INDEPENDENT EVALUATION GROUP

IEG REACH

FEBRUARY 13, 2006

Based on the Turkey Country Assistance Evaluation, discussed by the CODE Subcommittee on October 24, 2005.

# Turkey: Country Assistance Evaluation

- Until the end of the 1990s, Turkey was unable to develop a political consensus to tackle macro-economic instability and consequently the Bank was unable to make much headway in its dialogue on the structural distortions which underlay serious fiscal imbalances: the deficits of the State Owned Enterprises; agricultural subsidies; deficits on the pension system; and losses of the State Banks.
- With financial crises in 1999 and 2001 a clearer national consensus emerged on the need for reform and the Bank was able to support this effectively through adjustment lending. This also helped open the door for a broader dialogue on reforms in the financial sector, infrastructure regulation and the social sectors.
- Rapid growth since 2002 and the agreement to open negotiations on EU accession are providing for an expanded agenda of Bank support in the above areas, but also on private sector development and environmental management.

## Background

Turkey's economic liberalization ran aground during the decade of the 1990s. Fiscal and quasi-fiscal imbalances led to annual inflation rates of 50–90 percent and contributed to periodic financial crises. In 1994, 1999 and 2001 economic contractions of 5-7 percent of GNP negated the growth rates of the intervening years. Coalition Governments were unable to reach consensus on the measures needed to get the macro-economy under control. The causes of the problems were broadly understood: large subsidies channeled through loss-making State Owned Enterprises (SOEs); agricultural price supports and subsidized inputs; the growing deficit on the pension system and the use of the State Banks as a source of extra-budgetary finance.

The first significant steps to regain control over the macro-economic situation were taken in 1999 when Turkey adopted a crawling peg with IMF support. This did not prove sustainable and in 2001 further measures were adopted along with substantial financial support from the IMF and World Bank. The measures sharply reduced the deficit of the SOEs; eliminated most agricultural subsidies and support prices, substituting them in part with less distorting Direct Income Support payments to farmers; and recapitalized the State Banks. Measures undertaken to reduce the deficit in the pension system in 1999 did not prove sufficient and the deficit widened sharply in the succeeding years. Overall, however, Turkey achieved a major turn-around in its macro-economic situation as a consequence of these measures. The years since 2001 have seen rapid growth and reductions in the public debt burden and the public sector borrowing requirement. At end-2004, inflation came down to single digit levels for the first time in more than two decades and Turkey reached agreement with the EU to begin negotiations for accession.

## World Bank Assistance

The evaluation covered the period from July 1, 1993 to June 30, 2004. There were four broad areas covered by the Bank's Country Assistance Strategies during this period. First and foremost, the Bank tried to engage the authorities in a dialogue on the key structural reforms needed for fiscal and macro-economic stability. Second, there was support for programs to strengthen growth, competitiveness and productivity, such as financial sector reform, infrastructure regulation, agricultural productivity and private sector development. Third, the Bank sought to help Turkey address poverty issues both through the programs cited above, but also through improving the coverage and quality of the health, education and social protection systems. Finally, the Bank provided support for improved natural resource management including helping Turkey develop systems for dealing with natural disaster.

Bank support in the earlier part of the period was largely confined to investment lending given the lack of progress in the macro-economic dialogue. With weak portfolio performance, by 1996 new lending had fallen to very low levels. Bank economic and sector reporting also ground to a halt during this period as ministries under different coalition partners found it difficult to achieve common positions on issues such as poverty analysis and regional development.

A number of steps were taken in the mid-90s by Bank management to restore a closer working relationship with the Turkish authorities. In 1996 the portfolio was jointly restructured and subsequent years saw substantial improvement in quality; in 1997 the Bank supported a proposal by the Turkish Government to increase the number of years of compulsory schooling; and the Bank responded to the major earthquake in 1999 with what was acknowledged by both the Turkish authorities and its development partners as impressive speed and efficiency. When the financial crisis unfolded that year, the Bank was a full partner with the Fund in providing financial support through the first new adjustment lending in more than a decade and in helping the authorities define the structural reforms needed to underpin the macro-economic program. In the subsequent crisis of 2001 the Bank's assistance was equally important and valued in defining the further structural measures which were needed. Subsequently the Bank has continued to support Turkey's adjustment as well as its aspirations towards accession to the European Union, through a wide-ranging program of adjustment and investment lending.

For the evaluation period as a whole the outcomes supported by the Bank are rated moderately satisfactory. In particular the measures to address the fiscal and structural problems in 1999 and 2001, after years of neglect, appear to have laid the basis for future growth and poverty reduction.

A primary lesson from this evaluation is the importance of the Bank maintaining its analytical capital in a country, even during those periods when there is little response. When the Turkish authorities finally opted for reform, the Bank was in a position to provide proposals in the key development sectors which were extremely helpful to the policy-makers. The study also points out the importance of maintaining a senior managerial focus on a country and of closeness to the client through decentralization during periods when relationships must be rebuilt.

## Recommendations

Looking forward, the study recommends that the Bank focus its efforts increasingly on support for Turkey's EU accession aspirations. This may require the Bank giving more emphasis to environmental management in its strategy. The Bank should also resume its support for the private sector. The Bank should help Turkey improve the investment climate for both foreign and domestic investment through improved regulation and governance. This needs to be much more effectively coordinated with the IFC program than has been the case in the recent past. While the Bank has been able to contribute to institution building in Turkey it has been less effective in supporting efforts to build more efficient, policy-oriented line ministries. The report identifies this as a major challenge for the Bank going forward.

## Government and Management Response

The Turkish Government comments that the Bank's efforts to support poverty reduction are sometimes too narrowly focused on the social sectors, and put too much emphasis on increased expenditures rather than quality of outcomes. The Government commends the Bank's recent efforts to streamline and simplify lending procedures, but expresses concern that conditionality for development policy lending should be more selective and better reflect the Government's program. Cross conditionality between the Bretton Woods Institutions is also a matter of concern. They underline the value of the support received for their economic program and the importance of continuing support for Turkey's EU aspirations and express special appreciation for the high quality of the Bank's analytical and advisory services. Regional Bank Management expressed its agreement with the analysis and recommendations.

*Task Manager: Basil Kavalsky*

*Senior Manager, IEGCR: R. Kyle Peters • Director: Ajay Chhibber*