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OPERATIONS EVALUATION DEPARTMENT
TURKEY COUNTRY ASSISTANCE EVALUATION (CAE)
APPROACH PAPER

Country Background

1. In the early 1980s the Turkish government began a series of major economic reforms to reverse the previous decades of state-led industrialization. The spearhead of the change was the opening of the economy through trade liberalization. The private sector responded with alacrity, and GDP, exports, and employment grew rapidly. There was also a substantial increase in public investment for infrastructure. Unquestionably this was badly needed, but without the supporting fiscal policies Turkey settled into the pattern of inflation running at 50-60 percent a year, which was to characterize the economy through the nineties.

Box 1: Economic Indicators

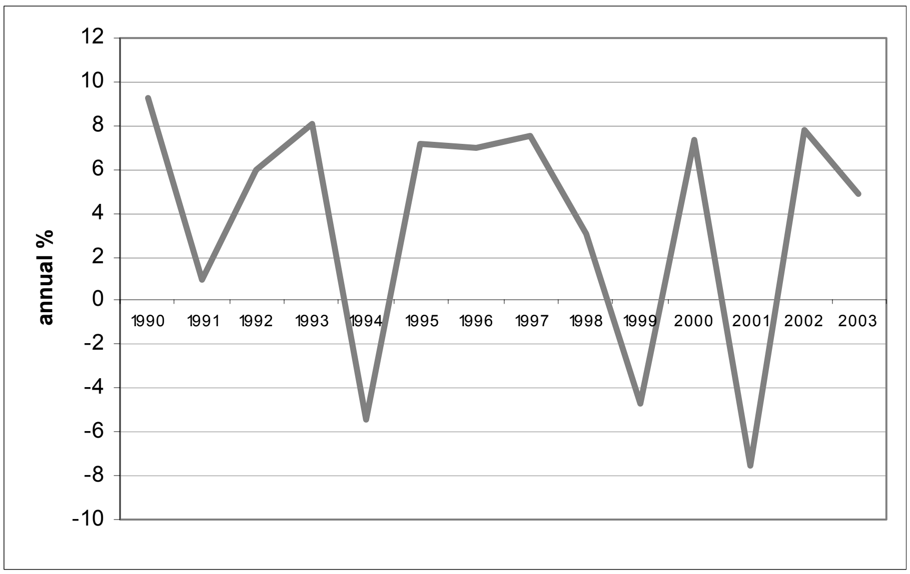
Since World War II successive political leaders have struggled to develop a national consensus on the appropriate path to achieve Turkey's aspirations to economic growth and a global role commensurate with its location, size and history. There have been major achievements, with significant progress in the last two decades. Many of Turkey's social and economic indicators are now similar to those of comparators in its income bracket. In 2003 Turkey had a population of 70 million and GNI per capita of about US$2,500. Only 2 percent of the population have incomes below US$1 a day, although poverty in general and growing urban poverty in particular, remain a matter of concern. Relative to its comparators in the Europe and Central Asia Region, Turkey has a larger share of GDP in agriculture and a smaller share in industry. There are a number of areas where the country lags its comparators in the Region: Levels of Foreign Direct Investment are low, averaging only 1 percent a year of GDP since 1998; only 26 percent of women participate in the labor force; illiteracy is about 14 percent and secondary school enrolment 60 percent; 24 percent of the Turkish adult population has upper secondary education (compared with for example 46 percent in Poland). There is also a high level of interregional inequality, with the poorest region having an average income about 22 percent that of the richest.

2. After the initial momentum following the liberalization measures, the economy began to lose steam in the late-eighties. It proved difficult to put in place the institutional changes which were needed to sustain growth. The public sector still provided major sources of rents and political patronage. The government failed to follow through with enterprise privatization and was unable to reduce the overall deficit. Growth slowed sharply in the period from 1988 to 1991 with the exception of a very good agricultural year in 1990.

3. Turkish economic growth in the period since 1990 has been characterized by a high degree of volatility as shown in Figure 1 below. High growth rates in 1992 and 1993 were followed by a financial crisis in 1994 and a sharp reduction in growth. The economy

proved resilient, however. The flexible exchange rate allowed for a massive real devaluation and growth averaged over 7 percent between 1995 and 1997, in spite of inflation that went as high as 90 percent a year. There were a number of reasons for this rapid growth. Turkey benefited from relatively high growth rates in the richer economies, which led to growth in exports, demand for Turkish workers and the supply of remittances. The ‘suitcase trade’ with the former Soviet Union is estimated to have yielded as much as US$6 to US$8 billion a year of informal exports. Finally, the investments in tourism in the eighties paid off in the nineties with a very large increase in earnings in that sector.

Figure 1: Turkey, GDP growth (annual percent), 1990-2003



Source: WDR indicators

4. In 1998 following the Asian and Russian crises the economy began to slow down. A new stabilization program supported by the Fund had as its main feature a pre-announced crawling peg and a matching fiscal deficit, designed to reduce inflationary expectations. This was associated with significant structural reform measures.
The short term effects were positive and there was a rapid recovery in 2000 with GDP growth of over 7 percent. This recovery proved short-lived, however, and in February 2001 there was a sharp fall in the value of the Turkish lira and the crawling peg was abandoned. In May 2001, the Government enacted a program of economic measures including fiscal measures, reforms of the banking system and a renewed effort on privatization. In the 2002-2004 period economic growth recovered. The Government which was elected at the end of 2002, has kept the key elements of the reform package in place and committed itself to beginning negotiations for European Union membership.

The Bank Program

5. The Bank has had a long engagement in Turkey starting in the late 1940s. From 1968 through 1980 loans were provided for most of the key economic sectors. The Bank

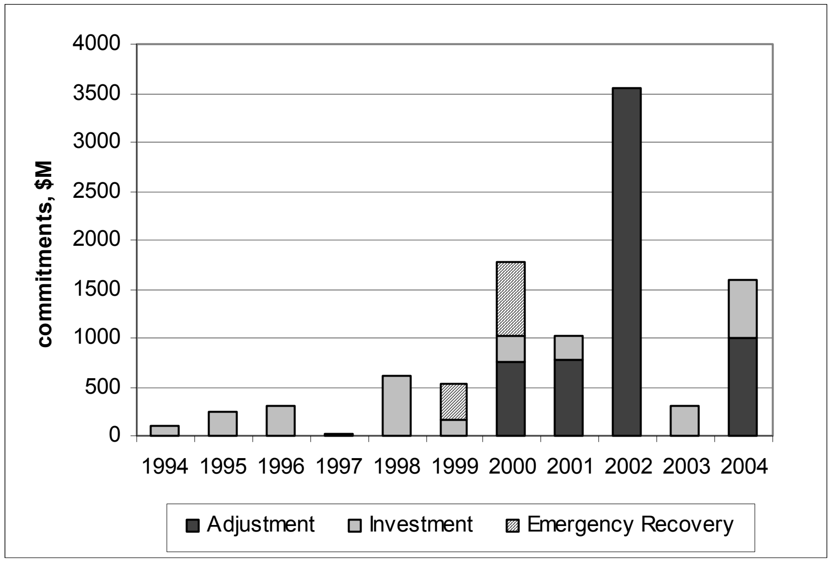
responded to the reforms of the early eighties with a sharp increase in the level of lending. Turkey was the recipient of the Bank's first ever Structural Adjustment Loan (SAL) in 1981 and there were four further SALs during the following years. Total commitments exceeded a billion dollars a year in FY86-88. At that time, however, the Bank became increasingly concerned that the high growth rates would not be sustainable unless the Government took steps to increase macro stability and to build on the policy changes of the early eighties. In FY88 the Bank decided not to provide additional adjustment loans until Turkey could demonstrate progress in dealing with the fiscal deficit and tackling some of the underlying structural problems.

6. The consequence of this was a decline in the aggregate level of lending. The three year moving average which had peaked at over US$1 billion in 1988, fell steadily to about US$600 million in 1993 (the figure would have been US$500 million if not for the earthquake relief project in that year). Net flows from the Bank to Turkey were increasingly negative. The Bank, while not making new adjustment loans, continued to make investment loans. Between 1988 and 1993 the Bank made a total of 22 loans to Turkey, covering a wide range of sectors—water, health, education, social protection, energy, transport, the financial sector, the agriculture sector, and rural development.

7. This evaluation takes as its starting point the dialogue of the Bank with the new Turkish leadership in 1994. At that time, the Bank was preparing to gear up its activities in Turkey. With the economic downturn and the financial crisis of that year discussions were held with the Government on a possible adjustment loan to help in banking supervision and privatization. It did not prove possible to reach agreement on the specific measures to be included in the operation, however.

8. In the following years, Bank lending to Turkey plummeted, as shown in Figure 2 below. Lending was reduced to one or two projects a year during FY94 to FY97 for an annual average of US$170 million with a low of US$19.5 million in FY97. At the end of FY93 Turkey had the fifth largest Bank portfolio with 5.27 percent of total Bank loans outstanding. By end-FY98 it was the tenth largest borrower, with a 3.12 percent share of loans outstanding. The Bank continued to look for investment lending potential in areas where it might make a strategic contribution, but this was hampered by the slow disbursement rates of many projects in the portfolio. By FY97 there were still 35 projects in the Bank portfolio—the Bank was in every sector but with projects with small loan amounts relative to the programs they were supporting. A program was initiated in FY97 to revamp Turkey's investment loan portfolio. It included an increased role for local staff in supervision, and a formal structure for joint handling of the portfolio. By FY03 the number of active projects had been reduced to 12.

Figure 2: Bank Lending to Turkey by Instrument



Source: WB Business Warehouse.

9. From FY94 to FY97 there were three Country Directors (CDs) for Turkey in addition to a long period with an Acting Director. With the Bank reorganization of 1997, a new CD was appointed and the position was decentralized to the Ankara office in 1998. Turkey suffered a major earthquake in August 1999 and the Bank moved quickly to make a sizeable loan. In the fall of that year the Bank began work on new adjustment lending to support the stabilization program which was being put in place. The main focus of the Bank's support was financial restructuring especially the strengthening of the regulatory framework for the commercial banking sector. In 2002 the Bank provided very large levels of new adjustment lending in support of the new package of reform measures which the Government had introduced. The low levels of lending during most of the nineties had created significant headroom for new Bank lending, and in FY02 the Turkey program amounted to US$3.55 billion—the largest for any country in the Bank in that year, and by far the largest amount in the history of the Bank's work in Turkey. With the election and change of Government at the end of 2002, lending fell initially to US$300 million in FY03 as economic growth resumed. A new adjustment loan was negotiated and lending in FY04 was considerably above the previous year.

10. During the first half of the period under review the Bank had a limited program of knowledge work in Turkey by comparison with other countries of its size and Bank portfolio. Aside from Country Economic Memoranda in the mid-1990s, the most substantial studies carried out by the Bank were in agriculture and education. The Bank and the Turkish authorities were unable to reach agreement on conducting a Poverty Assessment. There was a significant change in 1999 with the resumption of adjustment lending and the need to deepen the Bank's understanding of the areas critical to fiscal adjustment, such as public sector management, the financial sector and the corporate sector. In addition the Bank expanded its work on social sector issues and undertook

further studies of the education sector, the health sector, and perhaps most significantly carried out assessments of living standards in both 2000 and 2003.

Focus and Methodology

11. During the period from FY94–FY04 the Bank prepared four country assistance strategy documents for Turkey. In each of these, the primary objective was to assist in the necessary fiscal restructuring and the focus on areas such as banking, agricultural subsidies, and energy, reflected this emphasis. A second objective was to support private sector-led growth and promote human resource development, especially education to raise the productivity of the labor force. A third objective related to natural resource management and disaster mitigation.

12. The CAE will assess the Bank's assistance to Turkey over the period FY94-FY04 taking into account the changing political and economic environment. It will examine the differences between the Bank's approach during the period from FY94-98 when the Bank had relatively low levels of lending and knowledge activities and the rapid expansion in both these areas between FY99 and FY04. The assessment will review: (i) the Bank strategy for helping Turkey define its development priorities and design programs to address them; (ii) the effectiveness of Bank assistance in supporting the implementation of those priorities and programs; and (iii) the extent to which contributions to major outcomes involved the Bank, other development partners, the Government, as well as exogenous forces. The evaluation will include a review of relevant documents and interviews with the staff of the Bank, other key donors, representatives of the Government, NGOs, and civil society.

13. The specific issues which will be addressed are the following:

Overall Bank Strategy and Program Mechanics

- Perhaps more than in most countries the Bank's lending program in Turkey over the period under review was extremely volatile ranging from very small to very large amounts. Did these movements in the lending program contribute to the influence and effectiveness of the Bank in supporting Turkey's development? How did the Bank's lending levels relate to other sources of finance for the Turkish economy?

- To what extent did the objectives identified in the country assistance strategies reflect the primary development priorities of the country? Did the Bank's strategies reflect the political economic and institutional contexts of the country? Were the sector strategies and programs well-designed and consistent with the overall Bank strategy? Were the Bank's strategies selective? Was there country ownership to support such strategies?

- In particular, given some of the lagging social indicators and the prevalence of substantial income inequality, did the Bank pay sufficient attention to poverty, social development, gender and regional issues in designing its program?

- Did the Bank select the right mix of instruments needed to implement the strategy? Did the shift from investment lending to adjustment lending in the latter half of the period reflect the country's development priorities? Were lending and non-lending services integrated to support the overall country strategy? Were projects designed to reflect the implementation capacity of counterparts?

- Has the Bank partnered effectively with the Turkish Government, NGOs (both local and international), the private sector, and other development partners in supporting Turkey's development program? Was IBRD assistance well-coordinated with respect to the rest of the Bank Group, the IMF and other donor agencies? Did it support the country's concern to position itself effectively in the dialogue with the European Union?

- How did the Bank's organizational changes—the turnover of CDs prior to FY97, the relocation of the CD to Ankara, and the increasing role of the country office in project implementation—impact the program?

- Did the Bank implement and monitor procurement, financial management, and other safeguard issues in its program? What were the Turkish Government's views of the Bank's policies and procedures for procurement, financial management and safeguards? Did project preparation include an analysis of the Government's capabilities in these areas? Has the Bank provided support to capacity building, governance and accountability in various sectors and levels of the Government?

Fiscal Adjustment

- Did the Bank's analysis and advice on privatization, banking reform and energy take into account the extreme political sensitivities surrounding these issues?

- How critical was the Bank's analysis and advice on the replacement of agricultural subsidies to their eventual removal and did the Bank provide sufficient support to ensuring the sustainability of the direct income support approach in the face of both political and fiscal pressures?

- Did the Bank build and sustain a dialogue in these areas which could provide the basis for agreed conditionality in adjustment lending and institutional development in the sector?

- How important was the Bank's contribution to the improvement of public expenditure management in Turkey and especially on ensuring that all public investment programs were channeled through the budget? Were the Bank's investment loans to Turkey subject to the same discipline?

- Was there an explicit division of labor with the Fund to ensure that critical issues such as improved tax policies and tax administration were tackled in tandem with reform of public expenditure management?

Human Resource Development

- Did the Bank add value to the various human resource development activities in which it participated? Did it undertake sufficient analysis of the costs and affordability of reforms in the social sector? Did it build constituencies within the Government? How critical was Bank involvement to the success of the Turkish authorities in extending compulsory education from 5 years to 8 years in the late 1990s? Has the work which has been undertaken on the health sector and on the social security system assisted the Turkish authorities in formulating effective programs in these areas?

- Given the persistence throughout the period of a gender gap in most human resource indicators, did the Bank pay sufficient attention in its work in the key economic sectors to gender issues and did it reflect these in its program design?

Environmental Management and Disaster Mitigation

- Does the Eastern Anatolia Watershed Development project represent a model on which the Bank could build in support of improved environmental programs in Turkey? Given the high costs per hectare, can it be effectively replicated?

- Was the extensive investment the Bank has made in disaster relief and early warning systems an appropriate use of the Bank's lending resources and capacity? Is there ownership of these programs and effective use of the resources provided for them?

CAE Outputs, Budget and Timetable

15. The CAE will be issued to CODE in FY06.. The main mission will be in early spring of 2005. The OED team will produce background papers on the key areas of strategic focus as well as a cross-cutting note on portfolio management issues, that will be discussed within the Bank and with the Government, and will be the basis of the evaluation work. Consultations with the Government will take place before issuing the report. Peer reviewers are Indermit Gill (PREM Sector Manager, East Asia) and Gene Tidrick (OED and principal author of the China CAE) as well as an external peer reviewer.