December 18, 2000

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Köhler:

1. In our letter of December 9, 1999, requesting a three-year stand-by arrangement with the Fund, and in two subsequent letters—dated March 10 and June 22, 2000—requesting completion of the first two reviews, we described the main elements of our ambitious disinflation and fiscal adjustment program, charting the course of economic policies over 2000–02. This letter provides an update on economic developments since the completion of the second review, discusses our policy goals for 2001–02 in light of these developments, and outlines the key policy measures needed to achieve those goals. With this letter we also request the completion of the third and fourth program reviews, as well as access to Fund resources amounting to SDR 5.784 billion under the Supplemental Reserve Facility.

Recent macroeconomic developments

2. Steady progress has been made in achieving the key goals of our program. We expect that by December 2000, the 12-month CPI inflation rate will be about 38 percent. This is above the program target of 25 percent, an overshooting that is partly due to the large and unexpected rise in international energy prices. However, it is about half the inflation rate at end-1999, and the lowest inflation rate since the mid-1980s.

3. Fiscal performance continued to be strong, meeting, by a wide margin, the program's end-June and end-September 2000 fiscal performance criteria and indicative floors, respectively, for the primary surplus and for the overall balance of the consolidated government sector (CGS, which includes the consolidated central budget, selected extrabudgetary funds (EBFs), eight nonfinancial state economic enterprises (SEEs), and three social security institutions) (Annex A). For the whole year, we expect the primary surplus of the CGS to exceed the program target by some 1 percent of GNP. This, together with the fall in interest

rates and the sizable amount of expected privatization proceeds, will lead to about a 3 percentage point decline in the public debt-to-GNP ratio (excluding the securities issued for the recapitalization of the banks taken over by the Saving Deposit Insurance Fund (SDIF)).

4. Total receipts from privatization will, however, fall short of the original program target, owing to delays in the conclusion of the sale of the GSM license and of part of Turk Telecom. We now project privatization receipts to reach US$3½ billion in 2000, against the original target of US$7½ billion. As actions to remedy this delay have already been taken, or are about to be taken (see below), we request the modification of the end-December 2000 performance criterion on the primary surplus of the CGS inclusive of privatization receipts (<u>Annex B</u>).

5. Following the deep recession in 1998–99, economic activity—fueled by consumer spending, investment, and exports—recovered strongly this year. This recovery reflects to some extent a post-earthquake rebound, but also renewed confidence in economic prospects and a major fall in interest rates during the first half of the year, which have stimulated domestic spending. In light of these developments, real GNP growth in 2000 may exceed the program's target range of 5-5½ percent.

6. The strong recovery of domestic demand, as well as the rise in international oil prices, has led to a sharp increase in imports. Although export volume growth has also accelerated and tourism revenues are projected to reach an historical peak, the external current account deficit is likely to widen this year to about 5 percent of GNP, against about 1 percent of GNP in 1999. At least 2 percentage points of this increase are related to unanticipated external shocks (the rise in international oil prices, the appreciation of the U.S. dollar, which has negatively affected our competitiveness in European markets, and the rise in international interest rates). Thanks to increased confidence in our macroeconomic policies, this deficit has been readily financed for most of the year. Up to mid-November, international bond issues amounted to US$7½ billion (against a plan of US$6 billion for 2000) and gross international reserves, valued at program cross-exchange rates, had increased by US$3½ billion. The performance criteria on NIR and external debt for end-June and end-September 2000 were observed (<u>Annex A</u>). Up to mid-November, monetary and exchange rate policies were rigorously implemented. The net domestic assets (NDA) of the Central Bank of Turkey (CBT) were kept within the specified narrow band (as implied by the no-sterilization rule introduced at end-1999), and the NDA performance criteria for end-June and end-September 2000 were observed (<u>Annex A</u>).

7. During the last ten days of November and in early December, Turkish financial markets experienced a period of high volatility. Financial difficulties of one medium-sized bank, which was subsequently taken over by the SDIF, and the sell-off by that bank of large stocks of government paper in the secondary market led primary dealers to suspend the posting of the rates on government paper. This triggered massive capital outflows, in spite of the rise of interest rates to 100–200 percent. At the same time, the CBT increased the supply of NDA well outside the program's corridor, out of concerns for the effect that excessively high interest rates would have on the banking system. Those events, in the context of weaker international market sentiment for emerging economies, led to a loss of US$6 billion of foreign exchange reserves. On November 30, the CBT announced that it would stop providing liquidity to the market, halting in this way the loss of reserves. Interest rates, however, skyrocketed to over 1,000 percent. The pressure on financial

markets eased only with the announcement of a policy strengthening and the request of access to the Supplemental Reserve Facility.

Policy objectives and overall macroeconomic management strategy for 2001-02

8. In spite of the recent financial market turmoil, the results achieved in 2000 are generally positive and have strengthened our resolve to achieve the program's key macroeconomic goals—bringing inflation down to single digits by end-2002, restoring the viability of public finances and, in this way, setting growth on a sustainable path. In particular, there is a need to ensure that the improvement in domestic economic conditions is consistent with a viable external position, after the widening of the external current account deficit projected in 2000. More specifically, our policies for 2001 will be oriented to avoiding the risks that could arise from excessive domestic demand pressures, minimizing the likelihood of further slippages in inflation performance (thus preserving external competitiveness), and bringing down the external current account deficit to a more sustainable level. To this end, our overall macroeconomic framework for 2001, including fiscal policy, has been significantly strengthened with respect to the original program targets. Critical steps are also being taken in the banking area, with the goal of reducing the banking system's vulnerability to shocks and speeding up its restructuring. Finally, new structural reform initiatives will be started, including in the critical area of privatization, a source of potentially large foreign exchange inflows.

9. The program for 2001-02 focuses on achieving the following goals:

- A CPI inflation rate (December/December) of 12 percent in 2001. CPI inflation is targeted to be in the single digits by end-2002.

- A real GNP growth rate in the range of 4–4½ percent in 2001, a deceleration with respect to the likely outturn in 2000. Growth should accelerate to 5–6 percent in 2002 and beyond, spurred by a positive supply response to the structural reforms under way and increased macroeconomic stability.

- An external current account deficit not exceeding 3½ percent of GNP, a level that should be readily financed and well below the 2000 expected outcome. The external current account deficit is expected to be below 3 percent of GNP in 2002.

10. While we regard the above macroeconomic targets as mutually consistent, the primary goal of our policies in 2001 will be to ensure that the inflation target is achieved and that the expected improvement in the external position is realized. Achieving and sustaining over time a stable macroeconomic framework is the necessary condition for maximizing the growth prospects of the Turkish economy over the medium term.

Fiscal policy

11. The primary position of the public sector (which includes the consolidated central budget, EBFs, local governments, SEEs, social security institutions, the CBT, and the unemployment insurance fund) will be strengthened not only with respect to the projected

2000 outcome, but also with respect to the original program targets. This strengthening will be instrumental in reducing overall macroeconomic risks and in lowering more rapidly the public debt-to-GNP ratio, which at end-2000 will still be above its average of the 1990s.

12. Our objective is to improve the primary surplus of the public sector by some 2 percentage points of GNP, from the projected 3 percent of GNP in 2000 to 5 percent in 2001 (against an original target of 3¾ percentage points of GNP). The public sector borrowing requirement is projected to decline from 18½ percent of GNP in 2000 to 10 percent of GNP in 2001. The operational deficit of the public sector (the deficit adjusted for the erosion in the real value of public sector debt due to inflation) is expected to fall from some 5½ percent of GNP in 2000, to 3 percent of GNP in 2001 (excluding interest payments of about 0.3 percent of GNP on the securities issued to recapitalize the SDIF banks taken over during 1998-99). Public sector debt is projected to fall by 4½ percentage points of GNP, excluding the issue of securities for recapitalizing banks. In 2002, we intend to keep the primary surplus of the public sector at about the 2001 level. This is expected to be sufficient to keep the operational deficit at about the same level of 2001.

13. The targeted improvement in the public sector accounts will involve a coordinated effort not only at the level of the central government, but also at the level of the non-central components of the public sector. Regarding the central government, we expect the primary surplus excluding privatization receipts, interest receipts, and transfers of profits from the central bank to be at least TL 8,735 trillion in 2001 (5.7 percent of GNP, against 4.9 percent of GNP in 2000). After adjusting for the inclusion of the Public Participation Fund in the budget, this represents an improvement of 1 percentage point of GNP with respect to 2000.

14. In addition to the measures introduced in September 2000, which are expected to save some ¼ percent of GNP on an annualized basis, further steps are being taken in the run up to the approval of the 2001 budget, partly to offset the expiration of temporary measures that were introduced in the 2000 budget. More specifically, the following measures are being implemented:

- Regarding direct taxes, we will extend to 2001 the system of quarterly advance payments for personal and corporate income taxes, raising the rate for the advanced corporate income tax from 20 to 25 percent; increase the rates for the withholding tax on deposits, repurchase agreements, and investment allowances; contain the indexation of personal income tax brackets to targeted inflation; reintroduce presumptive income taxation (based on living standards). Taking into account the expiration of the tax deferral in the earthquake regions, these measures are expected to yield 1.2 percent of GNP.

- Regarding indirect taxes, we will extend to 2001-02 the special communication and transaction taxes, while doubling the rate of the latter; increase VAT rates for telephone services and natural gas; increase the rates and levels of taxes on motor vehicles; and increase taxes on vehicles using LPG, as well as other fees. These measures are expected to yield 1.2 percent of GNP. In addition, we will set the rate of monthly increase of the petroleum consumption tax at least equal to targeted CPI inflation.

- Regarding nontax revenues, we will extend to 2001-02 the special education levy; renew the levy on the Istanbul Stock Exchange and other boards, and increase the fees on domestic and import credit (resources utilization support fund). These measures are expected to yield 0.7 percent of GNP.

15. On the expenditure side, the 2001 program aims to keep the real growth of primary expenditure of the central government (net of earthquake-related expenditure and tax rebates, and after adjusting for the inclusion in the budget of the PPF) well below the GNP real growth rate. To this end, the following policies will be implemented:

- Civil servants' wages will be raised in December so as to offset the excess of inflation over targeted inflation during 2000. As to the first half of 2001, wages will be raised by 10 percent in January. However, should CPI inflation exceed 10 percent, there will be an additional increase in civil servants' salaries equal to the difference between the CPI inflation rate and 10 percent. The same policy (setting salary increases in line with targeted inflation with a later adjustment if inflation exceeds the target) will be applied also in the second half of 2001. Moreover, the hiring of civil servants in 2001 will be limited to 80 percent of civil servants retired in the previous year (except in the sectors of education, health, and security).

- As in 2000, the Ministry of Finance will issue in January 2001 a directive that will reduce all primary expenditure (excluding personnel, transfers to social security funds, and tax rebates) by 2 percent with respect to budgetary allocations in 2001 (with an expected yield of 0.1 percent of GNP);

- Finally, savings of 0.3 percent of GNP will be generated during the implementation of the budget by cuts in "other current expenditure" covered by Article 53 of the budget law.

16. Regarding the noncentral components of the public sector:

- Reflecting the full-year effect of the introduction of unemployment insurance premia during the second half of 2000, the primary surplus of the unemployment insurance fund is expected to improve from 0.2 percent of GNP in 2000 to 0.5 percent of GNP in 2001.

- The primary balance of the EBFs is expected to improve from -0.5 percent of GNP in 2000 to -0.2 percent of GNP in 2001. This improvement reflects primarily the inclusion in the central budget of the PPF.

- The primary balance of the SEEs is expected to improve from -1.5 percent of GNP in 2000 to -0.9 percent of GNP in 2001. In addition to prudent wage policies, this improvement reflects the following measures: (i) the cut of sugar beets quotas from 12½ to 11½ million tons, and the increase in the support price of sugar beets by no more than 12 percent; (ii) a further reduction in the volume of support purchase of cereals and additional offloading of TMO grain stocks; (iii) as of December 2000 the average electricity price sold by TEAS will be US$4.5 cents/kwh and related price increases for TEDAS (that would allow TEDAS to cover the increased cost of purchasing electricity from TEAS) will be implemented; and (iv) the policy of eliminating the subsidy on LPG will be completed by end-January 2001. In addition, we will continue to implement the policy of hiring up to a maximum of 15 percent of retired personnel in the SEEs in the Treasury's portfolio in 2000. Personnel transferred from one SEE to another SEE will be counted against this ceiling. Only the Treasury will have the authority to allow new hiring within that limit.

17. Enactment of the measures indicated in paragraph 14, and approval by the parliamentary planning and budget commission of the 2001 budget in line with the above-mentioned fiscal targets (and including provisions allowing the introduction of fees on electricity consumption), will be prior actions for the presentation to the IMF Executive Board of our request for the completion of the third and fourth reviews under the stand-by arrangement, and for access under the Supplemental Reserve Facility (henceforth "prior actions").

18. The attainment of the 2001 fiscal targets will be monitored through a set of performance criteria and indicative targets:

- A quarterly performance criterion on the primary surplus of the CGS excluding privatization receipts. The floor for end-2001 will be TL 8,110 trillion (5.2 percent of GNP); for the first quarter of 2001, monthly indicative ceilings will be in place (Annex B).
- An end-year performance criterion on the primary surplus of the CGS inclusive of privatization receipts, with quarterly indicative targets (Annex B).
- Quarterly performance criteria on the noninterest expenditure (excluding tax refunds) of the consolidated central government (Annex C).
- Quarterly indicative ceilings on the overall deficit of the consolidated government sector, excluding privatization receipts, so as to monitor the developments not only in the primary balance, but also in interest payments (Annex D).

19. We believe the above fiscal measures are sufficient to achieve the program's goals. However, we would introduce additional fiscal measures, should it be necessary for the attainment of the key macroeconomic targets, in particular inflation and the external current account.

Public debt management

20. In 2000 public debt management has succeeded in lowering borrowing costs, while maintaining the average maturity of domestic public debt broadly unchanged (it was about 15 months in October 2000). The market for floating rate notes (FRNs), an instrument launched in the second half of 1999, has developed rapidly (FRN issues have represented about 21 percent of domestic debt issued through auctions in 2000). The share of gross external debt over total debt of the public sector is projected to remain broadly constant between 1999 and 2000 (at about 40 percent). We request the revision of the end-December 2000 short-term debt limit to US$1.1 billion from $0.5 billion to provide some room for securing additional financing, if needed.

21. In 2001 we will continue with our policy of balancing the need for a lengthening of maturities of domestic debt with the need to avoid locking in at the current interest rates in a period of continued disinflation. While in 2000 the main emphasis was to avoid a shortening of the maturities, in 2001 we will aim at a moderate increase in the average maturity of domestic debt, partly through the further growth of the market for FRNs. We

will also aim at maintaining the share of external debt of the public sector in total debt broadly constant. This policy has been reflected in the ceilings on contracting and guaranteeing of external debt of the CGS included in Annexes G and H. The end-December 2000 short-term debt limit is carried over until the third quarter of 2001 before reverting in the final quarter to the level initially agreed for the first year of the program (i.e., US$0.5 billion).

Incomes policy

22. In the public sector, in addition to the wage policy described above for civil servants, the wage contracts for public sectors workers are due for renegotiation in the months ahead. In these negotiations the overall macroeconomic targets of the program, as well as the need to strengthen the financial position of the SEEs, will be taken into account.

23. Minimum wage increases are determined by the Minimum Wage Commission, consisting of representatives of the government, the trade unions, and the employers. As in 2000, the government will endeavor to ensure that the minimum wage increase in 2001 will be in line with targeted inflation.

24. In order to facilitate the decline in inflation, the government will play a more active role in the discussions between social partners, as well as in its contacts with the private business sector, so as to facilitate wage settlements, as well as pricing decisions of the private sector, that are in line with the inflation target.

Monetary and exchange rate policies

25. The goal of monetary policy in the aftermath of the financial crisis of late 2000 has been to move NDA gradually closer to its mid-November 2000 level, so as to facilitate the recovery of foreign exchange reserves, while avoiding an excessive increase in total base money supply. More specifically, NDA was lowered to TL 1,840 trillion on December 11, 2000. NDA will not exceed TL 1,460 trillion on January 11, 2001. Correspondingly, we request the end-December 2000 NDA performance criterion—which is to be computed as the average between the stock of NDA on December 11 and the stock of NDA on January 11 (on account of the volatility in base money demand at end-2000 due to religious holidays)—to be revised to TL 1,650 trillion (Annex E). At the same time, we request the revision of the end-December 2000 NIR floor to US$10.4 billion (Annex F) at the new program cross-exchange rates. This new target takes into account the lower post-crisis external reserves position of the CBT. For 2001, the NIR floor is set to increase to US$12 billion by June.

26. Between December 11, 2000 and January 11, 2001, the demand for base money, as well as net international reserves, is expected to experience large seasonal movements related to religious holidays and the end-year closing of books. During this period movements in NDA and NIR will be closely monitored in consultation with Fund staff, and monetary policy will be promptly tightened if these movements exceed the normal seasonal fluctuations.

27. During the first half of 2001, the monetary framework will continue to be characterized by the pre-announced exchange rate path with no band. As already announced, the devaluation rate will be lowered from 1 percent per month in the last quarter of 2000, to 0.9 percent per

month in the first quarter of 2001, and to 0.85 percent per month during the second quarter of 2001. Regarding NDA, we will continue the policy of gradual reduction of the excess of NDA created during the crisis. This policy is reflected in the NDA ceilings (performance criteria) included in Annex E, for end- January, February, March, and June 2001, which also reflect the decline in reserve requirement coefficients effective as of January 12. Thus, by end-June 2001, about 50 percent of the excess of NDA created during the crisis (adjusted for the change in reserve coefficients) will be eliminated. While, for the purpose of assessing compliance with the performance criteria, only the above test dates will be relevant, NDA between test dates is not expected to exceed systematically, or by large amounts, a linear interpolation of the NDA ceilings (with the exception of the second and third week of March which are affected by religious holidays). Should capital inflows be stronger than currently envisaged, NDA will be kept below the above baseline, so as to avoid, to the extent made possible by our exchange rate commitment, that capital inflows lead to an excessive increase in money supply and to an interest rate level that is not consistent with the attainment of the program's inflation targets. The appropriateness of the NDA ceilings in the above two paragraphs will be reassessed during the forthcoming program reviews, in light of developments in the external accounts and inflation.

28. As envisaged in our Letter of Intent dated December 9, 1999, as of July 1, 2001, a gradually widening band will be introduced around the central exchange rate path, and more flexibility will be given to NDA policy, so as to permit a gradual shift to a monetary framework that allows greater focus on the direct pursuit of price stability. This shift is deemed necessary to avoid being locked into a monetary framework that—while appropriate during the initial phase of disinflation—may lead to unnecessary rigidities in the long run.

29. More specifically, as of July 1, 2001:

- The exchange rate will move within a symmetric, progressively widening band that will open around its mid-point. The mid-point of the band will continue to be preannounced, according to the modalities introduced at end-1999. The depreciation rate of the mid-point will be 0.85 percent per month during the third and fourth quarters of 2001. Within the exchange rate band, the exchange rate will be determined in the foreign exchange interbank market, and the CBT will buy or sell foreign exchange in the market only as an agent of the treasury.

- The band about the mid-point will widen daily at a rate of 15 percentage points per annum, measured from edge to edge. The total width of the band will thus reach 7½ percent at end-December 2001, 15 percent at end-June 2002, and 22½ percent at end-December 2002.

- In order to allow the exchange rate to move freely within the band, NDA policy will have to become more flexible, and increasingly focused on the attainment of the inflation target (see next paragraph). For this purpose, the increase in NDA ceilings for the second half of 2001 (Annex E) has been set equal to the expected increase in the demand for base money in Turkish lira in the second half of 2001 (consistent with the inflation and real GNP growth targets). Because of uncertainties in projecting money demand during disinflation as well as the strength of capital inflows during the first half of the year, the NDA ceilings have for the moment been set as indicative (together with other program parameters for the second half of 2001; see annexes). They are expected to be turned into performance criteria during the forthcoming program reviews.

30. The increased flexibility in managing monetary policy that will gradually become available as of the second half of 2001 will be used by the CBT with the primary goal of sustaining disinflation. We will thus start a gradual shift from a monetary framework centered on the exchange rate to one centered on formal inflation targeting, which has been successfully adopted by several other countries. As a necessary step to support this shift, a new central bank law will be enacted by end-April 2001 (a condition for the completion of the eighth review) with the goal of designating price stability as the primary monetary policy objective of the CBT, enhancing its operational independence in the pursuit of that objective, increasing its degree of accountability for monetary policy decisions, and enhancing the transparency of monetary policy formulation. All this will also be necessary to make the central bank legislation consistent with the Maastricht Treaty, with a view to Turkey's prospective participation in the European Union. As regards monetary policy transparency and accountability, the CBT has already started publishing quarterly inflation reports to analyze inflation developments. Also, work has started on enhancing the analytical and statistical capabilities of the central bank, in line with the requirements of inflation targeting.

31. In order to reduce the burden on banks of reserve requirements, as of the reserve requirement period starting on January 12, 2001, the reserve requirement coefficient on Turkish lira deposits will be reduced from 6 percent to 4 percent. No other change in liquidity and reserve requirements will be made during 2001. The liquidity implications of these changes have been taken into account in setting the NDA ceilings for 2001.

32. The above monetary framework is consistent with our disinflation goals, as well as with the goal of maintaining our net international reserves at a comfortable level, and above the floors (performance criteria and indicative targets) indicated in Annex F.

Structural issues

33. Structural reform remains a key component of our economic agenda. Actions in this area have been formulated in close collaboration with the World Bank and will be supported by loans from the Bank.

Privatization

34. Our privatization program remains guided by the need to improve economic efficiency, and reduce the domestic and external borrowing requirement of the public sector. Of the US$3.5 billion collected in privatization receipts in 2000, US$2.7 billion arise from the sale of enterprises in the portfolio of the Privatization Agency (PA), US$0.3 billion from the transfer of operating rights (TOR) of power plants, and US$½ billion from the first installment of the sale of the GSM license. The privatization deals concluded in 2000 have already secured privatization receipts for 2001 amounting to US$2.1 billion (of which US$2 billion from the sale of the GSM license). Thus, while falling short of the original target, the total amount receivable for privatization deals concluded in 2000 amounts to US$5.6 billion, as much as collected since the privatization program started in 1986.

35. To accelerate privatization in 2001, the government will carry out a tender for the sale of 33.5 percent of the shares of Turk Telecom to a strategic investor with transfer of strong management rights. To this effect:

- The government has published on December 14, 2000 the tender announcement in the official Gazetta, and the tender committee will approve by the same date the tender specification (prior action);

- The tender specification, with transfer of strong management rights, and an information memorandum will be made publicly available by January 14, 2001 (a condition for the completion of the fifth review);

- The tender committee will issue the final tender documents—including the authorization agreement and the tariff regulation—and invite bids by March 30, 2001 (a structural performance criterion); and

- The tender committee will select the winning bid by end-May 2001.

The tender for the sale of 51 percent of Turkish Airlines (THY) has been announced on December 14, 2000 (a prior action), finalizing the sale by end-March 2001 (structural benchmark).

36. Establishing an appropriate regulatory framework for a competitive market in electricity and divesting state assets in that sector through outright sales are key elements of our reform strategy which aims to increase economic efficiency and attract foreign direct investment. To this end, we will:

- Submit to parliament by December 14, 2000 (prior action) and in line with the Economic Reform Loan of the World Bank, an electricity markets law that: (i) establishes an independent regulatory body with full authority over tariff policy, (ii) sets in place the framework for the outright sale of state-owned generation plants and distribution companies, (iii) sets March 31, 2001 as the deadline for reaching financial closure on the transfer of operating rights (TOORs) for state-owned generation and distribution companies. Enactment of this law by end-January 2001 is a structural performance criterion.

- Amend by end-January 2001 the law on state economic enterprises (Law 233) to allow for the restructuring of TEAS into separate electricity generation, transmission and trading companies.

- Issue by end-January 2001 the restructuring decree for TEAS.

- Announce by December 31, 2000 the list of 29 BOT projects—with a total capacity of about 1.5 gwh—that can qualify for treasury guarantees on condition that they are commissioned by 2002 in order to help meet the potential shortfall in electricity supply during 2001-02. Given the improved prospect for electricity supply, no additional BOT projects will qualify for treasury guarantees.

- Launch by April 15, 2001 the pre-qualification tender for the sale of the electricity distribution companies, which remain under state management after the March 31, 2001 deadline for the TOORs.

37. To allow further progress in 2001, by December 20, 2000, we will transfer additional companies to the PA (implementing, with some delay, the actions envisaged in one of the program's structural benchmarks). The companies will include, in addition to agricultural companies (see below), some factories of MKEK (machinery and chemicals) and of ETI holdings.

38. Altogether, and taking into account privatization receipts expected in 2001 from deals concluded in 2000, we expect total privatization receipts to reach some US$6-7 billion (3-3½ percent of GNP) in 2001. With the exception of US$1.1 billion that will be used by the PA for operational costs and transfers to the SEEs, all the above privatization receipts, and any addition to them from whatever source, will be transferred to the treasury for debt reduction.

Social security reform

39. Building on the breakthrough pension reform adopted in 1999, the government has designed a second package of reforms aimed at improving the administration of the pension funds and introducing a voluntary private pension system. Four decree-laws had been adopted in September, but, based on the recent constitutional court decision, they will have to be submitted as laws to parliament (although they remain temporarily in force). These laws call for the creation of a social security agency supervising the activities of SSK (the major public pension fund), Bag-Kur (the pension fund for self-employed and farmers), IS-Kur (employment agency in charge of the management of unemployment insurance), and the administrative restructuring of these institutions. Moreover, legislation already submitted to Parliament envisages parametric adjustments in SSK and Bag-Kur (such as the increase in health premia and co-payments) and the introduction of a voluntary private pension system.

Fiscal management and transparency

40. We are determined to continue improving fiscal management and transparency. The Report on the Observance of Standards and Codes—Fiscal Transparency Module of the IMF was published in July. After closing 25 budgetary funds and 2 EBFs during the first half of the year, we had intended to close another 21 budgetary funds and 4 EBFs in October 2000 (a structural benchmark). However, due to a constitutional court decision, the necessary decree-laws could not be passed by the Council of Ministers. They will be submitted to parliament and enacted by mid-February 2001 (a structural benchmark). The closure of the 15 remaining budgetary funds (with the exception of the Support Price Stabilization Fund (DFIF), needed to channel the resources from World Bank loans) and one EBF will be enacted by June 2001, as stated in our December 9, 1999 Letter of Intent (a structural benchmark). As a result, all budgetary funds (with the exception of DFIF) will be eliminated in the 2002 budget, and the number of EBFs will be limited to six. No new budgetary fund or EBF will be created.

41. Also in the area of fiscal transparency, we intend to submit to parliament by end-June 2001 a law on public finance and debt management that defines clear borrowing rules and limits for the public sector, and incorporates into the budget on-lending and debt guarantee operations of the treasury (a structural benchmark). Regarding the government's contingent liabilities, we have further improved transparency by publishing the maturity structure of government guarantees and the terms of other contingent liabilities. In 2001, we will include in the monthly reports of the Treasury a "lending minus repayments" item following the IMF's *Government Finance Statistics* standards, thus expanding the coverage of the budget balance to include net treasury payments of guaranteed debt. As envisaged in the December 1999 Letter of Intent, the 2001 budget law sets explicit limits on the issuance of new guarantees in 2001 (meeting one structural benchmark).

42. To improve expenditure management, we will complete by mid-2001 the implementation of a computerized accounting system that will allow a better monitoring of spending and costs in government units. Moreover, a new budget classification in line with international standards will be completed by June 2001 for implementation on a pilot basis for the 2002 budget (with the support of the Public Financial Management Project with the World Bank). We also intend to initiate in 2001 the necessary studies to move toward accrual-based accounting, with a view to starting pilot implementation with the 2002 budget.

Tax administration

43. In 2000–01, we will continue to strengthen tax administration, with a view to increasing tax compliance, which is an essential condition for ensuring the efficiency and equity of the tax system. To this end, the computerization of operations has been completed in all major tax offices as planned (covering more than 90 percent of tax revenues) and will be rolled out in most of the remaining offices in 2001. We will improve the processing and sharing of taxpayer data (including third-party information) by merging and reorganizing the three data processing centers and we will gradually extend the assignment of tax identification numbers (TINs) to a broader range of taxpayers. Specific steps regarding the TINs will be identified at the time of the January review mission. Building on these improvements, we will strengthen the enforcement of tax laws and regulations by expanding the range and scope of verification and audit of taxpayers. These measures will increase tax collection, as well as lead to a reduction in tax arrears without any tax amnesty.

Agricultural policies

44. Substantive progress has been accomplished under the program in reforming agricultural policies with the objective of phasing out indirect support policies by end-2002 and replacing them with direct income support (DIS). This will promote greater economic efficiency of agricultural policies, and allow stricter control on their fiscal cost and better targeting to the poorest farmers. The support purchase price for tobacco was raised in line with targeted inflation in 2000, and the spread of the support price for wheat over international prices was lowered to 35 percent. The support price for sugar beets was raised in November by 25 percent. After the approval of the Agricultural Sales Cooperatives (ASCUs) law, progress has been made in analyzing their financial position in preparation for their restructuring. Business plans for the 2000/01-crop year have been approved for all ASCUs and are in line with the 2000 budget allocation. Finally, credit subsidies have been

fully phased out.

45. Looking ahead, the support prices for wheat will be increased in 2001 by no more than targeted inflation, and its spread with respect to international prices will be at most 20 percent. DIS—for which an allocation has been included in the 2001 budget—will be extended at the national level. The payment will be made in two installments annually. The farmers' registry is expected to be substantially completed by July 2001 and the first payment to registered farmers will be made in the second half of 2001. We expect this reform to be supported by an Agricultural Reform Investment Program from the World Bank.

46. The phasing out of the indirect support policies would lead to a reduced involvement of the state in the production and marketing of agricultural products. This will lead to a rapid privatization of the SEEs involved in this area. To that effect, at least six sugar factories of TSFAS (the SEE involved in the purchase and processing of sugar beets) will be transferred to the PA's portfolio by December 20, 2000 (prior action), with the aim of completing their privatization by end-2001. The remaining sugar factories will be transferred to the PA portfolio during 2001 with the aim of completing their privatization by end-2002. A sugar law reforming the sugar market will be submitted to parliament by February 15, 2001 and enacted by March 15, 2001. Restructuring TEKEL and reforming the tobacco sector will involve:

- Adopting by end-January 2001 a decree restructuring TEKEL and issuing a high privatization commission decision which would allow the transfer of all of TEKEL's tobacco-processing units to the PA's portfolio;

- Enacting by end-January 2001, the alcoholic beverage law which was submitted to parliament in early 2000;

- Enacting by end-January 2001 a tobacco law which would set in place an auction mechanism for tobacco purchases, henceforth, phasing out the support purchase policy for tobacco.

Banking

47. The government is committed to strengthening the banking sector through a two-pronged strategy aimed at both strengthening discipline on and sustaining confidence in banks. The principal milestones of this strategy are the establishment of an independent Banking Regulation and Supervision Agency (BRSA) and the Prime Minister's announcement that the government will, until further notice, fully protect depositors and other creditors in domestic deposit-taking banks. The following paragraphs focus on: (i) the actions taken by the BRSA since its inception; (ii) the steps undertaken to implement the guarantee of depositors and creditors; (iii) the strategy to resolve the banks already taken over by the SDIF and to recover part of the value of their assets; (iv) the strategy for keeping the rest of the banking system sound, (v) information on the actions regarding public banks, and (vi) other issues related to bank supervision.

48. The BRSA has legally taken on all responsibilities granted to it by the Banking Law approved in June 1999 and became fully operational as of end-August 2000, meeting a

structural performance criterion. Banking supervision departments at the Treasury and the Central Bank have been closed and their staff transferred to the new agency, including staff of the Savings Deposit Insurance Fund (SDIF), which has now become a legal entity administered by the BRSA. Most of the required additional staff has already been hired. An Asset Management Unit (AMU), in charge of recovering the value of the assets of the banks taken over by the SDIF, was also set up and is now being staffed to allow an efficient management of assets transferred to it.

49. The BRSA carefully monitors the condition of all banks through off-site analysis of bank balance sheet and income reports and through on-site examinations. Loan classification and loan loss provisioning rules have been substantially strengthened and the BRSA is committed, as required by law, to the prompt intervention of any bank that becomes insolvent so as to minimize the cost of bank failures to the government and the SDIF, and facilitate the orderly strengthening of the banking sector. Accordingly, the license of a branch of a foreign bank with one office in Turkey was revoked in September and the branch is being liquidated. Two more insolvent banks were taken over by the SDIF on October 27, and one more on December 6, joining the eight banks already under SDIF control. These three banks remain open and will be fully recapitalized up to at least 8 percent of risk-weighted assets by the SDIF. In addition, an insolvent investment bank had its license revoked on December 6 and will be liquidated.

50. The government announced on December 6 a temporary full guarantee of depositors and other creditors (except deposits by owners, deposits in connection with criminal activities, subordinated debt, and shareholder equity). The guarantee covers all domestic deposit-taking banks (including foreign branches of domestic banks for which consolidated accounts have to be submitted to the BRSA) and will be administered by the SDIF according to the Banking Law. The guarantee is given effect by the BRSA intervening in banks that are insolvent or otherwise unable to meet their commitments. In a similar fashion, eight banks were intervened over the past years, thereby ensuring continuous access by depositors and other creditors to their assets. The technical work describing the existing legal framework for the guarantee is underway. This will lead to a public announcement clarifying the nature and scope of the guarantee fully protecting depositors and other creditors (including the legal and operational aspects) and to a protocol between the Treasury and the SDIF on the modalities governing the financing of the guarantee's operations. The public announcement will be made no later than January 15, 2001 (a condition for the completion of the fifth review.)

51. The financial needs of the SDIF will continue to be covered by loans from the Treasury. The interest rate charged on the loans to the SDIF, as well as the schedule of payments of interest and repayment of principal, will be in line with the financial needs of the SDIF, including its need to build up a sufficient amount of liquid reserves. To insure that the SDIF will be able to resolve (liquidate, or recapitalize and sell) intervened banks in the least cost manner, without any disruption to depositors and other creditors, the SDIF has the authority to borrow resources from the Treasury as needed.

52. On November 16 the BRSA announced its strategy to deal with the resolution of the ten banks then under its control. In developing the strategy the BRSA had available to it the recommendations of the consultants who were hired in July to advise the central bank on this matter. For the eight banks owned by the SDIF prior to October, the strategy includes the following steps:

- The SDIF has borrowed from the Treasury the government securities in foreign currency and TL needed to fully recapitalize the banks owned by the SDIF. For this purpose, a loan of US$6.1 billion was concluded on November 16 with a two-year grace period and repayment over the subsequent ten years.

- The banks were recapitalized to at least 8 percent of risk-weighted assets through the transfer of government securities on December 7. Their losses were written off against the capital thereby created.

- Strict fit-and-proper criteria were adopted in a new regulation issued by the BRSA for ownership of banks. The new regulation was published in the *Official Gazette* on November 5 paving the way for the selection of potential investors in the banks owned by the SDIF.

53. Subsequent to these steps, the SDIF will proceed with its announced schedule to sell all banks under its control:

- Potential investors must seek the BRSA's confirmation that all qualifications are met before being eligible to make bids when these banks are offered for sale. An "expression of interest" letter must be received by the SDIF by December 15, and the BRSA will notify potential investors of its approval no later than December 22, 2000.

- Each potential investor approved by the BRSA will be given basic information on the banks and will be asked to indicate by January 15, 2001 which banks or combinations of banks the investor might be interested in purchasing.

- Using the above information from the pre-qualified potential investors, the SDIF will determine based on strict criteria by January 20 which banks it will offer for sale or otherwise resolve (a prior action for the fifth review). In all cases, depositors and creditors will be fully protected. Information on banks for sale will be provided by February 20, 2001, together with the request for bids to be received by April 24, 2001 (a prior action for the sixth review). During this period bidders will be given access to detailed information about banks ("due diligence").

- The buyer(s) for each package(s) will be selected no later than May 7, 2001.

54. The financial restructuring for the two banks acquired by the SDIF in October 2000 will be carried out and detailed plans for their resolution will be announced to the public by end-January 2001. A similar approach will be followed as has been adopted for the above eight banks owned by the SDIF, but with up to a two-month delay at every stage. The timetable for the resolution of the bank taken over in December 2000 will be discussed as part of the January 2001 review mission.

55. As part of the above strategy, nonperforming loans of banks to be resolved will be transferred to the AMU. In keeping with the policy of openness, and to maximize recovery prospects, the BRSA will disclose to the public the procedures that it has adopted for the

operation of the AMU. The announcement will include information on the operational guidelines for the AMU, including: (i) procedures for asset transfers, (ii) procedures for maximizing loan recoveries; and (iii) the manner and basis for monitoring and evaluating the AMU's performance. This announcement will be made ahead of the transfer of bad assets to the AMU.

56. The resolution of any bank intervened in the future, as called for in the Banking Law, will be handled following procedures similar to those described in the above paragraphs.

57. Regarding the state banks, the stock of duty losses of Halk Bank and Ziraat Bank will be converted into securities bearing market interest rates, in line with progress in implementing the restructuring plans of these banks. The interest on the stock of duty losses will accrue in 2001 at a rate equal to the monthly weighted average of treasury bill and discount bond rates times 1.33 for Ziraat Bank and times 1.60 for Halk Bank. The strategy to privatize the state banks will proceed on the basis of the law enacted in November 2000.

58. Consultation with the banking community on draft new regulations on internal risk management systems and on adjusting capital adequacy requirements to reflect market risks is ongoing and has delayed their adoption from end-August, as originally planned. The regulations will be adopted by end-January 2001 (a structural benchmark) and will be effective as of January 1, 2002.

59. As required by the banking law approved in June 1999, the BRSA will issue by end-January 2001, a regulation redefining indirect exposure to shareholders (connected lending).

60. As for the tax deductibility of loan loss provisioning, a tax regulation will be adopted providing for the full deductibility of the provisions that banks are mandated to make based on bank supervision regulations. At the same time, the deductibility of general provisioning will be eliminated. This regulation will be adopted by end-March 2001 and will be implemented with effect from April 1, 2001 (a structural benchmark).

Statistical issues

61. Improving the statistical base for economic policy has been an ongoing effort in the last few years. In this respect, the CBT has recently introduced new reporting requirements for bank lending rates. In the period ahead, the institutional capacity to compile balance of payment statistics needs to be strengthened, in light of the difficulties in this area encountered in recent years (especially regarding the external service accounts). To this end, the amendment in the CBT law will provide the CBT with the explicit mandate to compile balance of payment statistics, and with the authority to request from nonbank entities (as well as banks) the information necessary for this purpose. The CBT intends to continue the ongoing work to improve the measurement of external service receipts.

* * *

62. We believe that the policies and measures described herein are adequate to achieve the objectives of our program, but we stand ready to take additional measures, if necessary, to keep the program on track, consulting regularly with the Fund. Purchases under the

arrangement will be subject to monthly reviews during the first quarter of 2001 and quarterly reviews thereafter for the duration of the arrangements.

Very truly yours,

/s/ Mr. Recep Önal Minister of State for Economic Affairs	/s/ Mr. Gazi Erçel Governor of the Central Bank

ANNEX A

Table 1. Turkey: Quantitative Performance Criteria and Indicative Targets

	March 31, 2000		June 30, 2000		September 30, 2000	
	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome
I. **Performance criteria**						
1. Floor on the cumulative primary balance of the consolidated government sector (in trillions of Turkish lira)	1,550		2,600		3,900	
Adjustment for earthquake-related expenditures	196		398		744	
Adjusted floor	1,354	2,810	2,202	4,283	3,156	5,971
2. Ceiling on the stock of net domestic assets of the CBT (in trillions of Turkish lira)	-1,200	-1,266	-1,200	-1,291	-1,200	-1,308
3. Floor on net international reserves (in millions of US$)	12,000		12,750		12,750	
Adjustment for disbursements of foreign loans in excess of baseline	1,330		2,208		2,684	
Adjusted floor (in millions of US$)	13,330	16,657	14,958	17,769	15,434	17,874
4. Ceiling on contracting or guaranteeing of new external public debt (in millions of US$)	12,000	11,918	16,000	15,024	20,000	17,374
5. Ceiling on the stock of public short-term external debt outstanding (in millions of US$)	500	0	500	0	500	0
II. **Indicative targets**						
1. Floor for the cumulative overall balance of the consolidated government sector (in trillions of Turkish lira)	-6,000		-12,150		-15,850	
Adjustment for earthquake-related expenditures	196		398		744	
Adjusted floor	-6,196	-4,495	-12,548	-9,319	-16,594	-11,984
2. Floor on the cumulative primary balance of the consolidated government sector including privatization proceeds (in trillions of Turkish lira)	2,150		3,850		5,900	
Adjustment for earthquake-related expenditures	196		398		744	
Adjusted floor	1,954	2,827	3,452	5,009	5,156	7,526

Source: Data provided by the Turkish authorities.

ANNEX B

Table 2. Turkey: Performance Criteria and Indicative Floors on the Cumulative Primary Balance of the Consolidated Government Sector

	Floors (In trillions of Turkish lira)
1. Cumulative primary balance from December 31, 1999 to:	
December 31, 2000 (performance criterion)	4,500
2. Cumulative primary balance from January 1, 2001, to:	
January 31, 2001 (indicative floor)	400
February 28, 2001 (indicative floor)	1,220
March 31, 2001 (performance criterion)	1,850
June 30, 2001 (performance criterion)	3,540
September 30, 2001 (performance criterion)	5,930
December 31, 2001 (performance criterion)	8,110
3. Cumulative primary balance including privatization proceeds from December 31, 1999 to:	
December 31, 2000 (performance criterion)	6,700
4. Cumulative primary balance including privatization proceeds from January 1, 2001 to:	
March 31, 2001 (indicative floor)	3,320
June 30, 2001 (indicative floor)	5,580
September 30, 2001 (indicative floor)	9,760
December 31, 2001 (performance criterion)	12,540

1. The primary balance of the *consolidated government sector* (CGS), Table 2, items 1 and 2, comprises the primary balances (primary revenue minus noninterest expenditures) of the consolidated central government (consolidated budget), the extrabudgetary funds (EBFs) identified below, the eight state economic enterprises (SEEs) identified below, the social security institutions (SSIs), and any new government funds and institutions established after November 1, 2000. The CGS will also include the unemployment insurance fund during 2001. The floors on the primary balance of the CGS will be monitored:

- For the central government from above the line on a modified cash basis (the so-called consolidated budget-adjusted balance)
- For the EBFs, SSIs, and the unemployment insurance fund from above the line on a cash basis;
- For the SEEs, from below the line as described in paragraph 8.

2. For the purposes of the program, the primary revenues will exclude interest receipts of the consolidated central government and the unemployment insurance fund, profit transfers of the Central Bank of Turkey (CBT) and proceeds from the sale of assets of the CGS (privatization proceeds or transfers thereof). Interest receipts of EBFs, SEEs, and SSIs will not be excluded. As well, the floor on the primary balance will be adjusted upwards for any increase in revenues arising from changes in the revenue sharing agreement between any components of the CGS and other elements of the public sector, including local authorities. The floor on the primary surplus will be adjusted upwards (downwards) in line with the

projected surplus (deficit) of the primary balance of any fund or entity that is incorporated in the CGS after November 1, 2000.

3. A separate annual performance criterion (Table 2, items 3 and 4) is established on the primary balance including proceeds from privatization to be received by the CGS.

4. Privatization proceeds received by the CGS exclude any privatization receipts in cash of the central budget for the sale of a GSM license to Turk Telecom.

5. For the purposes of the program, revenues of the CGS will exclude payments-in-kind and other nonmonetary forms of payments. As well, net lending of any component of the CGS will be considered as a noninterest expenditure item. In 2000, payment of guaranteed debt by treasury on behalf of other components of the public sector will not be regarded as net lending; in 2001 it will not be regarded as net lending up to the quarterly baseline reported in Annex I.

Extra budgetary funds

6. The EBFs included in the definition of the performance criterion for December 2000 are: the defense fund, the privatization authority's budget, the public participation fund, and the mass housing fund. The EBFs included in the definition of the performance criterion for 2001 are: the defense fund, the privatization authority's budget, and the mass housing fund.

7. The balances of the following budgetary funds and EBFs-which do not have the legal authority to borrow, and will not be given such authority during the duration of the stand-by arrangement-are excluded from the definition of the performance criterion: petroleum consumption fund; revenue improvement administration fund; support stabilization fund; resource utilization fund; fuel price stabilization fund; budget education health tax fund; and social aid and solidarity fund.

State economic enterprises

8. The eight SEEs whose primary balances will be included in the definition of the performance criterion are: TTK (coal company), TSFAS (sugar company), TMO (soil products office),TEKEL (tobacco and alcoholic beverages company), TCDD (state railways), TEAS (electricity), TEDAS (electricity distribution), and BOTAS (natural gas). The primary balance of these SEEs will be monitored as the sum of net financing minus accrued interest made by the SEEs. For December 31, 2000, net financing will be monitored as: net financing from the banking system (excluding pre-export financing from the Eximbank) plus net external borrowing (excluding normal trade financing) plus the net increase in arrears on tax liabilities. For the performance criteria and indicative targets in 2001, the net change in arrears on tax liabilities will be excluded, while the change in net arrears to and net advances from the private sector and to/from the non-CGS public sector (including subsidiaries and joint ventures), as well as net interest payments undertaken by the Treasury, will be added.

9. Net financing from the banking system (excluding pre-export financing from the Eximbank) is defined as the change in all claims of these institutions on the SEEs listed above, including loans and capitalized interest arrears, less the change in deposits and repos

of SEEs in these institutions, as reported by these SEEs. Changes in claims and deposits denominated in foreign currency will be valued at the average of the exchange rates between the Turkish lira and each corresponding currency prevailing during the quarter in question. As of September 30, 2000 the stock of net banking claims on SEEs as defined above stood at TL 216 trillion, valued at the exchange rates on that day.

10. Net external borrowing is defined as the receipt of external loans (including guaranteed debt and on-lending, and excluding normal trade financing) less amortization (excluding repayments of guaranteed debt and on-lending undertaken by the Treasury), valued at the exchange rate at the time of transaction. As of September 30, 2000 the stock of external loans stood at TL 2,415 trillion, valued at the exchange rates on that day.

Social security institutions

11. The deficits of the social security institutions (SSIs) are covered by transfers from the central government budget, and their primary balance is projected to be in balance in 2000 and 2001. The floor on the primary surplus of the CGS will be adjusted upwards for any increase in the expenditure arrears of the SSIs. Arrears of the SSIs are defined as those payments overdue by more than one month, and in the case of Bag Kur exclude arrears to the common retirement fund. Regarding the 2000 performance criteria, the stock of arrears of Bag Kur stood at TL 300 trillion on October 31, 1999, while ES and SSK had no expenditure arrears. Regarding the 2001 performance criteria, the stock of arrears of Bag Kur stood at TL 140 trillion on September 30, 2000, while the two other institutions had no expenditure arrears.

Adjusters

12. For the purposes of the program in 2000, earthquake-related expenditures are defined as all expenditures related to the earthquake in the consolidated central budget (excluding increased transfers to the SSIs), as well as in the budgets of all other EBFs included in the CGS, excluding the mass housing fund, as reported in the reporting form introduced specifically for this purpose.

13. For the purposes of the program, the floor on the primary balance of the CGS (Table 2, items 1 and 3) will be adjusted downwards for earthquake-related expenditures up to a limit of TL 1,360 trillion for December 31, 2000.

14. The floor for the end-December 2000 primary surplus will be adjusted upward for any issue of noncash debt in excess of TL 1,700 trillion. The floors for the primary surplus for 2001 will be adjusted upward for any issue of noncash debt other than for bank recapitalization and securitization of duty losses and for the restructuring of the Agricultural Sale Cooperative Units. It will also be adjusted upward for any off-balance sheet expenditure of any component of the CGS.

ANNEX C

Table 3. Turkey: Performance Criteria on the Cumulative
Primary Expenditure of the Central Government

	Ceilings (In trillions of TL)
Cumulative primary expenditure from January 1, 2000 through:	
March 31, 2001 (performance criterion)	5,830
June 30, 2001 (performance criterion)	12,950
September 30, 2001 (performance criterion)	20,880
December 31, 2001 (performance criterion)	29,870

1. The primary expenditure of the consolidated central government (Table 3) comprises the cumulative non-interest expenditure of the consolidated central government (consolidated budget). The quarterly ceilings will be monitored from above the line on a modified cash basis (the so-called consolidated budget adjusted non-interest expenditure).

2. For purposes of the program, primary expenditure (Table 3) will exclude tax rebates, transfers to Eximbank, and treasury payments of guaranteed debt up to the quarterly baseline reported in Annex I.

3. The deficits of the social security institutions (SSIs) are covered by transfers from the central government budget. The ceiling on the primary expenditure of the central government (Table 3) will be adjusted downward for any increase in the expenditure arrears of the SSIs. Arrears of the SSIs are defined as those payments overdue by more than one month, and in the case of Bag Kur exclude arrears to the common retirement fund. On September 30, 2000, the stock of arrears of Bag Kur stood at TL 140 trillion, while the two other institutions had no expenditure arrears.

4. The ceiling on the primary expenditure of the central government (Table 3) will be adjusted downward for any off-budget expenditure of the central government.

ANNEX D

Table 4. Turkey: Indicative Floors on the
Cumulative Overall Balance of the Consolidated Government Sector 1/

	Floor (In trillions of TL)
Cumulative overall balance from December 31,1999 to:	
December 31, 2000 (indicative floor)	-18,750
Cumulative overall balance from January 1, 2001 to:	
March 31, 2001 (indicative floor)	-2,620
June 30, 2001 (indicative floor)	-5,780

September 30, 2001 (indicative floor)	-7,310
December 31, 2001 (indicative floor)	-8,670

1/ See Annex B for the definition of the consolidated government sector.

1. The overall balance of the consolidated government sector (CGS), Table 4, comprises the primary balance of the CGS as defined in Annex B, the net interest payments of the consolidated central government and the unemployment insurance fund and gross interest payments of the EBFs, SEEs, and SSIs, and the overall balance of any new government funds and institutions established after November 1, 2000. The monitoring of the different components of the overall balance will be as indicated in paragraph 1 of Annex B. Revenues of the CGS will be defined as in paragraph 2 of Annex B; i.e., excluding privatization proceeds.
2. All the adjusters specified in Annex B to apply to the primary balance of the CGS will also apply to the overall balance of the CGS (Table 4).
3. In addition, the floor on the overall balance will be adjusted downward for any interest payment on securities issued to cover the state banks' duty losses.

ANNEX E

Table 5. Turkey: Performance Criteria on the
Net Domestic Assets of the Central Bank of Turkey

	Ceilings (In trillions of TL)
Outstanding stock as of September 30, 2000:	-1,308
December 31, 2000 (performance criterion) 1/	1,650
January 31, 2001 (performance criterion) 2/	900
February 28, 2001 (performance criterion) 2/	800
March 31, 2001 (performance criterion) 2/	650
June 30, 2001 (performance criterion) 2/	200
September 30, 2001 (indicative target) 2/	480
December 31, 2001 (indicative target) 2/	950

1/ The performance criterion shall be calculated as the average of the stocks prevailing on December 11, 2000 and January 11, 2001.
2/ The performance criterion (indicative target) shall be calculated on the average of the stocks prevailing during the five working days immediately preceding each of these dates.

1. The net domestic assets (NDA) of the Central Bank of Turkey (CBT) are defined as base money less the net foreign assets of the CBT valued in Turkish lira at end-month actual exchange rates.

2. Base money is defined as currency issued by the CBT, plus the banking sector's deposits in Turkish lira with the CBT. As of September 30, 2000 base money amounted to TL 4,802 trillion.

3. Net foreign assets of the CBT are defined as the sum of the net international reserves of the CBT (as defined in Annex F), medium-term foreign exchange credits (net), and other net foreign assets. As of September 30, 2000 net foreign assets of the CBT amounted to TL 6,776 trillion.

4. The cumulative net change in the devaluation account from its balance at end-1999 (excluding any distribution of unrealized foreign exchange profits) will be subtracted from the end-quarter NDA stock as calculated above.

5. The NDA ceiling for end-2000 will continue to be subject to the adjuster specified in Annex D of the December 1999 Letter of Intent. The NDA ceilings for 2001 in Table 5 take into account the lowering in the reserve coefficients to be implemented as of January 12, 2001, as described in the letter of intent. No further change in reserve or liquidity coefficients will take place in 2001. The NDA ceilings for 2001 will be adjusted for any change in the definition of the aggregate to which the reserve requirement applies according to the following formula:

   $D\ NDA = R*D\ B$,

   where: R denotes the 4 percent reserve requirement plus the 2 percent liquidity requirement coefficient and D B denotes the change in base generated by a change in the definition of the reserve aggregate. Neither this coefficient nor the averaging period will be changed during 2001.

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

ANNEX F

Table 6. Turkey: Performance Criteria on Net International Reserves

	Floors (In millions of US$)
Outstanding stock as of November 30, 2000	11,096.4
December 31, 2000 (performance criterion) 1/	10,400
January 31, 2001 (performance criterion)	10,700
February 28, 2001 (performance criterion)	10,900
March 31, 2001 (performance criterion)	11,000

June 30, 2001 (performance criterion)	12,000
September 30, 2001 (indicative floor)	12,200
December 31, 2001 (indicative floor)	12,400

1/ The performance criterion shall be calculated as the average of the stocks prevailing on December 21, 2000 and January 11, 2001.

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

2. For the purpose of the program, gross foreign assets include all short-term foreign (convertible) currency-denominated claims on nonresidents, monetary gold valued at the November 30, 2000 average London fixing market price of US$269.05 per troy ounce, foreign bank notes, balances in correspondent accounts, and any reserve position in the IMF. At present encumbered reserves consist of foreign asset holdings on accounts of the Turkish Defense Fund (amounting to US$425.8 million at November 30, 2000). The special Dresdner portfolio (amounting to US$897.6 million on November 30, 2000) is also encumbered, but is not subtracted from foreign reserve assets given the overlap with one-year foreign currency denominated liabilities (see below). Reserve assets as of November 30, 2000 amounted to US$19,428.1 million.

3. Gross international reserve liabilities include all foreign currency denominated liabilities (or TL-denominated liabilities indexed to any exchange rate) to nonresidents with an original maturity of up to and including one year, reserves against foreign currency deposits or any other short-term liability in foreign exchange toward the banking sector, claims from central bank, letters of credit, overdraft obligations of the central bank, and liabilities arising from balance of payments support borrowing irrespective of their maturity (including liabilities to the IMF). On November 30, 2000 reserve liabilities thus defined amounted to US$8,331.7 million.

4. The net forward position is defined as the difference between the face value of foreign currency-denominated central bank off-balance sheet (forwards, swaps, options, and any future contracts) claims on nonresidents and foreign currency obligations to both residents and nonresidents. As of November 30, 2000 these amounts were zero.

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

ANNEX G

Table 7. Turkey: Performance Criteria on Contracting and Guaranteeing of New External Debt

	Limits (In millions of

	US$)
Cumulative flows from end-December 1999 to end-December 2000 (performance criterion)	23,500
Cumulative flows from end-December 2000	
March 31, 2001 (performance criterion)	5,500
June 30, 2001 (performance criterion)	11,250
September 30, 2001 (indicative ceiling)	14,750
December 31, 2001 (indicative ceiling)	17,750

The limits specified in Table 7 apply to the contracting or guaranteeing by the consolidated government sector (as defined in Annex B) of new, nonconcessional external debt with an original maturity of more than one year. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (adopted by the Executive Board of the International Monetary Fund on August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received. The term "nonconcessional" means containing a grant element of less than 35 percent on the basis of the currency-specific discount rates based on the OECD commercial interest reference rates in place at the time at which the contract is entered into, or guarantee issued. Excluded from this performance criterion are credits extended by the IMF, adjustment lending from the World Bank, long-term liabilities of the Central Bank of Turkey and sales of treasury bills and bonds denominated in TL or FX to nonresidents in either the domestic primary market or the secondary market. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract is entered into, or guarantee is issued.

ANNEX H

Table 8. Turkey: Performance Criteria on the Stock of Short-Term External Debt Outstanding

	Ceilings (In millions of US$)
Outstanding stock as of October 31, 2000:	0
December 31, 2001 (performance criterion)	1,100
March 30, 2001 (performance criterion)	1,100
June 30, 2001 (performance criterion)	1,100
September 30, 2001 (indicative ceiling)	1,100
December 31, 2000 (indicative ceiling)	500

The limits specified in Table 8 apply to the stock of debt of maturity of one year or less, owed or guaranteed by the consolidated government sector (as defined in Annex B). The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (adopted by the Executive Board of the IMF on August 24, 2000). Excluded from this performance criterion are sales of treasury bills denominated in Turkish lira or foreign exchange to nonresidents in either the domestic primary market or the secondary market, normal import-related credits, reserve liabilities of the Central Bank of Turkey, and forward contracts, swaps, and other future market contracts. Debt falling within the limit shall be valued in U.S. dollars at the program cross exchange rates specified in Annex J.

ANNEX I

Table 9. Turkey: Program Baseline for Selected Variables 1/

	2000	2001			
	Dec.	Mar. 31	June 30	Sep. 30	Dec. 31
Payment of debt guaranteed by the consolidated government sector (in trillions of Turkish liras)	n.a.	235	700	1,040	1,460

1/ The current baseline applies to end-2000 and 2001 performance criteria.

ANNEX J

Table 10. Cross-Exchange Rates for Program Purposes 1/

	Value per U.S. Dollar	Value per Euro
Program exchange rate		
Euro	1.15500	
Austrian schilling		13.7603
Belgian franc		40.3399
Finnish markka		5.94573
French franc		6.55957
Deutsche mark		1.95583
Irish pound		0.78756
Italian lira		1,936.27
Japanese yen	109.87	

Luxembourg franc		40.3399
Netherlands guilder		2.20371
Portuguese escudo		200.482
Spanish peseta		166.386
Swiss franc	1.750	
United Kingdom pound	0.702	

1/ These program exchange rates shall apply to the performance criteria/indicative ceiling or floors for the period December 31, 2000-end December, 31 2001; currencies not specified here shall be converted at the representative exchange rates reported to the IMF as of November 29, 2000.
2/ Constituent currencies of the euro shall be converted into euro at the official European Union conversion rates and then converted into the U.S. dollar value.