistance is urgently needed. US aid to Turkey ($98 million) was unlikely to be approved by Congress before February. In the meantime, discussions with IMF and commercial banks were underway. Mr. Demirel hoped that the Bank would also help with a second program loan, and assistance in the fields of energy and rural development.

3. Mr. McNamara commented that these were exactly the areas where the Bank would like to move soon. He hoped that agreement with the IMF and action on power tariffs would facilitate the Bank's task. He suggested that Mr. Esenbel pursues the discussion with me regarding the main features of our program.

4. On December 20, Mr. Davar and I met with Mr. Esenbel and explained that we had already agreed with the Government that Mr. Davar would visit Ankara in early January to resume discussions on the medium-term economic policies and the lending and economic/sector work programs. The principal areas of economic policies that we hoped to discuss were explained to Mr. Esenbel. If the outcome of these discussions was favorable and if agreement was reached with the IMF, we hoped to be able to move fast on the second program loan. Preparation and appraisal of the other projects in the pipeline had continued unabated, but the loan for Karakaya was contingent upon the increase in power rates which the previous Government had undertaken to introduce by January 1, 1980. We also stressed the need to improve project coordination and implementation, to maintain close economic and sector dialogue and to speed up disbursements. Mr. Esenbel indicated he would inform Mr. Demirel of these problems.

Original to Mr. McNamara's Office

cc: Messrs. Stern, Benjenk o/r, Knox o/r, Dubey, Davar

/bp

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INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
DATE: December 18, 1979
THROUGH: Mr. E. Stern, VPO ES
FROM: Maurice P. Bart, Acting RVP, EMENA MPB

SUBJECT: Your Meeting With Mr. Melih Esenbel

1. Mr. Esenbel, who was in Washington until early 1979 as Turkey's Ambassador, and whom you know well, is scheduled to meet you at 6.30p.m. today. I will join you for this meeting.

2. Mr. Esenbel is in the US for "medical treatment", and he may be making only a courtesy call on you. But since he is quite close to Prime Minister Demirel, it is quite possible that he may have been asked to take the opportunity to convey a personal message to you.

3. The economic situation in Turkey continues to be difficult. Adherence to actions worked out in the context of the July 1979 Standby Arrangements to reinforce the stabilization efforts are therefore essential. After it won a vote of confidence in late November, the Demirel government immediately invited the IMF for "the review" which the Standby Arrangements envisaged prior to the release of the Second Tranche in late November. The IMF mission has been in Ankara since December 3 and is scheduled to return today. I understand from Mr. Whittome that there are good prospects that the Government would make a sizeable adjustment in the exchange rate and increase public revenues through fiscal measures and adjustments in SEE's prices. The Government is seeking from IMF the release of a larger Second Tranche, to compensate for the delay in releasing it by the scheduled date in late November, as well as help to mobilize cash from foreign banks, including the Bank for International Settlements, to alleviate growing illiquidity in foreign exchange. I would recommend that you advise Mr. Esenbel that Turkey should settle as quickly as possible with the IMF since both economic recovery and continued external aid are largely contingent upon pursued stabilization efforts.

4. As regards Bank assistance, there has been no abatement in our appraisal or preparation work. Three loans totalling $146 million have already been signed in the current fiscal year. You may also wish to emphasize that in order to enable you to recommend to our Executive Directors the continuation of an expanded program of Bank lending, including the Second Program Loan, it is important for the Bank to be satisfied that sound short-term and medium-term economic policies, including those discussed with the Ecevit Government in the context of our recent special economic report (which is due to be distributed to the EDs shortly) and of the Second Program Loan, would continue to be pursued by the new government. In this context, we have proposed to the Finance Minister, who has agreed, that a mission led by the Division Chief for Turkey, Mr. Davar, should visit Ankara in January to discuss the economic policies which the new government intends to pursue. You might note the importance these policies would have on the processing of the Second Program Loan and on the expansion of the Bank lending program. In this context, you might hope that the Government would indeed take actions in the coming weeks

to fulfill the undertaking given to you personally to increase the electric power rates from January 1, 1980, to enable TEK to earn a 5.5 percent return in calendar 1980. Should the economic and sectoral frameworks be conducive to expanded Bank lending, we would hope to exceed substantially in FY80 the level of $312 million reached last year. In fact, if all the projects in the program progressed smoothly, we could for the first time reach the $500 million mark.

cc: Mr. E. Stern

AJDavar:bb

I'm a bit more skeptical about the direction in which Demirel will move, and how fast.

ES

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
THROUGH: Mr. Shahid S. Husain, Acting VPO
FROM: Maurice P. Bart, Acting RVP, EMENA

DATE: February 4, 1980

SUBJECT: Your Meeting With Mr. Turgut Ozal

1. Mr. Turgut Ozal, Undersecretary, Prime Minister's Office and Acting Undersecretary, State Planning Organization (SPO), is scheduled to meet you at 5.30p.m. on February 5. Mr. Davar and I will join you.

Background for Visit

2. Mr. Ozal was one of the architects of Turkey's 1970 stabilization program. In 1972/73, he was a consultant and later, a staff member in our Industrial Projects Department. Thereafter, he joined private industry in Turkey. Politically, he is a member of Mr. Erbakan's National Salvation Party. But Mr. Demirel's reliance on him at this critical juncture, in shaping and implementing the economic package his government announced on January 25, underlines Mr. Ozal's reputation for pragmatism and decisiveness in Turkish circles.

3. Mr. Ozal can be expected to convey a personal message from the Prime Minister, stressing his Government's determination to take drastic economic measures, as evidenced by the January package, and urge on that basis that the Bank should proceed immediately with the proposed Program Loan II and help with increased loan assistance. He might also stress that such assistance could contribute significantly to a safety net of about $1 billion in foreign exchange, which Turkey requires to ensure the success of the new package of economic measures.

Present Situation

4. The economic situation is grim. Recent oil price increases will force Turkey to spend at least $3.2 billion on oil imports in 1980, ($2.5 billion in 1979), with oil consumption contained at the 1977 level. This bill is estimated to equal about 63 percent of Turkey's merchandise exports and non-factor services in 1980. Together with the rather hard terms on which the bilateral medium-term and the short-term commercial debts have been rescheduled, the next 3 years will be particularly difficult ones for Turkey, with extreme pressure on its balance of payments. Furthermore, inflation has reached 80 percent in 1979. However, the Government clearly recognizes that the 2-1/2 year old economic crisis can no longer be resolved through short-term palliatives, and medium-term measures - including some structural changes - must be undertaken. There is also determination to do so. The threat of intervention implicit in the Turkish military chiefs' recent warning to political parties to resolve pressing internal security and economic problems quickly, is being used by this Government to introduce the necessary changes, without being undercut by the usual doctrinaire opposition of other political parties. It is against this background, that after discussions with the IMF in December and the tacit approval of the Military and key political parties, the Government announced its rather far-sweeping economic package on January 25.

The New Economic Package

5. The package considerably exceeds the bounds of a normal stabilization package, and will inevitably bring about policy and structural changes of some sweep in the medium-term. The four key departures from traditional Turkish economic policies which that package contains, are highlighted below:

(a) The TL has been devalued by nearly 100 percent, to TL70 = US$1.00; a lower rate of TL55 = US$1.00 now applies only to the imports of fertilizers, insecticides and their inputs. Significantly however, the principle is implicitly built into the package that in future, the TL's parity value based on the differential inflation in Turkey and that of its weakest trading partner, will almost automatically be made by the Central Bank following consultation with a new Money and Financial Committee, now headed by Mr. Ozal.

(b) Prices of several SEE products and services, to add some TL350 billion to 1980 revenues, have been increased from between 50 to 300 percent. (Among these, bulk power tariffs have been raised from 120 krs/kwh to 280 krs/kwh.) More importantly, except for cargo rates for railways and shipping, coal/lignite and electricity tariffs for aluminium and ferrochrome production, all SEE goods and services have been taken off the list of "basic items" whose prices only the Cabinet could fix. In future, the Boards of the SEEs will fix their prices, which must not only cover their operating costs but also generate the cash for their future investments; neither will any longer be funded from the central budget, nor by borrowings from the Central Bank. This policy would be a milestone in Turkish economic management, if it holds.

(c) Substantial measures have been announced to provide additional incentives for exports, to liberalize the import licensing regime and to stimulate foreign investment in agriculture, mining, industry and especially, oil exploration/production. Towards the latter objective, a special department has been created in the Prime Ministry, which alone is to automatically approve all foreign investments up to $50 million and screen those over that figure. Besides, foreign investors are assured repatriation of the proceeds of their equity when sold, a principle that IFC had been urging.

(d) To generate non-inflationary resources, a sizeable tax package is being presented to the Parliament, and a policy of presenting future ones has been announced. Since tax proposals have rarely reached Parliament in the past, nor has it approved one in the last 8 years, this is another major change of direction. In addition, all lending interest rates have been increased by 2 percent, bringing their level to between 18 and 26 percent; besides, ceilings on rates have been removed for loans with a maturity over 5 years, and these are now to be negotiated between a borrower and his bank. This liberalization of the interest rate regime, is another major first in Turkish policy.

(e) In a further attempt to bring down inflationary growth to 50 percent in 1980, legislation is being introduced whereby public and private sector salaries would increase automatically by one-half of the base of 40 percent and the actual inflation rate in a given period.

6. Recognizing the sweep of the package, IMF is recommending a modified Standby Agreement to its Board by February 22, which would provide an equivalent of US$200 million in 1980. Meanwhile, it has arranged bridge financing of about $270 million to assist Turkey till then. Germany, as you know, is now taking the lead in quickly arranging an increased aid package, through the OECD, to ensure the success of these stabilization measures.

Proposed Position

7. I would recommend that you congratulate the Government for the measures it has taken, and express the hope that the January package will be followed by a sustained effort to introduce the structural changes which alone can extricate Turkey from its economic crisis and enable it to resume sound growth. You might want to recall that in all your visits to Turkey, you mentioned structural adjustments as what you felt should be the key economic objective, and as the prerequisites for export promotion, efficiency in the SEEs, resource mobilization and allocation, job creation, etc. It is obvious now that the measures taken in recent years, however courageous they may have been, fell short of what was needed to respond to changed international and economic circumstances. Any Government in Turkey for years to come would face the need for structural reforms, and would require sufficient political support to carry them out.

8. You might reiterate the Bank's readiness to help Turkey and demonstrate its immediate support, by negotiating a second program loan of $200 million (as approved by Mr. Stern). You should however stress, in line with Bank policy for such loans, that it is important that the Bank receives a letter of intent, which, besides summarizing the measures in the January package as the Government desires, must reflect the substance of the draft letter outlining key areas of medium-term economic policy, some specific measures and dates for them, which Mr. Davar discussed in depth in mid-January with the Finance Minister, Mr. Ozal and other senior officials. Mr. Ozal was to bring such a communication with him, and this may be discussed tomorrow morning when Mr. Davar and I meet him, before his meeting with you. From our first talks with the Turkish delegation and from what we heard from Mr. de Groote, the Government is extremely reluctant to give the Bank such a letter of intent. Hence, it would be worthwhile for you to urge him to finalize a mutually satisfactory draft before he leaves Washington, so that we can negotiate the loan very soon, indeed possibly next week.

9. Regarding other Bank assistance in FY80, work is proceeding on Karakaya, Sumerbank Textile Rationalization and Livestock V projects. The major problem in the way of Karakaya, i.e. tariffs, appears to have been resolved. While the detailed calculations are being made, it appears that with a tariff increase to 280 krs/kwh effected as part of the January economic package, TEK should be able to earn a 5.5 percent return in 1980, fulfilling the commitment made by government to you in April '78 and which you had informed them in Belgrade is an essential step before negotiating this project. You might therefore express the hope that the Government would take steps to resolve any issues relating to these 3 projects, so that they can proceed to

our Board by June. Inclusive of the Program Loan, this would result in lending of $560 million to Turkey in FY80, which will exceed the highest amount reached last year, by nearly 50 percent.

10. Since Mr. Ozal will be the main coordinating figure in Turkey on Bank activities, you should take the opportunity to stress that to enable you to continue an expanded lending program, it must be backed by Turkish efforts in the following direction: (a) the dialogue on major macro-economic and sector issues which has now been initiated, should be intensified, in order to underpin the increased lending program the Bank is prepared to consider, and a continuing program of economic/sector work activities should be quickly hammered out and its implementation become a matter of routine; (b) a new high level coordinating mechanism, to replace the one existing under the last government, must be quickly established to resolve major policy or implementation bottlenecks impeding rapid implementation of ongoing Bank projects; and (c) an effective Turkish mechanism should be set up to monitor the preparation of future projects, instead of the Bank continuing to play the leading role in this field.

cc: Mr. McNamara's Office (2)
cc: Messrs. Husain (Acting VPO), Benjenk (o/r)(EMNVP), Haynes (EMP), Dubey (EMNVP)

AJDavar:bb

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert McNamara
THRU: Mr. Shahid Husain, Acting VPO
FROM: Maurice P. Bart, Acting RVP, EMENA

DATE: February 5, 1980

SUBJECT: Meeting with Mr. Ozal

1. I should report to you before you meet with him at 5:30 PM the outcome of a long meeting we had this morning with Mr. Ozal, after he briefly met with Mr. Husain.

2. In summary, Mr. Ozal explained that the rationale behind the new economic package (described in para 5 of the memo I sent you yesterday) involved fundamental reforms in the exchange and pricing mechanisms by shifting from State control to market determination, while retaining a lid on wage increases. These reforms aimed to spur private sector's exports and would lead to a basic reorientation of the public sector from dependence on budget subsidies to self-financing. They would be followed by further measures on taxation, tariffs, export promotion, and debt management. However, the Government's intentions on such matters as taxation could not be publicized without endangering its very existence. Mr. Ozal felt that the measures already taken went much beyond what you had sought in your letter of November 1978 to Prime Minister Ecevit (copy attached), or in the undertakings contained in Finance Minister Muezzinoglu's letter of July 1979, or indeed what in substance the Bank was seeking in a letter of intent. In the circumstances, he did not see the need to give to the Bank a letter of intent along the lines of the draft we had prepared.

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3. I took the position that while some parts of the draft letter of intent had been overtaken by events (e.g. those concerning the exchange rate, foreign investment, and SEE prices), other points where the package did not include corrective measures still needed to be tackled through specific studies leading to plans of action.(e.g. taxation, rationalization of protection, debt management and investment priorities). What the letter sought seemed to correspond to what the Government intended to do.

4. Mr. Ozal declined an offer I made to discuss this afternoon the substantive points on which there was no disagreement and the best way they could be included in a communication from the Government. He promised instead to send a letter to the Bank within the next few days exposing the Government program. In keeping with Mr. Stern's instructions, I warned him that if this letter did not cover the specific objectives and timetable covered by the draft letter of intent, it may not be considered by the Bank's management as a suitable basis for a second program loan.

5. I feel that the framework and rationale of the economic package which Mr. Ozal described would, if described in his letter, provide us with a much more meaningful basis for the program loan than what we have at present. If he does not include the specific measures and timetable which were the operative part of the draft letter of intent, we would have

to shift them to a supplemental letter to the loan documents. The key point is to obtain a policy statement which is as close to a program of structural changes as is politically feasible to the Government, as well as monitorable performance criteria.

cc: Messrs. Husain, Benjenk o/r, Haynes, Davar, Dubey

/bp

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: February 14, 1980

FROM: Adi J. Davar, Acting Director, EM2

SUBJECT: TURKEY: Mr. McNamara's Meeting with Mr. Turgut Ozal

1. On February 6, 1980 Mr. McNamara met with Mr. Turgut Ozal, Undersecretary in the Prime Ministry and Acting Undersecretary, State Planning Organization, accompanied by the Turkish Ambassador, Mr. Elekdag, the Executive Director for Turkey, Mr. de Groote and several senior Turkish officials. Messrs. Shahid Husain, Maurice P. Bart and I attended.

2. Mr. Ozal extensively summarized the economic package which the new Government had announced on January 24, 1980 and the underlying new economic philosophy. He highlighted that the actions which were taken through this package, amounted to not merely a basic shift in Turkish economic policy, but also the initiation of structural changes in key areas: The new policy directives are: (a) private enterprise is now to be given a leading role in economic development, hitherto dominated by the public sector; (b) both the public and the private sectors are to be exposed to market forces; (c) most SEEs are now to fix their own prices, so they could cover their operating deficits and generate cash for their investment, since they would have no future recourse to the Budget or to Central Bank borrowings; (d) the import regime had been liberalized; and (e) a beginning had been made to liberalize the interest rate regime. More importantly, the Government intends: (a) to reach planned targets by relying on market forces, rather than on micro level planning and administrative fiats to achieve them; and (b) to make exchange rate adjustments in time to cover the differential between inflation in Turkey and that of her main trading partners, as a major devise to increase exports and earn foreign exchange. Mr. Ozal then outlined the major steps taken to encourage foreign investment in oil, industry and agriculture, including actions which IFC had been urging, namely, to ensure re-patriation of profits and of proceeds following sale of investors equity. He explained that on Economic Committee and a Money and Banking Committee had been established to coordinate and take decisions on major timely economic and monetary matters, besides new departments in the Prime Minister's office to facilitate foreign investment and review incentives for exports.

2/14

3. Mr. Ozal hoped that this bold package of measures through which structural changes had been initiated, would facilitate securing of substantial and timely assistance from international and bilateral sources. According to Turkish calculations, a safety net of at least \$1.2 billion was needed to ensure the success of the package and to put through the fundamental changes in Turkish economic philosophy. Turkey was therefore disappointed that out of the \$900 million committed by bilateral at the May 1979 OECD meeting, a significant amount had not yet been signed by the bilaterals, and of the agreements signed, only about \$250 million had been disbursed. He felt that

the reasons for this were: onerous disbursement conditions and tied aid. Consequently, Turkey will press OECD to provide the new aid substantially in an untied manner. He stated that to ensure that the benefits of the new aid were not eroded by extremely onerous terms on which the short and medium term debt had been rescheduled, Turkey would also press for a pari passu rescheduling on more realistic and liberal terms.

4. Against this background, he hoped that Mr. McNamara would take the lead in not only substantially increasing lending assistance to Turkey beyond that so far attained, but could help by providing a Second Program Loan soon for $200 million. He stated that the measures the Government had taken, exceeded what the Bank had urged Turkey both under its recent Special Economic Report, as well as the draft Letter of Intent that had been proposed last month in the context of the Second Program Loan. He therefore urged that this loan be provided on the basis of the actions taken so far, and there was no need to provide a Letter of Intent. He also argued that the politics in Turkey was such, that if the Government gave a Letter of Intent detailing actions that it would take over the course of the next several months, the opposition would successfully scuttle not only those measures, but additional stronger measures which the Government had in mind.

5. Mr. McNamara congratulated the Government on taking the bold and far-reaching measures through the January 80 Program. He was particularly glad that one of the basic decisions made by Turkey was to move more or less to the concept of the "crawling peg". While recognizing the scope and the ambit of that Program, he urged that follow-up actions be taken in time to bring about the fundamental structural changes. He stressed the Bank would move with the Karakaya, Livestock V and Sumerbank Textile projects to the Board before the end of June 1980, and urged Mr. Ozal to agree with the Bank during his visit, on a time-dated action program which would ensure that the Bank could lend for all 3 projects in the current fiscal year. He did not want these projects to slip beyond FY80.

6. While reiterating the Bank's readiness to help Turkey now with the Second Program Loan, he felt that the position taken by Mr. Ozal regarding the Letter of Intent, "created troubles for the Bank". He explained that because of the onerous burdens put on developing countries by oil price increases, the Bank intended to start a new type of lending designed to alleviate such pressures, and based on understandings reached regarding structural economic changes that the Borrowers would make in the medium term. He handed a copy of the paper distributed to the Board on the subject on February 5. In this background, he hoped that Turkey would be able to reach an agreement with the Bank on a statement of economic actions that it was going to take over the next several months, including those to foster the structural changes which Mr. Ozal had indicated that his Government had initiated. In response to Mr. Ozal's demurrer that he could not do so, because that would help the Opposition undercut the more substantive measures that the Government intended to take, Mr. McNamara rejoined that he hoped that Mr. Ozal would also understand his difficulties. Given the Bank's

intention to provide lending based on agreed structural changes, Mr. McNamara could not see how he could "ramrod" a Program Loan for Turkey without any commitments, since that would jeopardize the prospects of providing support to several developing countries through structural program loans.

7. As a way out of this dilemma, he made a proposal, which he stressed he still wanted to discuss with his staff, namely, that the Second Program Loan could be broken up into two loans. One for $75.0 million to be provided now in light of the measures the Government had taken, and the second one for $125.0 million after 6 to 12 months when the Government felt it could make commitments on the structural changes it was prepared to undertake in the future. The meeting ended on the note that Mr. Ozal might still wish to review whether he could not provide a letter which could reflect the requirements of the structural program loans, or whether he wished to proceed on the basis proposed by Mr. McNamara.

Cleared with and cc: Mr. Bart (EMNVP)
cc: Mr. McNamara's Office (2)
Messrs. Husain (VPO), Stern (o/r) (VPO), Benjenk (o/r), Dubey (EMNVP), Haynes (EMP).

AJDavar:hr

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President
THROUGH: Mr. Ernest Stern, VPO
FROM: Roger Chaufournier, RVP, EMENA

DATE: May 12, 1980

SUBJECT: Your Meeting with Mr. Turgut Ozal

1. Mr. Turgut Ozal, Undersecretary of the Prime Ministry and Acting Undersecretary of the State Planning Organization, is scheduled to meet you at 6:00 pm on May 13. Messrs. Bart, Davar and I will join you.

Background for His Visit

2. You met Mr. Ozal in early February. He is the key designer and implementer of the program of major economic policy changes announced in January 1980. Politically, he is a member of Mr. Erbakan's National Salvation Party. But because of his pragmatism and ability to get things done, he has become the "economic lynchpin" on whom Prime Minister Demirel relies.

3. The chief purpose of Mr. Ozal's visit is to persuade the commercial banks, the Bank and the IMF to further support the Government's January Program, and especially to finalize a new Standby Arrangement with the IMF. An IMF mission visited Turkey last month, to explore the possibility of a 3-year Extended Fund Facility (EFF), but felt that a sufficient basis was unavailable at this stage. It has instead proposed a new and larger 1-year Standby Arrangement from June 1980. We understand that Mr. de Larosiere is personally reviewing the matter to see if a basis is available for either a larger Standby of about SDR 350 million, or a longer-term facility.

Present Situation

4. Despite the expected strong public resistance to the January measures, the Turkish public and private sectors have stoically accepted them. While the latter generally regard them as necessary and in the right directions, a watch and wait attitude is evident. Worker remittances and exports have recently picked up somewhat. However, as anticipated, the immediate impact of the general measures has been to push domestic prices. The annual rate of inflation in end-March is estimated to be higher than the 80 percent rate reached in end-1979. Consequently, although the exchange rate fixed in late January was somewhat higher than necessary, and it has since been rigorously adjusted to take account of fluctuations in cross rates, the IMF feels that an adjustment to about TL85 = $1 should be made by July. The Government is trying to hold the line on wages, despite increasing pressures for sizeable wage increases from the labor unions. The bills presented to Parliament to increase taxes and also wages below the level of inflation in accordance with a strict formula, are facing opposition. However, the one introducing a Value Added Tax, is expected to be approved in the near future. Meanwhile, to ensure achievement of the stipulated credit ceilings, IMF is urging a further increase in SEE prices over the sizeable ones (150 - 600 percent) made since January. The Government is also clamping down on investments, as well as on the pace of implementing ongoing projects.

5. The OECD meetings on March 26 and April 15 resulted in bilateral commitments of only $1.16 billion. This is well below the target of about $1.4 billion in disbursement terms in 1980, which the German Finance Minister had mentioned during his meeting with you. Taking into account disbursements against commitments made up to December 1979, and a projected level of exports and imports (including an oil bill of above $3.2 billion), we had estimated that Turkey would need a minimum of $1.6 billion in disbursement terms in 1980, to attain a low growth of about 1.5 percent in that year. Because of the lower OECD commitments, this gap is unlikely to be filled even if our $200 million Structural Adjustment Loan is fully disbursed by December and IMF releases fresh monies against a new Standby. This will inevitably have adverse effects on Turkey's growth in 1980, and its prospects for an early recovery.

Proposed Position

6. You might express satisfaction that with Turkey's efforts, the Bank has been able to deliver since your last meeting with Mr. Ozal in February, not only the Structural Adjustment Loan, but also the three project loans that you had promised, which result in a total commitment of $600 million in the current Fiscal Year, the highest amount ever provided to Turkey. This has been possible because of the Government's continuing efforts in implementing the policy measures announced in January. You might however indicate that you would wish to see gradual, but substantive, followup actions on fostering the structural changes initiated in January, in order to be able to justify to the Board, continuation of lending at a level of about $500 million each year.

7. During Mr. Davar's discussions last month with the Finance Minister and Mr. Ozal, the Government took the position that non-project lending through structural adjustment loans, would be of considerable help to Turkey under present economic conditions, and should command priority in Bank assistance over the next 2 to 3 years. It also accepted the principle that this type of assistance would entail Government decisions, based on discussions with the Bank, as to the key areas in which structural adjustments were needed and could realistically be fostered during the period of each future structural adjustment loan, together with the setting-up of quantitative targets and benchmarks in loan documents to evaluate the progress. The possibility was explored tentatively of setting quantitative targets expressed in terms of some significant macro-economic indicators, e.g. percentage of taxes to GDP, percentage of investments to GDP, achievement of a marginal savings ratio, ceiling for current account deficit, achievement of specified export levels etc. The Government felt that such or similar targets or ratios to evaluate progress, had to be set; however, it wanted the flexibility to consider some other quantitative yardsticks also. You might therefore encourage the Government to begin discussions on this subject with our economist team currently in Turkey, and with our mission next month to conduct the first review envisaged under our March loan and at the same time, to appraise the $50-$75 million supplemental structural adjustment loan, for Board consideration around October, which you had mentioned to the German Finance Minister and to our Board.

8. Against this background, it would be useful if you: (a) reconfirmed the Bank's willingness to help Turkey through a series of sizeable structural adjustment loans, over the next 2 to 3 years, provided the Government formulated and implemented a program which could justify such loans; (b) reiterated the need for a close and continuing macro-economic dialogue, which would enable the Government and the Bank to evolve and agree upon such a program; and (c) invited Mr. Ozal to indicate the type of quantitative measures that he might be able to envisage to meet the Bank's objectives and the political realities in Turkey. You should however clarify that: (a) the $50-$75 million loan around October would be evaluated against the progress made by Turkey towards the benchmarks set in the loan documents of our March loan; and (b) therefore, your queries relate to the larger structural adjustment loans we are prepared to provide in the next fiscal year and thereafter.

9. Meanwhile, I understand that some progress is being made in Mr. Ozal's discussions this week with the IMF from the viewpoint of working out a satisfactory basis for a 3-year EFF. This development is encouraging, since that could also provide Turkey and the Bank with a viable starting point to agree on the basis for the phased achievement of structural adjustments, over the medium-term future.

10. You should also take the opportunity of stressing that an expanded lending program can be supported, provided we receive concerted Turkish support in the following directions: (a) to provide an adequate underpinning for an increased lending program; it is important that a program of economic/sector work activities be agreed upon for the next 2 to 3 year-period; (b) an effective Turkish mechanism to monitor the preparation of future projects should be set up, instead of the Bank continuing to play the leading role in this area; and (c) provision of adequate local currency financing for, and resolution of the issues confronting, some ongoing projects has to be arranged to ensure improved project implementation.

cleared with and cc: Messrs. Bart, Zaman (EM2)

cc: Messrs. Knox (EMP), Dubey (EMNVP), Baig, Faruqi (o/r) (EM2)

AJDavar:cml

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President
THROUGH: Mr. Ernest Stern, VPO
FROM: Roger Chaufournier, RVP, EMENA

DATE: May 12, 1980

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Proposed Position

6. You might express satisfaction that with Turkey's efforts, the Bank has been able to deliver since your last meeting with Mr. Ozal in February, not only the Structural Adjustment Loan, but also the three project loans that you had promised, which result in a total commitment of $600 million in the current Fiscal Year, the highest amount ever provided to Turkey. This has been possible because of the Government's continuing efforts in implementing the policy measures announced in January. You might however indicate that you would wish to see gradual, but substantive, followup actions on fostering the structural changes initiated in January, in order to be able to justify to the Board, continuation of lending at a level of about $500 million each year.

7. During Mr. Davar's discussions last month with the Finance Minister and Mr. Ozal, the Government took the position that non-project lending through structural adjustment loans, would be of considerable help to Turkey under present economic conditions, and should command priority in Bank assistance over the next 2 to 3 years. It also accepted the principle that this type of assistance would entail Government decisions, based on discussions with the Bank, as to the key areas in which structural adjustments were needed and could realistically be fostered during the period of each future structural adjustment loan, together with the setting-up of quantitative targets and benchmarks in loan documents to evaluate the progress. The possibility was explored tentatively of setting quantitative targets expressed in terms of some significant macro-economic indicators, e.g. percentage of taxes to GDP, percentage of investments to GDP, achievement of a marginal savings ratio, ceiling for current account deficit, achievement of specified export levels etc. The Government felt that such or similar targets or ratios to evaluate progress, had to be set; however, it wanted the flexibility to consider some other quantitative yardsticks also. You might therefore encourage the Government to begin discussions on this subject with our economist team currently in Turkey, and with our mission next month to conduct the first review envisaged under our March loan and at the same time, to appraise the $50-$75 million supplemental structural adjustment loan, for Board consideration around October, which you had mentioned to the German Finance Minister and to our Board.

8. Against this background, it would be useful if you: (a) reconfirmed the Bank's willingness to help Turkey through a series of sizeable structural adjustment loans, over the next 2 to 3 years, provided the Government formulated and implemented a program which could justify such loans; (b) reiterated the need for a close and continuing macro-economic dialogue, which would enable the Government and the Bank to evolve and agree upon such a program; and (c) invited Mr. Ozal to indicate the type of quantitative measures that he might be able to envisage to meet the Bank's objectives and the political realities in Turkey. You should however clarify that: (a) the $50-$75 million loan around October would be evaluated against the progress made by Turkey towards the benchmarks set in the loan documents of our March loan; and (b) therefore, your queries relate to the larger structural adjustment loans we are prepared to provide in the next fiscal year and thereafter.

9. In this connection, you should encourage Mr. Ozal to find an acceptable via media to secure a 2 or 3-year EFF from the IMF, since that could also provide Turkey and the Bank with a viable starting point to agree on the basis for the phased achievement of structural adjustments, over the medium-term future.

10. You should also take the opportunity of stressing that an expanded lending program can be supported, provided we receive concerted Turkish support in the following directions: (a) to provide an adequate underpinning for an increased lending program; it is important that a program of economic/sector work activities be agreed upon for the next 2 to 3 year-period; (b) an effective Turkish mechanism to monitor the preparation of future projects should be set up, instead of the Bank continuing to play the leading role in this area; and (c) provision of adequate local currency financing for, and resolution of the issues confronting, some ongoing projects has to be arranged to ensure improved project implementation.

cleared with and cc: Messrs. Bart, Zaman (EM2)

cc: Messrs. Knox (EMP), Dubey (EMNVP), Baig, Faruqi (o/r) (EM2)

AJDavar:cml

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

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OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
ROUGH: Mr. Ernest Stern, VPO
FROM: A. David Knox, Acting RVP, EMENA ADK

DATE June 26, 1980

SUBJECT: Your Meeting with Mr. Turgut Ozal

1. Mr. Turgut Ozal, Undersecretary of the Prime Ministry and Acting Undersecretary of the State Planning Organization, is scheduled to meet you at 6:00 PM today. He met earlier this morning with Mr. de Larosiere. Messrs. Zaman, Baig and I will join you.

Background

2. You met Mr. Ozal on May 13 (the brief prepared for that meeting is attached) and earlier on February 5, 1980. He recently suffered a mild heart attack, but is reported to have recovered.

3. The major purpose of Mr. Ozal's visit is to request the Bank to help in resolving the deadlock in the recently held OECD debt rescheduling meetings which were adjourned on June 19, 1980 (as he did with the IMF). He might also request speedy processing of the First Structural Adjustment Loan (SAL I) Supplement. We understand that Mr. de Larosiere has assured Mr. Ozal of the Fund's continued support for Turkey. (On June 18, the IMF approved a new 3-year Standby Arrangement for $1.6 billion, with about $600 million for the first year.) He has asked Mr. Woodward to attend the OECD debt rescheduling meeting when it reconvenes in July.

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4. Mr. Chaufournier's recently concluded visit to Turkey appears to have been very successful. Mr. Demirel thanked Mr. Chaufournier profusely for the help the Bank has given. The Prime Minister also reaffirmed his Government's commitment to the pursuance of the January 1980 economic policy measures, and reportedly said that the Government's main preoccupation now is to curb consumption.

Recent Developments

5. The political situation continues to remain uncertain. The Parliament has not succeeded in electing a new President, and is to debate a no-confidence motion against the Government next week. However, since Mr. Demirel's Justice Party (JP) joined the opposition in voting to include it on the agenda, it is expected that the Government is confident of continued support, particularly from the National Salvation Party (NSP), whose support is crucial. It is also expected that JP will push for early elections, possibly in October, with the Republican Peoples Party (RPP) opposing, but this has to be decided before the Parliament adjourns for summer recess in July.

6. The economic outlook for 1980 continues to remain difficult and the success of the Government's January program rests very much on the availability of external capital. Creditor Governments, however, seem to be reluctant to go ahead with a major rescheduling of official debt, nor the banks to rollover commercial debt.

7. The recent OECD rescheduling meetings were adjourned because of the failure of the creditors and the Government of Turkey to come to an agreement. The Government was requesting rescheduling of obligations on debt already rescheduled in 1978 and 1979 (service payments amounting to some $250 million per half year). The creditors were willing to reschedule only the arrears that had accumulated with respect to the rescheduled debts. Also, while Turkey was asking for rescheduling consolidated debt service obligations over the next 3 years, the creditors were not willing to entertain rescheduling obligations due beyond one year, even though it was realized that this will lead to the accumulation of new arrears. Apparently, the Germans sided with the Turks, while the United States (with France, though less vocally) took the hard line. The majority, including the British, seemed to be inclined to follow the consensus.

Proposed Position

8. Debt rescheduling. You might reiterate Bank's awareness of Turkey's massive needs including the need for rescheduling its huge outstanding debt. The Bank was represented by its Paris Office at the recent Paris meeting, and Mr. Shakil Faruqi will be representing the Bank when it re-convenes in July. You might indicate that while the Bank would stress its support on adequate rescheduling on suitable terms, the matter would have eventually to be resolved between Turkey and its bilateral creditors.

9. Bank assistance and SAL I Supplement. The Bank expects to maintain assistance around the level provided in the current year ($600 million - an 80 percent increase over the previous year) if the Government continues its efforts in implementing the policy measures announced in January. The proposed FY81 lending program of $565 million includes a Supplement of $75 million to SAL I and SAL II of $200 million, as well as projects for enhanced oil recovery and exploration, urban employment, and in the industrial and agricultural sectors. You might indicate that we plan to process the SAL I Supplement for Board approval in October, subject to satisfactory progress in meeting SAL I conditions which are being currently reviewed in the field. Though the disbursements under SAL I amount only to $16 million, our information is that as nearly $140 million has already been committed, disbursements are expected to pick up in the coming months, and the entire loan is expected to be disbursed by end-January 1981. Subject to satisfactory progress in meeting SAL I conditions, the SAL I Supplement is expected to be approved well before SAL I is fully disbursed.

10. SAL II. We also plan to appraise SAL II in October/November along with a second review of SAL I. You may wish to stress to Mr. Ozal that progress in maintaining a dialogue on economic policies is essential for the success of our future structural adjustment lending. In this connection, you may wish to stress that the Bank places considerable emphasis on the Public Sector Investment Study, for which a mission to be led by Mr. Faruqi is to visit Turkey in September.

cc: Messrs. Zaman, Baig

cc (o/r): Messrs. Chaufournier, Bart, Dubey, Davar, Faruqi

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: July 2, 1980

FROM: Mirza T. Baig, Senior Loan Officer, EM2DA

SUBJECT: TURKEY: Mr. McNamara's Meeting with Mr. Turgut Ozal

1. Mr. Turgut Ozal, Undersecretary of the Prime Minister's Office and chief economic adviser to the Prime Minister, met Mr. McNamara at 6.00 p.m. on June 26. Attending from the Bank were Messrs. Stern, Knox, Zaman, Koch-Weser and Baig. Mr. Ozal was accompanied by Mr. Tevfik Altinok, Chief Financial and Economic Counselor at the Embassy, and Mr. Omer Esener, Assistant to the Executive Director.

2. Mr. Ozal's major purpose in meeting Mr. McNamara was to explain the deadlock which occurred at the OECD debt rescheduling meeting June 17-19, and to seek his assistance in urging the creditor countries, particularly the United States, to be more forthcoming at the next such meeting which is tentatively scheduled for July 8-10.

3. Mr. Ozal explained that, in addition to rescheduling new debt falling due in the proposed consolidation period (July 1, 1980 to June 30, 1983), the creditor nations were willing to reschedule only those arrears on previously rescheduled debt which had accumulated up to the end of June 1980, but were not willing to reschedule debt obligations on previously rescheduled debt beyond the cut-off date of June 30, 1980. The Turkish position was that, because of its balance of payments position, the country would not be able to meet the service payments resulting from such a rescheduling, and wanted all debt falling due in the consolidation period, as well as accumulated arrears, to be realistically rescheduled, preferably on the basis of a five-year grace period and a five-year repayment period.

4. In response to Mr. McNamara's question, Mr. Ozal said that debt service obligations on previously rescheduled debt, which was the sticking point, amounted to about $250 million for July-December 1980, and $450 million each year for 1981 and 1982. Mr. Ozal mentioned that Turkey's financing problems for 1980 were very acute. To obtain the same import volume as in 1976 at 1980 prices would require $10.5 billion, which was clearly beyond reach. Imports for 1980 are at present estimated to reach about $7 billion.

5. Mr. Ozal went on to say that the crops were good this year, monthly inflation was reduced from 8 percent per month early in the year to 2 percent in May, and that subsidies for bread had been eliminated. Interest rates had been freed, and although "gentlemen's agreements" between banks kept the rates at 14 percent for 6 months, 27 percent for 1 year and 36 percent for 4-year money, the Government planned to introduce 2-year bonds at rates which would force the banks to change their practice.

6. On the political front, Mr. Ozal felt the planned censure motion next week would fail and the possibility of early elections, although advocated by the ruling Justice Party, was being opposed by the major opposition

Republican Peoples Party. Mr. Ozal also hoped the next Structural Adjustment loan would be larger than the previous one ($200 million). Mr. McNamara said that would be difficult, in view of the great demand on limited Bank resources.

7. Mr. Ozal had mentioned that he planned to see Treasury Secretary G. William Miller and State Department Undersecretary Richard Cooper to try to soften the hard US position on the further rescheduling of already rescheduled debt. Mr. McNamara asked Mr. Ozal to let him know the results of that meeting.

8. On June 27, Mr. Ozal called Mr. Knox to tell him of his discussions with Messrs. Miller and Cooper. He had outlined the grave situation in which Turkey found itself and had suggested that if they wanted a confirmation of what he was saying they might ask the Fund or the Bank. Mr. Ozal thought that he had a responsive reaction from Messrs. Miller and Cooper and that they might reconsider the US position. He hoped for Bank support.

9. Mr. Ozal also said that he had mentioned a possible compromise, which would be to include in this year's rescheduling the already rescheduled debt falling due in July-December 1980 and in 1981, leaving that falling due in 1982 for consideration next year.

Cleared with & cc: Messrs. Knox (EMNVP), Zaman (EM2)
cc: Messrs. Stern (VPO), Chaufournier (o/r)(EMNVP), Bart (o/r)(EM2),
Koch-Weser (EXC), Berk, Faruqi, Roy (EM2)
cc: Mr. McNamara's Office (2)

MTBaig:bb

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OFFICE OF THE PRESIDENT

Meeting with Mr. Ozal, Undersecretary of Prime Minister, Turkey, May 13, 1980

Present: Messrs. McNamara, Ozal, Akturk (Director General, State Planning Organization), Erdem (Secretary General, Ministry of Finance), Dincmen (Financial Counselor, Turkish Embassy), de Groote, Stern, Chaufournier

Mr. Ozal reported on the recent improvements of the Turkish economy: among others, the consumer price index indicated a reduced rate of inflation, the abolition of double pricing would increase Government revenues; however, the external balance situation continued to be difficult because of last year's oil price increases. At the beginning of last year, Turkey had paid on average $12.00 per barrel, at the beginning of this year, the price had been $30.00 per barrel, resulting in an increase of the oil import bill from $1.7 billion to $3.4 billion. The critical months were from now to September when the traditional export season started. If there were a serious shortage of oil, business confidence would be difficult to restore. Turkey was in the process of reaching a three-year agreement with the IMF; the conditions were acceptable to his Government and would be accepted by Turkey's patient people. He concluded that Turkey's five-year program of structural adjustment was well underway.

Mr. McNamara said that he was delighted to hear about the progress being made. The Bank recognized that structural adjustment constituted a five-year program and was anxious to cooperate with the Government on such a five-year program of action. He would be quite willing to go forward with another structural adjustment loan in September of 1980.

In response to a question by Mr. McNamara, Mr. Ozal said that he had had a good meeting with Mr. de Larosiere and hoped to reach agreement with the Fund during his present visit.

Mr. McNamara enquired about the position taken by Mr. Ecevit. Mr. Ozal reported that Mr. Ecevit had called his Government's program first the Brazilian model and later the Friedman model; now he called it the worst example of Mrs. Thatcher's program. In response to another question by Mr. McNamara, he said that terrorism continued at the same level; the ultra-left was fighting the ultra-right.

Mr. McNamara concluded that the Bank had acted forcefully by accomplishing a $600 million lending program this year. The Bank was anxious to do more.

CKW
June 2, 1980

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Memorandum For The Record DATE: September 23, 1980

FROM: Adi J. Davar, Division Chief, EM2DA

SUBJECT: TURKEY: Visit of Turkish Ambassador with Mr. McNamara

1. The Ambassador of Turkey to the US, Mr. Sukru Elekdag met with Mr. McNamara on September 19, 1980. Mr. Bart and I joined the meeting.

2. The purpose of the Ambassador's visit was to explain to Mr. McNamara and the Bank, the rationale of the Military takeover on September 12. The Ambassador recapitulated that despite several warnings given by the Military to the politicians over the last 9 months, it was clear that they were not putting aside their differences, in order to resolve Turkey's severe political and economic problems. The Ambassador explained that the takeover was therefore intended to preclude a disintegration of the Turkish economy and democracy, and perhaps prevent a civil war. He recapitulated instances, where despite presentation of strong draft legislation to the Parliament in early 1980 to control political anarchy, no action was taken to pass it; as a result, opium smugglers received severe penalties, whereas territorists killing people, escaped with little punishment. No progress was being made in electing the President; nor was other essential legislation being passed, e.g. taxes, wage controls, etc., which were so essential for the new policy of economic reorientation to succeed. In essence, the democratic processes were just not operating. The Military apparently felt that if democracy itself was to be saved for Turkey, it was time to step in.

3. It was against this background that the Ambassador urged Mr. McNamara and the Bank, to look at the military takeover. He stressed that the new administration's future actions would be predicated on its desire to provide Turkey as soon as possible, with an operating democratic system of government. A new constitution, based on a new electoral system, which would ensure that a democratic system can work effectively, had been commissioned. Meanwhile, the new administration had already announced that not only would all commitments made by Turkey to all economic institutions be honored, but that it fully supported the program of major economic reforms announced in January and that this program would be further strengthened. The Ambassador therefore urged Mr. McNamara to continue Bank support to his country.

4. Mr. McNamara thanked the Ambassador for explaining the background to recent political developments. He was also happy to have the reaffirmation that the new administration proposed to continue implementing the January program of structural adjustments and meeting its commitments to the IMF, the Bank and others. He added that in those circumstances, the Bank was proceeding to do business as usual with Turkey, and indeed some loan negotiations were being initiated. He however indicated that he and his colleagues looked forward to meeting the Turkish Delegation to the Annual Meetings for a detailed discussion on the future course of economic policies and actions which Turkey might envisage.

Cleared with & cc: Mr. Bart (EM2)
cc: Mr. McNamara's Office
cc: Messrs. Stern (SVP), Chaufournier (EMNVP)
AJDavar:bb

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: September 19, 1980

THRU: Mr. Ernest Stern, SVP, Operations

FROM: Roger Chaufournier, RVP, EMENA

SUBJECT: TURKEY: Your Meeting with the Turkish Ambassador

1. The Ambassador of Turkey to the US, Mr. Sukru Elekdag, whom you have met many times over the last several months, will be meeting you at 6.00p.m. this evening. Messrs. Bart and Davar will join you for this meeting.

2. I would expect that the reason underlying the Ambassador's request to see you, is to formally convey to the Bank, the assurances of continuity of economic policies by the new military Administration. He might also briefly reaffirm that Administration's objective of providing a new Constitution based on a viable electorate and political system, so that the future need for military takeovers can possibly be obviated. You might expect him to therefore conclude with a plea for uninterrupted Bank support, given the Administration's decision to continue the present economic policies of structural adjustments and to meet all international commitments, including to the Bank.

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3. My memorandum of September 16 to you (copy attached) provides background as to the recent political developments, the continuity of economic policies taken by the new Administration and the reassurances in this regard already conveyed to the Bank, in addition to what the Ambassador might convey to you. You might therefore express your satisfaction at hearing Turkey's reaffirmation about continuing its economic policy of structural adjustments, and indeed taking actions to reinforce this process in the months ahead. You might add that in those circumstances, the Bank would be prepared to continue its support to Turkey, particularly given the severe economic problems that it faces. You might however add, that you and the Bank staff will be looking forward to detailed discussions on the future course of economic policies and actions with the Turkish delegation at the forthcoming Annual Meetings.

Attachment

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
THROUGH: Mr. Ernest Stern, SVP, Operations
FROM: Roger Chaufournier, RVP, EMENA

DATE: September 16, 1980

SUBJECT: TURKEY: Latest Political Developments

1. Around dawn on Friday, September 12, the Military took power from Prime Minister Demirel, in a bloodless coup. The Parliament was dissolved. Messrs. Demirel and Ecevit have been put under "protective custody" in a Military camp near the Dardenelles; the National Salvation Party (NSP) leader, Mr. Erbakan and Col. Turkes, the leader of the extreme leftist National Movement Party (NMP), are being similarly held on an island near Izmir. Over 100 parliamentary deputies and the leaders of the rightist and leftist trade unions have been similarly detained, although the head of the conservative Turk-Is union has been left untouched. A large number of known extremists are reported to have been rounded up by the Military in their strongholds throughout Turkey, and placed under arrest.

2. The decision to take over power, seems to have been exercised with considerable reluctance. Turkey's armed forces have always prided themselves on being professionals and, while considering themselves as the preservers of Ataturk's national legacies, on remaining apolitical. They have intervened only in the last resort to prevent economic and political disintegration in 1960 and 1971. In both cases, power was handed back to civilian governments as soon as possible. This time, the Military has taken special care to avoid bloodshed or political reprisals, which marred the earlier coups. It has specifically announced that no proceedings will be instituted against any minister or politician, for political activities prior to the takeover.

3. It appears from all accounts, that the transfer of power has not only been peaceful, but the general public, by and large, has welcomed it, in the hope that the Military will be able to achieve a turnaround in the domestic security and economic situations, where the politicians have so far failed.

Possible Underlying Reasons for the Takeover

4. The Military had been watching the escalating political violence and continuing economic difficulties, with growing alarm. This, together with what it perceived as Turkey's weakening defense capabilities in an increasingly volatile geopolitical area especially after the events in Afghanistan, Iran, Iraq and Syria, persuaded them to issue a stern warning in early January 1980 to the politicians. There was an implicit threat of a takeover, unless the political parties cooperated in the national interest, to overcome the problems. What the Military essentially hoped for, was a grand coalition between Ecevit and Demirel, which did not materialize. Nevertheless, the long-languishing draft legislation to curb political anarchy, incorporating features on which the Military was keen, was quickly introduced into the parliamentary process by them; a bold program of far-reaching

structural adjustments in the economy was announced later in January, with the tacit assent of Ecevit's Republican Party (RPP), and after the rather unusual action of the National Security Council discussing and then accepting this program.

5. However, the various political parties thereafter again began pulling in different directions. Although over 100 ballots have been cast since March, the two major parties were unable to agree on a candidate to become Turkey's president. Until then, no serious legislative business could be conducted in Parliament. Hence, the critical tax and wage control bills, as well as the one designed to curb political violence, remained unconsidered; the government implemented the January '80 program through executive fiats, and by circumventing the Parliament, to the extent possible. Meanwhile, political violence mounted. It reached its zenith recently, with the assassination of the former Prime Minister Erim, to whom the Military gave power after the 1971 takeover, and of a key trade union leader. In August, Mr. Demirel persuaded the NSP to propose early elections this fall to the Parliament, only to find a few days later, that the same party joined the RPP in scuttling the proposal. Subsequently, the NSP engineered a vote of non-confidence against the Foreign Minister for following a policy leading Turkey into the EEC and for not breaking relations with Israel. While the extremists announced escalated political killings, an NSP meeting in early September, besides reportedly showing discourtesy towards the national anthem, called for the replacement of Ataturk's secular republic by an Islamic republic, with Konya as the capital. Over this period, the Military's warnings in May, July and twice in August, to rectify the political and economic situation, were largely ignored. Whereas it is difficult to pinpoint specific causes which could have triggered the takeover, it seems that all these developments taken together, might ultimately have persuaded the Military to step in.

The Present Situation

6. Until a new government and a legislative body are established, based on a new constitution and a new electoral system, the legislative and the executive powers of the government are held by the National Security Council. A six-man Committee of that Council, actually wields this power. It consists of the heads of the three armed forces plus the gendarmerie, and is headed by Gen. Kenan Evren. He also remains the Chief of Armed Forces, and in addition, has assumed the title of Head of State for the time being.

7. Gen. Evren is reputed to be a highly esteemed and pragmatic individual holding moderate political views, who is known to have so far prevailed on his colleagues to give the politicians a chance to steer Turkey out of the grim political and economic situation, by issuing the abovementioned periodic warnings. While it is difficult to speculate, the September 12 takeover may have been successfully pressed by the powerful Gen. Haydar Saltik, the Commander of the Agean Army and a strong supporter of the NATO alliance. Since the last several months, he has been the Secretary General of the National Security Council, and has now also been designated as the new Secretary General of the newly appointed Committee of that Council, which governs Turkey.

Its Policy Directions

8. The new administration's concern over the key questions of domestic security and the economy, was manifested by the almost continuous meetings on Friday and Saturday of the National Security Committee, to discuss these issues. On Saturday, under instructions from that Committee, the Chief Financial Counselor of the Turkish Embassy, phoned Mr. Davar to formally convey to us that the new administration fully supports the January '80 program of economic reforms, will continue to implement them vigorously, will fully meet commitments made to the Bank and IMF, and planned on further measures to strengthen the impact of that program, including through long-needed tax reforms. A similar demarche was made with the IMF, which seems inclined to release its September 27 drawing. The architect of the January '80 program, Mr. Ozal, has been asked to continue for the time being and, indeed, has been asked to assume de facto, the powers of an Acting Prime Minister.

9. The Civil Service Administration has been instructed to continue to run the administration on an apolitical basis. It is also understood that three or four technocratic civilians (including the permanent representative to the UN in Geneva and New York), would be asked along with the members of the National Security Council Committee to form a new Cabinet. Its formation within a week has been just announced, as also; that a constituent assembly will be formed to debate and approve a new constitution whose drafting has been begun.

10. It so far appears that the new administration is making a point about establishing a sense of continuity in economic policy, and that of purpose in resolving Turkey's critical internal security and economic problems, besides affirming adherence to all past commitments. It has also taken great pains to stress its pro-western orientation, including to NATO and the EEC. While this is understandable in view of the recent OECD steps to bail Turkey out financially, this is nevertheless reassuring. More importantly, it seems determined to replace the 1960 constitution with a new one, which can assure the continuation of democratic rule, but on the basis of an electoral and political system under which it can operate successfully, unlike the experience of the last two decades.

Relations with the Bank

11. The sense of continuity with the Bank, is accentuated by the above-mentioned specific actions taken to reassure us. This has been further emphasized by formal advice that negotiating teams will arrive to negotiate the two Bati Raman projects from September 18, and the SAL I Supplementary Loan from September 24. Two supervision missions now in the field, have been asked by me to continue, if they find that their administrative counterparts are available to do so. The Turkish authorities have indicated on the phone, that the missions will find this possible. The UNDP Resident Representative has indicated over the phone that things are calm and the administrative set-up is operative. The Turks have also specifically requested, including by cable, that the Investment Review Mission under Mr. Sadove, due to begin work

on September 22, should come, since arrangements have been made to give it full cooperation and have high level policy discussions in the first week and its entire last week. This assurance has been intimated to us, after specifically consulting with Mr. Ozal.

12. There is advantage in our taking a posture at this stage, that the Bank is prepared to continue doing its business, provided we are reassured about the continuity of economic policies and that important decisions can be made. So far, there has been reassurance on both. We shall, of course, need to review thoroughly the new situation, the economic program intended by the new administration and their impact on our planned activities, when we meet the Turkish Delegation at the Annual Meetings in a few days. Mr. Ozal will be leading that delegation. It is only after these discussions, that we should decide on processing the Bati Raman loans (for which negotiations had been invited in August) and the SAL I Supplementary loan, for Board consideration. Meanwhile, we are processing the latter for Loan Committee consideration, which will provide an opportunity to define a course of action in a rapidly changing situation.

Cleared with & cc: Mr. Bart (EM2)

cc: Messrs. El Darwish, Picciotto (EMP), Dubey (EMNVP)(o/r), Zaman (EM2)

AJDavar:bb

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Memorandum for the Record DATE: October 8, 1980

FROM: Adi J. Davar, Division Chief, EM2DA

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

1. Mr. McNamara met on October 2 with the Turkish Delegation, headed by Deputy Prime Minister Ozal, at the 1980 Annual Meetings. Messrs. Stern, Chaufournier, Bart, Dubey and Davar participated.

2. Deputy Prime Minister Ozal underlined Turkey's deep appreciation for the Bank's continuing support in its critical hour of need. Mr. McNamara responded that the credit for making that possible, must go to Turkey because it developed the bold and courageous program to restructure the economy and for initiated actions since then, to implement that program.

3. Mr. Ozal felt that the Turkish people not only understood, but accepted the need for implementing such a program. Responding to Mr. McNamara's query, he indicated that various aspects of that program would continue to be implemented over the next 3 to 4 years, to achieve a complete reorientation of the economy was essential. The military leaders had understood and accepted the January '80 program prior to its announcement at the time, and now that they had taken power, they continued to accept it and indeed wanted to strengthen its impact by taking those measures which had so far been stalemated in the Parliament, e.g. tax reforms. He confided that he had been allowed to talk to Mr. Demirel when he was being "detained", and the latter had asked Mr. Ozal to continue to serve the military in the country's larger interest. According to him, an indication of the military's determination to fully implement the January '80 program of structural adjustments, was its immediate acceptance of the proposal to drastically increase the prices of petroleum products, fertilizers and sugar in late September, to fulfill the commitment made by Turkey in August to the IMF. These increases are estimated to yield as much as TL 90 billion, over a 12 month period.

4. Mr. Ozal was however worried about the adverse impact in 1980 and 1981, because of the Iraq-Iran war. While Turkey had 5 weeks stock of oil, 35 percent of its supplies came from Iraq and 20 percent from Iran, both on a negotiated concessional basis. He had appealed to the Saudi Finance Minister to help Turkey, at least as a temporary expedient, but had received no firm commitment. So, while worker remittances were beginning to pick up from July onwards in response to the flexible foreign exchange regime which Turkey introduced in June, and he expected exports to now also respond positively to this and other incentive measures, the necessity to import oil at higher prices in substitution of Iraqi/Iranian suppliers could impose a larger import bill, or a further cutdown in non-petroleum imports. Alternatively, if sufficient oil supplies were unavailable, Turkish industrial and agricultural production would again be adversely affected, with inevitable adverse effects on exports as well as growth. While subsequent to the military takeover, Turkey especially intended to look very carefully at: (a) its projects to reduce reliance on capital intensive investments and emphasize those which increased employment; (b) ways and means of increasing domestic savings and containing the balance of

payments deficits, it appeared clear to him that 1981 and 1982 would be very difficult years for Turkey. It would therefore have to rely on substantial external support, including large structural adjustment loans. Mr. Ozal stated, that to give strength to his people to accept sterner measures which would be required to restructure the economy and to the private sector to continue investments, it was essential to show them that hope did exist for a better economy and that this was also the expectation of the international community.

5. He therefore requested Mr. McNamara to consider a lending program in FY81 which exceeded the $600 million mark reached in FY80, and a SAL II of around $300 million. Mr. McNamara made no commitments, except to say that the Bank was anxious to help with an early SAL II. He urged Deputy Prime Minister Ozal and Mr. Chaufournier to discuss how quickly it could be processed, based on a viable program of structural adjustments. Mr. Stern stressed that, recognizing that such a program could only be implemented over the medium-term, SAL II would have to be backed by a strong package of policy commitments and actions in selected areas, e.g. a meaningful protective tariff structure and improvements in the efficiency of the SEE sector, besides advances in the areas of domestic resource mobilization and liberalizing the foreign exchange regime. Mr. Ozal responded that indeed such changes should be possible. He expected the income tax reform and VAT bills, presented to the Parliament in January 1980, to be suitably revamped and put into effect in a few weeks time. He also wanted to begin changing the import regime for 1981 by taking action to promulgate: (a) an expanded list of imports which would be completely free from any quotas; (b) a list where they could be freely imported, based on a combination of tariffs and quotas; and (c) a list where imports of inputs could take place, depending on the competitiveness of the exportable goods, based on tariffs rather than on quotas. Mr. McNamara agreed that these appeared to be steps in the right direction, given the highly protected nature of Turkey's industry. Both he and Mr. Stern again urged the Delegation to preliminarily discuss the possible policy conditions of SAL II and a mutually convenient time for its processing.

6. Mr. McNamara then added that he needed Turkey's help to do something to improve project implementation. A large lending program would be difficult to support when nearly 50 percent of the monies so far committed, were undisbursed. He added that given Turkey's shortage of financial resources, he could very well understand that the Government would wish to hold back on implementing many of its ongoing projects, including those financed by the Bank, or go slow on some of them by providing limited budgetary funds. He however wanted the Government to take such decisions consciously on specific projects, and do all that it could to improve implementation of the remaining ones. Mr. Ozal responded that improved project implementation continued to be his objective, and he would see what Turkish arrangements he could make to improve it.

Cleared with & cc: Mr. Bart
cc: Messrs. Stern (VPO), Chaufournier (EMNVP), Picciotto (EMP), Dubey (EMNVP), Haynes, Carmignani, Hume (EMP), Zaman (EM2)

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OFFICE MEMORANDUM

TO: Files

DATE: December 31, 1980

FROM: Adi J. Davar, Division Chief, EM2DA

SUBJECT: TURKEY - Mr. McNamara's Meeting with the Minister of Energy

1. Mr. Serbulent Bingol, Minister of Energy and Natural Resources, accompanied by the Deputy Ambassador and the Chief Economic Counselor, met Mr. McNamara and Mr. Stern on December 19. I joined the meeting.

2. The Minister expressed his new Government's appreciation for continuing Bank support to Turkey in all sectors, including the energy sector. He emphasized that the essential objective of the military takeover was more to correct Turkey's political and economic malaise, rather than to retain power. Unlike takeovers in Latin America and Africa, Turkey's military intended to step down as soon as effective actions had been taken to cure that malaise, and steps had already been initiated in that direction. Mr. McNamara responded that while in principle he did not like the idea of military rule anywhere, he knew from his experience, that the Turkish armed forces did behave responsibly and constructively. Hence, although the new government faced enormous political and economic problems, he was not surprised that they were being tackled with deliberation and pragmatism. He wanted the Minister to assure his colleagues that given a continuation of these difficult but essential actions, the Bank would continue to do all it could to help Turkey. He recalled that he had also talked to Chancellor Schmidt in the matter, and had pledged maximum Bank support to complement the aid raising efforts being undertaken by Germany.

01/06

3. Turning to the energy sector, the Minister emphasized the importance his government attached to reducing Turkey's dependence on imported oil for energy, as well as for industrial and transport, use. He therefore particularly appreciated the Bank's recent assistance through the two loans for petroleum projects, and hoped for continuing Bank support in this priority subsector. He added that during his discussions earlier that afternoon with senior Bank officials, he had also confirmed his interest in increasing the production of coal and lignite, using the financial and technical collaboration of foreign partners as the Bank had suggested. Mr. McNamara responded that to support Turkey's pragmatic new policy of inviting foreign companies to step into these subsectors, especially of petroleum, the Bank would be prepared to assist, if the Government so wished, with arrangements with foreign firms in respect of projects the Bank may finance in these subsectors. Responding to Mr.Stern's query regarding an energy sector review on which the Bank placed considerable emphasis, the Minister responded that during the same discussions with the Bank officials, he had already agreed to such a review in the early part of 1981. Mr. Davar clarified that the Minister had agreed that it would be much more helpful to Turkey, if such a review focussed on issues like demand, supply, pricing and investments aspects and analysed them in depth, with a view to assisting Turkey in evolving a viable energy policy rather than doing a traditional sector review covering the entire water front.

4. While welcoming this positive Turkish response, Mr. Stern stressed the need to ensure speedy and effective implementation of the Elbistan and Karakaya power projects. Now that solutions to complete the Elbistan project effectively, had been agreed between Turkey and the colenders, it was important to ensure that these were put into effect to preclude further delay. The Minister responded that he had personally visited Elbistan prior to the meeting of the colenders, had stimulated some of the solutions reflected in the Protocol with the colenders and had every intention of ensuring that they were implemented. As regards Karakaya, it seemed to him that the Italian contractor wanted to reopen negotiated solutions to escalate the contract price further. However, he would take steps to ensure that a mutually fair compromise was quickly worked out by Turkey with the contractor. The meeting ended on a note of Turkey and the Bank continuing to work closely together.

cc: Mr. McNamara's Office (2)
cc: Messrs. Stern (SVPO), Chaufournier (EMNVP), Bart (EM2),
Picciotto (EMP), Rovani (EGY).

AJDavar:hr

FORM NO. 75
(1-76)

THE WORLD BANK

ROUTING SLIP	DATE: December 17, 1980

NAME	ROOM NO.
Mr. Ernest Stern	
12/17	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		URGENT

REMARKS:

<u>Brief for Mr. McNamara's Meeting with the Turkey Energy Minister</u>

Since Mr. Chaufournier is ill, I am sending this briefing memorandum directly, for your approval and signature.

FROM:	ROOM NO.:	EXTENSION:
AJD ~~Adi~~ J. Davar	F-718	72383

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: December 17, 1980

TO: Mr. Robert S. McNamara, President
Mr. Ernest Stern, Senior Vice President, Operations ES

FROM: Adi J. Davar, Acting Director, EMENA CPII

SUBJECT: TURKEY: Your Meeting with His Excellency Serbulent Bingol, Minister of Energy and Petroleum Resources

1. Mr. Bingol, Minister of Energy and Natural Resources, is scheduled to meet you on December 18 at 5.00 p.m. Messrs. Chaufournier, Bart and I will join you. The Minister has been in charge of the energy portfolio only since early October, following a recent military takeover in Turkey. His bio-data is attached.

Background to Visit

2. Minister Bingol is visiting the US for an energy conference in Florida. During his courtesy call on you, he is likely to take the opportunity to highlight his Government's new policies in the energy sector, and possibly press for increased Bank assistance for energy, and especially power, projects. Mr. Chaufournier, Mr. Rovani and the senior staff of the Region, have been invited to a working lunch with the Minister on December 18. It is therefore likely that we will then discuss some of the matters. Nevertheless, it would be most helpful if you could touch on some key issues of interest to the Bank. I am therefore summarizing the background regarding the energy sector, as well as our present involvement and future plans for assisting the sector.

Sector Background

3. A careful approach towards the development of the energy sector, is crucial to Turkey's structural adjustment process. The burden of oil imports on the balance of payments, is heavy. In 1980, the volume of oil imports maintained at the 1977 level, cost Turkey $3.2 billion, or nearly 20% more than its total merchandise exports. Even if the volume of oil imports is contained at the 1977 level up to 1985, the bill would rise to $6.1 billion, assuming an increase of 3% p.a. in real terms in international prices.

4. Recognizing this, Turkey has already set in place, some major elements of a sound energy policy, to restrain the growth of energy consumption and develop domestic energy resources. Prices of petroleum and petroleum products were substantially increased in January, and again in mid-September after the military takeover, to well above their import prices. Besides, with the exception of diesel, most prices are close to West European levels, and currently there is no subsidy to consumers. In addition, it is now Government's policy to pass on all future price increases, as well as those needed to reflect foreign exchange changes, promptly to the consumers. While these new pricing policies should have a beneficial effect, significant savings in the import bill may be limited, given the compression of oil imports which has already taken place. The increasingly important aspects of a sound energy policy, therefore also lie in the direction of: (a) stimulating energy conservation; and (b) rapidly developing domestic energy resources.

5. Towards the former objective, energy audits in major economic subsectors where significant energy savings should be possible, together with a review of institutional means for achieving them, are being commenced under our recent Petroleum Exploration Project. To substitute domestic fuel resources for imported oil, the Government has taken actions (and more are planned), e.g. (a) to direct SEEs to convert where possible, from oil to lignite; (b) to base new fertilizer plants, to the extent possible, on lignite as feedstock; (c) to require all new housing construction to use only domestic fuels for heating; and (d) to grant incentives to new private sector projects using domestic fuel resources. Towards the second objective, the highest priority has been accorded to completing ongoing energy projects. In addition, in a major policy reversal, the January'80 program of structural adjustments included the policy of actively promoting foreign investments for oil, gas, coal and lignite exploration and production. This has been followed up, by a package of attractive inducements. While some oil companies have reacted favorably, little similar interest has been evidenced for coal/lignite.

Bank Support

6. Meanwhile, through its recent Bati Raman and Petroleum Exploration projects, the Bank initiated support for the oil/gas subsector, by helping Turkey to increase recovery in established oilfields and to confirm the exploration potential of promising areas. Prior to this, we had concentrated on the power subsector (Elbistan, Karakaya and Transmission). However, given that subsector's institutional problems, and the relatively easier availability of external financing for power projects (nearly 40% of committeed external financing of $3.6 billion, has been made available for such projects), we propose to concentrate in future on the oil/gas, and hopefully of coal/lignite, subsectors where such financing has not been forthcoming. Such Bank presence could also act as a catalyst to attract official aid, as well as investments by foreign companies.

Topics for Discussion

7. While congratulating the Minister on his appointment and thanking him for explaining the Government's new energy policy, you might wish him success in accomplishing the difficult tasks that lie ahead. You might assure him, that the Bank recognizes the crucial contribution of the sector to the success of the Government's program to restructure the economy, and that we are ready to help. You might then raise the following points.

8. Energy Sector Review: While we have good knowledge of the power and oil/gas subsectors, and under the Karakaya Project are helping in a pricing study designed to lead to a consistent scheme of energy pricing, our overall integrated knowledge of the energy sector, especially of the coal/lignite subsector, is inadequate. Although as a condition of presenting the Bati Raman and Petroleum projects to our Board, the Government agreed on a comprehensive energy sector review this year, we understand that, since then, the Minister has expressed some reservations. The major institutional tasks in the sector include: (a) a drawing up of a balanced energy plan for the next few years; (b) integrating demand, supply, pricing, imports and investment requirements; (c) strengthening planning and coordination between agencies involved in the subsectors, as well as improving project implementation capacity; and (d) determination of

a priority investment program, balanced among the various subsectors. You might therefore emphasize to the Minister, the importance you attach to the undertaking of a comprehensive energy sector review later in this fiscal year, since that would help provide Turkey with an integrated framework for developing a rational longer-term policy towards energy, and a basis to support future Bank assistance for the oil/gas and coal/lignite subsectors as well as for structural adjustments.

9. Coal/Lignite Development: This year, the Government reversed actions taken in 1978 to nationalize coal/lignite mines, and has also offered attractive inducements to the Turkish and foreign private sector companies to exploit this large energy resource. However, only 20 percent of the known coal/lignite resources have been firmly established through geological surveys. The technology for exploiting coal, and the relatively poor quality lignite, for energy, industrial and domestic use is not available in Turkey. Besides, the SEE in charge of coal/lignite development, i.e. TKI, is one of the most inefficienct ones. At the same time, it would appear that countries such as Germany and France, who have vast coal/lignite deposits and developed relevant technologies, could help Turkey in this area, if a correct approach were developed to tap their interest. A possible approach, tentatively discussed with the Government, includes the incorporation of a Turkish company, in which a large foreign firm experienced in lignite operations could have a meaningful equity holding, to exploit promising deposits; or as a second best alternative, a Turkish-owned company could be established by the Government under commercial laws, to which a foreign firm could give technical expertise on a royalty or technical service fee basis. In this background, you might indicate that the Bank's willingness to support a nationwide geological survey to estblish coal/lignite deposits, as well as viable projects designed to rapidly increase production in established coal fields (e.g. Zongulduk) and fields having good quality lignite (e.g. Seyitomer).

10. Elbistan and Karakaya Project: The implementation of Elbistan is nearly four years behind schedule. However, during high level discussions between the Government and the colenders in November, a Protocol has been signed, under which Turkey agreed to a number of measures designed to ensure that: (a) the project is not constrained in future by lack of local currency; and (b) construction management capacity is augmented by recruiting foreign experts. While complimenting the Minister on these initiatives, you should however emphasize the need for continuing vigilance in implementing the agreed Protocol, so that this project is now completed without further delays. With regard to Karakaya, construction is proceeding rather slowly, because of continuing differences with the contractor on questions of price escalations and similar financial matters, as well as because of the lack of adequate senior staff to support an excellent project manager. Without going into details, you might urge the Minister to take whatever steps that are now necessary, to ensure timely implementation of this project.

cc: Mr. McNamara's Office (2)
Messrs. Chaufournier (o/r)(EMNVP), Bart (o/r)(EM2),
Carmignani/Picciotto (o/r)(EMP), Rovani (EGY), Reekie (EMP)

VNRajagopalan/AJDavar:bb

Attachment

BIO-DATA

Mr. Serbulent Bingol
Minister of Energy & Natural Resources

Mr. Bingol was born in 1921. After completing his studies in Turkey, he undertook graduate studies in engineering in Germany.

In the sixties, he held the positions of Governor of Denizi, and later, Trabzon provinces. He was the Minister of Construction and Resettlement in the late Mr. Erim's technocratic Cabinet of 1972. He was appointed as the Minister of Energy and Natural Resources in early October, after the Military takeover in mid-September this year.

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President ES.
THRU: Mr. Ernest Stern, SVP, Operations
FROM: Attila Karaosmanoglu, Acting RVP, EMENA AK.

DATE: December 5, 1980

SUBJECT: TURKEY - Visit of Minister of Energy

1. I understand that your office was directly approached by the Turkish Ambassador requesting a meeting between you and the new Minister of Energy, Mr. Serbulent Bingol, on December 18.

2. We have since learned from the Embassy that since he is in the United States for an Energy Conference, the Minister wishes to pay a brief courtesy call on you and highlight his new Government's policy towards energy investments.

3. Given his request, the general difficulties our power project portfolio has encountered in Turkey, and possible scope for involvement in new energy subsectors of oil and lignite, I would suggest that you accede to his request.

cc: Messrs. Chaufournier (o/r), Bart (o/r), Picciotto
/bp

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: February 17, 1981

TO: Mr. Robert S. McNamara
THROUGH: Mr. Ernest Stern, Senior Vice President, Operations ES.
FROM: Roger Chaufournier, RVP, EMENA

SUBJECT: TURKEY - Briefing for Your Meeting with Deputy Prime Minister Ozal

1. Deputy Prime Minister Ozal will be lunching with you on Thursday, February 19 at 12:30 p.m.

Background of His Visit

2. He will be visiting Washington partly to finalize the draft Statement of Development Policies, which has been worked out by the SAL II appraisal mission as a basis for that loan (Issues Paper and Statement attached). Another important reason, is to establish high-level links with the new U.S. administration and persuade it to increase its support to Turkey and especially take a bigger role in coordinating OECD aid efforts, in view of some hesitation on the part of Germany. The Government fears that current European discussions on how to treat Turkey's military regime, will affect bilateral donors' actions at a proposed OECD-sponsored pledging session in late March, or even lead to a postponement of that meeting. Turkey would then become even more dependent on support from the U.S. and multilateral institutions, especially the Bank, in filling its 1981 balance of payments gap of at least $2 billion.

3. Mr. Ozal is therefore likely to request your intervention with both U.S. and Germany to maintain the timetable for an early OECD pledging session, to increase their likely contributions (U.S. is prepared to maintain it at the 1980 level of $300 million, provided Germany matches it), and to persuade them to spearhead a larger aid mobilization effort. He will also ask Bank support at that meeting, in terms of both our evaluation of the Government's policies and a generous lending program. Finally, he will request as large a structural adjustment loan as possible, as soon as possible (para. 10 onwards). Meanwhile, Turkey remains in good standing with the IMF, and during his visit Mr. Ozal will be meeting with Mr. de Larosiere on Thursday, February 19 at 9:30 a.m. An IMF review mission is scheduled for April, to reach understandings on credit limits for the second quarter of 1981.

4. Recent Political Developments. Internally, but in response to pressure from European governments expressed largely through the Council of Europe, the Turkish Head of State, General Evren, has announced that a Constituent Assembly will be appointed between August 30 and October 29 to draw up a new Constitution. It will not include former politicians. No further steps towards democratic rule have been announced. The press is controlled on political matters but remains free on all others and devotes much space to debates on economic developments and policies. Externally, Turkey is moving closer to the Muslim world through heightened contacts with Saudi Arabia and at the recent Islamic Conference there. A good start has been made in obtaining financial assistance from Saudi Arabia (including $250 million in 1980-81).

5. Recent Economic Developments and Policy Reforms. The National Security Council and the civilian Government have taken steps to broaden both the agenda of policy and participation in economic decision-making, by creating an Economic Affairs Coordination Committee, chaired by the Prime Minister. As a result, Mr. Ozal's virtual monopoly of influence has been ended; this may lead to a greater collective responsibility in the Government for the harsh economic decisions which are taken. His influence, however, remains very strong, especially in external economic matters.

6. You may wish to congratulate Mr. Ozal on several encouraging recent developments. The most important is a surge of exports in the last quarter to a record $2.9 billion in 1980, an increase of 29 percent over 1979 and somewhat over IMF's and Bank's estimates. Industrial exports grew by 33 percent and agricultural exports by 24 percent. In addition, workers' remittances grew by 21 percent to a record $2.1 billion. These successes are attributable in large part to the Government's flexible exchange rate policy and deregulation of interest rates. Further, competition from Government bonds and brokers has pushed time deposit rates to 50 percent (from 30-36 percent only two months ago) and non-preferential lending rates to up to 65 percent, and broken the bankers' cartel. With inflation stabilized at about 3 percent per month for the moment, the general level of interest rates is positive in real terms for the first time in many years.

7. You may also wish to congratulate Mr. Ozal on several new and important economic reforms implemented or underway. First, in the last two months, the Government and National Security Council have enacted nearly the whole of a comprehensive tax reform package, which had eluded democratic governments for a decade. About 20 bills already passed, will greatly increase revenues (by 3 percent of GNP in the first year alone) and the buoyancy and equity of the tax system. Second, the 1981 import regime provides for a much greater (albeit still partial) degree of liberalization than we expected. Third, there has been some rationalization of the public investment program.

8. Finally, the Government has committed itself to the vital and difficult reform of the State Economic Enterprises (SEEs). Building on the price freedom introduced last January, recent decrees have cut off nearly all SEEs from the Central Bank and virtually frozen their staff levels. The Government is now going to tackle the very important issues of SEE management selection, pay, continuity and authority/autonomy. These issues are discussed in the attached draft Statement on Development Policies, as well as the Issues Paper.

Relations with the Bank

9. Close cooperation has continued in the last months with some positive results. As regards project implementation, local currency financing remains a serious constraint but steps have been taken by the Treasury to address the most pressing problems (e.g. Elbistan for which, in addition, an action program was agreed upon by the colenders and the Government in November). The progress of our economic and sector work and dialogue with the Turks has been

quite open and encouraging over the last fiscal year. This has been achieved during the preparation of the PCR for SAL I, the appraisal of the SAL Supplement, and Public Investment Review mission in November, and appraisal work of SAL II. In addition, we are planning to mount an Energy Sector mission, and an Industrialization and Foreign Trade Strategy mission led by Mr. Balassa, before the end of this fiscal year. Project preparation for the coming years is proceeding without serious problems; however, the lending program may have to be revised in light of changed priorities and resource availability; two project identification missions for industry and agriculture are expected to strengthen the pipeline if the key policy constraints they have identified are removed.

SAL II Appraisal

10. Against this background, Mr. Ozal is likely to raise two major points with you regarding SAL II: (a) loan amount; and (b) confidentiality of the Government's Statement of Development Policies. Let me, however, summarize the position you may wish to take on these matters.

11. Given the estimated 1981 foreign exchange gap exceeding $2 billion, against $1.4 billion initially projected for 1980, the likely favorable impact a larger Bank contribution could have on the aid mobilization efforts, and the fact that the policy package developed is now far more substantive than what the Bank supported last year with total SAL lending of $275 million, Mr. Ozal is likely to press for a loan of at least $350 million. At present, inclusive of SAL II for $200 million, the FY81 lending program for Turkey stands at $612 million, compared to $600 million achieved in FY80. Against this, we will have provided five loans totalling $247 million by end March. 1/ Three loans totalling $365 million, are planned for Board presentation before end May 1981. 2/ If you also concur that the SAL actions to which the Government is prepared to commit itself under the draft Statement are substantial, then also given the abovementioned other reasons, you may wish to consider increasing the SAL II loan to $300 million. This would then bring the FY81 lending to Turkey, to $712 million. We could absorb the increase within the Region's program for FY81-82. However, I do not believe it would be prudent to agree to a larger loan than $300 million, since that would bring the FY81 lending to well over $700 million. Incidentally, since the SAL II appraisal mission has just returned, there is little possibility for the loan to be brought to the Board before late May. I would suggest that you indicate this to Mr. Ozal, should he press for earlier Board consideration.

1/ Bati Raman - $62 m, Oil Exploration - $25 m, and SAL I Supplement - $75 m, all of which have been signed; and Labor Intensive Industry - $40 m and Fruit and Vegetable II - $45 m, both scheduled for Board presentation by end March.

2/ Fertilizer Rehab. - $100 m, SEE Finance (through DYB) - $65 m, besides SAL II for $200 m.

12. The draft Statement worked out by the SAL II appraisal mission, is a rather far-reaching document, containing actions which the Government plans to take in the coming months. Mr. Ozal is therefore concerned, that its circulation to our Board (or leakage before) may seriously embarrass the Government and jeopardize its ability to take these actions. He is therefore likely to urge, that the brief covering letter but not the attached Statement should be circulated by you to the Board. This may be difficult for the Bank to accept, even though the substance of the policies and commitments could be explained in the President's Report. One alternative, not discussed with the Government, would be to divide the Statement, and cover the politically difficult measures and commitments in a confidential letter, addressed to you, which would not be circulated to the Board. On the basis of the letter, you could inform the Board that you have received a communication which persuades you that the Government would take specific actions necessary to further implement its structural adjustment program described in the Statement circulated to the Board. You may wish to opt for this alternative.

Cleared with and cc: Messrs. Bart (EM2), Dubey (EMNVP), Hume (EMP),
Davar, Zaman, Berk (EM2)

cc: Messrs. Stern (SVPO), Chaufournier (EMNVP)

DBerk/AJDavar/MPBart:cml