GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

BOP/W/139
1 March 1991

Limited Distribution

Committee on Balance-of-Payments Restrictions

CONSULTATION WITH TURKEY (SIMPLIFIED PROCEDURES)

Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205) to assist the Committee in taking the decision referred to in paragraph 8 of that Declaration. It updates the paper prepared for the 1988 consultation (BOP/W/121).

I. Previous consultations with Turkey

2. The last full consultation with Turkey was held on 19 September 1988. The Committee commended Turkey for the extensive trade liberalization undertaken in the past five years and welcomed Turkey's commitment to continue the process. The Committee recognized that the measures taken by Turkey to promote domestic economic adjustment and diversification had been essential accompaniment to the trade liberalization process. Concern was expressed about the possible effects of inflation on the outlook for Turkey's economic policy. It was recognized that the level of, and means of financing, the public sector deficit were key elements in the outlook for inflation and growth. The Committee also noted the importance for Turkey of development and diversification of trade and of earnings from invisibles, and emphasized the need for stable and growing access to foreign markets.

3. The Committee welcomed the considerable movement away from quantitative restrictions on trade in favour of tariffs and other price-based measures since 1983. It encouraged Turkey to move further towards complete liberalization of measures maintained for balance-of-payments purposes, and to announce to the GATT, whenever practicable, a time schedule for such action. At the same time, it expressed concern about the growing number and effects of quasi-tariff measures, and the burden that these could represent for particular imports. In this connection, it looked forward to the phasing out of the stamp duty and the simplification of the tax structure applied to imports (BOP/R/178, paragraph 20 and 21).

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II. Main changes in Turkey's trade and exchange policies since the last consultation

4. Since the last consultation, Turkey has completely dismantled its import licensing system. Tariffs have also been reduced and there are plans to abolish the stamp duty. The guarantee deposit applied on imports has also been abolished. However, the scope of various special levies, particularly the Housing Fund levy, has continued to increase as that of quantitative restrictions has diminished.

5. Turkey has also liberalized all payments for current transactions and abolished all its previous bilateral payments agreements. On 22 March 1990, Turkey accepted Article VIII of the IMF Articles of Agreement, thus undertaking not to impose restrictions on payments for current international transactions or to engage in discriminatory currency practices without Fund approval (see L/6672).

6. In October 1989, Turkey sent a general communication to GATT concerning the progress of the overall liberalization which it had undertaken as part of its stabilization and structural adjustment programmes since 1980 (L/6588). This communication summarized reductions made up to that time in both tariffs and non-tariff measures.

(a) Import permits

7. Turkey has regularly provided information on its import licensing procedures. In its most recent notification (L/5640/Add.29/Rev.5), Turkey notified that, effective as from 17 January 1990, the import licensing system had been terminated by the abolition of the list of goods subject to permits. The importation of goods, other than those whose importation is prohibited by special law and not permitted, is free. However, automatic licensing for statistical and surveillance purposes remains in force for all imports. The licence permits the necessary foreign exchange payments to be made and the clearance of goods from customs.

(b) Special levies

(i) Public Housing Fund

8. Levies for the Public Housing Fund are imposed at varying rates, either ad valorem on the c.i.f. value of the import or at specific rates. These levies range from US$1 per ton for fish meal up to 45 per cent of import duties for some passenger cars. The number of items subject to this charge has steadily increased since its introduction in 1984. As of November 1990, it covered 5518 items with eight-digit HS level.

(ii) Other special levies and taxes

9. The Support and Price Stabilization Fund is financed partly by a surcharge on all imports. The rate applied is "exempt", 3 and 10 per cent according to the nature of imports.

10. Municipal tax is levied on all imports at a rate equivalent to 15 per cent of the applicable customs duty. Port tax of 5 per cent of tax-paid

value of goods was replaced in June 1989 by the "Transportation Infrastructure Tax" of 4 per cent for goods shipped by sea and 3 per cent for goods shipped by land or air.

11. Imports of minerals are subject to a surcharge of 2.5 per cent.

12. As a separate scheme, the legislation for the Encouragement of Investments and of Hard Currency Earnings, provides for special levies and refunds to the interested parties. Levies range between 5 to 20 per cent of the import value, and the refunds applied as 15-50 per cent of the sums of investments financed directly by the sources of the investor. As long as this encouragement scheme is applied, the import is exempt from the ordinary taxes, levies, surcharges and fund payments.

(c) Stamp duty

13. A stamp duty, levied ad valorem on the declared value of imports, has been in force since 1963. A waiver from obligations under Article II of the General Agreement was granted to Turkey in 1963 and has been regularly extended by the GATT Council. Turkey justifies this duty as a temporary fiscal measure necessitated by its high public sector deficit. In December 1989, the GATT Council approved an extension of the waiver granted to Turkey in respect of its stamp duty, until the removal of it or until 31 December 1991, whichever date is earlier (BISD 36S/433).

14. The most recent Council decision on the waiver allows the duty to be maintained at a rate not exceeding 10 per cent of the value of the imported goods until 31 December 1991, unless it is removed before that date. The Government of Turkey assured the contracting parties that, once the ongoing process of finding alternative sources of revenue through effective fiscal reforms was completed, the stamp duty would be eliminated (BISD 36S/433).

15. Currently, the rate of the stamp duty remains at 10 per cent.

(f) Tariffs and other taxes on imports

16. On 1 January 1989, Turkey adopted the Harmonized Commodity Description and Coding System and rearranged its customs tables accordingly.

17. During 1989, Turkey lowered import duties and reduced import surcharges on a wide range of items. Customs duties covering, overall, some 11,000 goods were reduced in March, May, August, September and October 1989 (see L/6588). Changes affected some consumer goods including electronic appliances and motor vehicles, as well as chemicals, petrochemicals, textiles, construction materials and some agricultural products. In October 1989, the Turkish Government reported to GATT that "At present the average effective tariff rate in Turkey is below 5 per cent, and furthermore the sum total of all the duties, taxes and surcharges levied by the Government does not exceed 9 per cent of the value of imports. This result is due to the fact that imports free of taxes and duties of any kind represent a large part of the total" (L/6588, para. 6). For the period of January-September 1990 the average effective tariff rate is estimated by the Turkish authorities as 5.5 per cent, and the average of all duties, taxes and surcharges at 11.4 per cent.

18. Turkey benefits from a waiver of its GATT tariff schedule relating to the implementation of the Harmonized System, valid until 30 June 1991 (L/6782). Turkey adopted the HS on 1 January 1989. Although the bound rates are higher, ordinary customs duties range between 0-1 per cent in the case of raw materials, 1-5 for intermediate and semifinished products, and 5-15 per cent and 40 per cent for finished goods. Higher rates (up to a ceiling of 50 per cent) apply to certain consumer goods considered luxuries.

III. Economic and trade developments

Introduction

19. The performance of the Turkish economy in 1988 deviated significantly from official targets. The rate of growth of GNP declined substantially while inflation - as measured by the consumer price index - averaged above 75 per cent. Although the Public Sector Borrowing Requirement (PSBR) fell by more than 2 per cent of GNP to some 6½ per cent,it exceeded its target level despite a cut in public investment. The current account registered a surplus for the first time since 1973, reflecting the contraction in domestic economic activity, the improvement in public finances and growing tourism receipts.

20. During 1989 the rate of economic growth fell to 1.6 per cent, the lowest since 1980. Agricultural output suffered a significant decline because of drought. Industry faced high wage demands and stagnating markets. The PSBR rose to 7½ per cent of GNP, almost 40 per cent above its programme target which contemplated a fiscal contraction equivalent to 1.3 per cent of GDP. Despite an easing of monetary policy and increases in prices of goods supplied by State Economic Enterprises (SEE), the inflation rate declined to about 63½ per cent in 1989.[1] An increased foreign trade deficit was only partially offset by higher tourism revenues and workers' remittances, leading to a fall in the current account surplus.

21. According to official estimates, the Turkish economy made a strong recovery in 1990. Economic growth is expected to have reached almost 9 per cent, with recovery in all major sectors. According to official estimates, the PSBR target was exceeded by more than 63 per cent in 1990. Under the impetus of tighter monetary policy and continued appreciation of the real effective exchange rate, inflation was on a clearly downward trend through August, but it rebounded later in the year as the effects of the Middle East crisis were felt. Figures available until August 1990 show the current account moving sharply into deficit, primarily as a result of a very large increase in merchandise imports.

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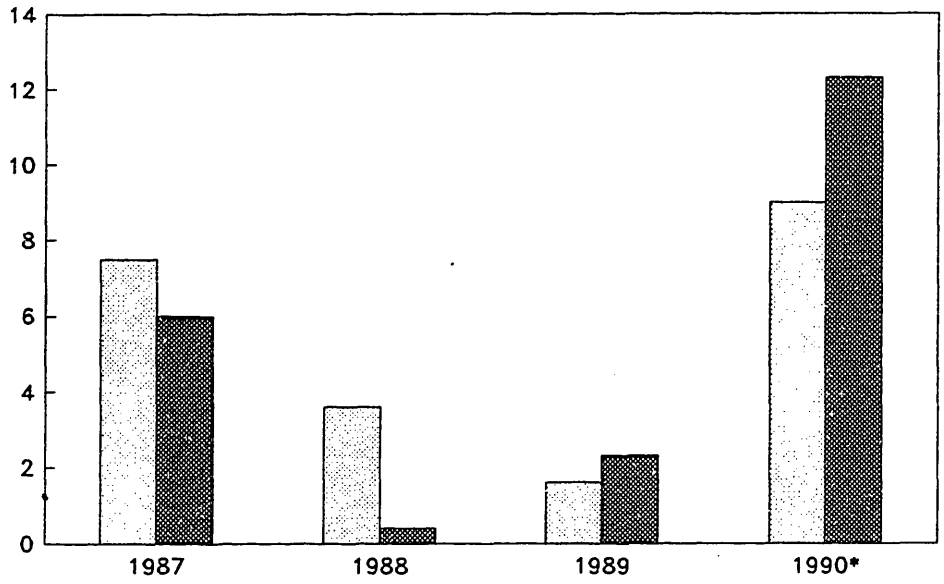
[1]With revised CPI weightings for 1989. On the basis of previous weightings, the CPI for 1989 shows an inflation rate of 69.6 per cent.

Aggregate supply and demand

22. Turkey's economic growth of 3.6 per cent in 1988 was fuelled almost completely by the external sector. Domestic demand growth stagnated, largely due to a fall in public sector demand, notably in investment in the transportation sector. In the private sector, the downturn in economic activity was most noticeable in consumption. The most dynamic area was private housing investment, which is supported by government subsidies. Agricultural output grew by 8 per cent as a result of a good harvest and industrial production rose by slightly more than 3 per cent. The external balance contributed to GNP growth as the current account moved into surplus for the first time since 1973.

23. In 1989, despite the impact of higher wages on domestic demand, real GNP growth was the lowest since 1980 at an estimated 1.6 per cent. This largely resulted from a fall of 11.5 per cent in agricultural output caused by a severe drought. Additional public investment cuts were also made in 1989. Manufacturing output recovered somewhat, while mining output fell by almost 4 per cent. Consumption expenditure started to recover but private sector investment continued to be negatively affected by accelerating inflation and the decline in general economic activity. The external balance made a negative contribution to growth of GNP, largely due to stagnating merchandise exports and a recovery in merchandise imports following the rise in domestic economic activity. In the second half of 1989, however, there was some recovery in growth, which continued into 1990.

Graph 1 – Turkey – Real GNP
and total domestic demand
(Annual percentage change)



Source: IMF.
*Estimates.

Public finances

24. The Turkish nonfinancial public sector comprises the central government, extra-budgetary funds (EBFs), and local governments - which are grouped under the heading "general government" in Graph 2 - plus the State Economic Enterprises (SEEs). In the second half of the 1980's, the EBFs and local government sectors have grown in importance, and as a result of a decentralisation process enacted by the authorities, spending control was weakened. Several programmes have now been set up to regain authority over spending.

25. Following an expansionary fiscal policy in 1987, the authorities undertook a programme for reducing the PSBR during 1988, by cutting expenditures, notably on capital transfers and investment. However, revenues fell short of the target largely as a result of the effects of higher-than-expected inflation and weak tax administration procedures. In 1988, the PSBR is estimated by the IMF to have been 6.7 per cent of GNP (the revised programme target was 6.2 per cent) against 8.8 per cent in 1987.[2] The surplus in the general government primary balance - that is, the difference between expenditure, excluding all interest payments, and revenue - fell short of its target value by almost 1 per cent of GNP, but was still much higher than in 1987. As to the borrowing requirements of the SEEs, they fell to 2.7 per cent of GNP from 4.4 per cent of GNP in 1987.

26. In 1989, the revised programme called for a reduction in the PSBR to 5.4 per cent of GNP. Expenditure restraint by the central government was to continue and tax revenue was to be increased by improved tax administration. Reduced borrowing requirements of SEEs and an increased deficit of the EBFs were expected, the latter largely due to a rise in investment expenditures. However, IMF estimates for the outcome in 1989 show a PSBR of 7.5 per cent of GNP.[3] The central government primary surplus almost disappeared. Interest payments were lower than expected in 1989 but expenditures for personnel and other current expenditures were significantly above the revised programme targets because of high public wage and salary increases. The revenue shortfall was larger than anticipated, especially in indirect taxes. There was virtually no improvement in the finances of the SEEs.

27. The programme for 1990 sought a contraction in the PSBR to 6 per cent of GNP, to be achieved largely by improving tax administration and despite a rise in current transfers and fixed investment. Estimates for the fiscal year, however, show a PSBR of almost 10 per cent of GNP. This is largely due to the continued excess of expenditure for personnel and other current expenditure by the central government and to the large deterioration of the finances of the SEEs (nearly 2 per cent of GNP above their programmed borrowing requirement) mainly because of financing of stocks accumulated

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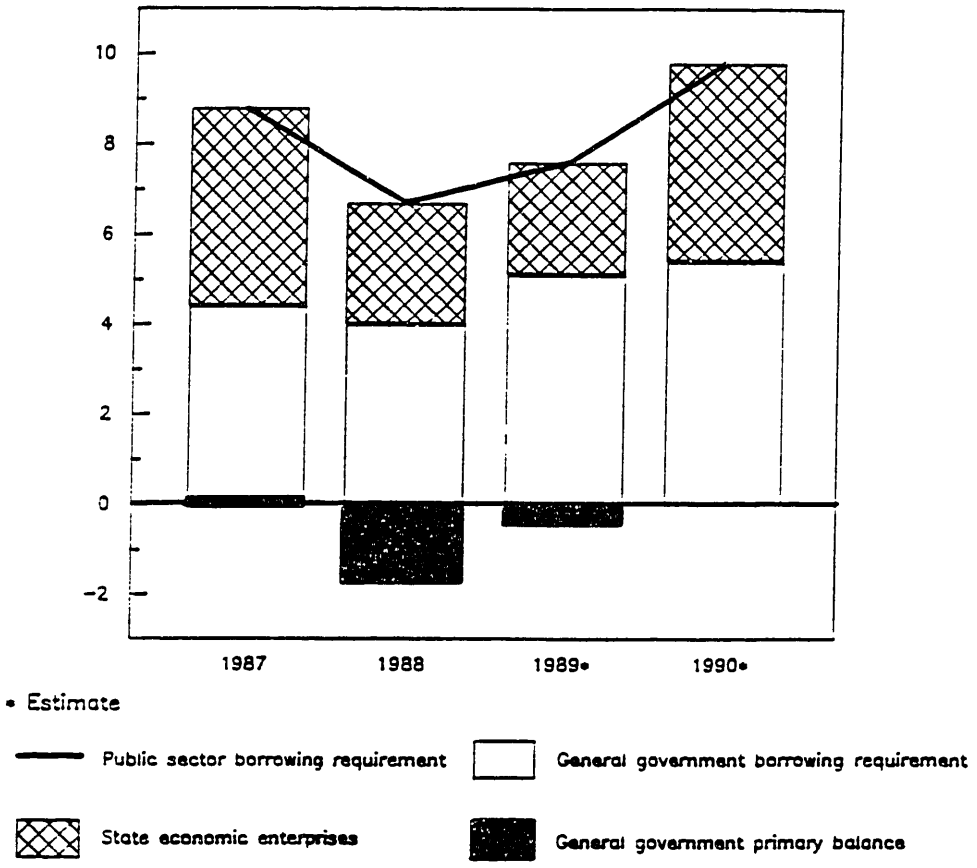
[2] Data supplied by Turkey show a PSBR of 6.2 per cent for 1988.

[3] Data supplied by Turkey show 7.1 per cent.

after the good harvest. According to official estimates, the primary surplus called for in the economic program did not materialise in 1990.

Graph 2 – Turkey – General government and public sector borrowing requirements
(Percentage of GNP)



Source: IMF.

Money and credit

28. In 1988, the most important sources of reserve money growth were credit to the public sector and growth in foreign assets. The latter resulted in part from larger-than-expected receipts of foreign exchange caused by a new policy seeking to encourage early repatriation of foreign

exchange. As real interest rates on deposits fell in the first three quarters of the year, velocity of money circulation and the currency/deposit ratio increased making inflation higher than anticipated. (It appears likely that there was also a shift into foreign currency and other foreign assets.) The authorities adopted a series of measures to tighten monetary conditions including a rise in interest rates on time deposits and in reserve ratios.[4]

29. In the first half of 1989, monetary policy was eased again. Until November 1989, the main source of reserve money growth was the rise in net foreign assets. The expansion of credit to the public sector was also important mainly in the first part of the year.

30. During the first half of 1990, the growth in reserve money fell and monetary conditions tightened under a new monetary programme framework introduced in January 1990. However, from the second quarter of 1989 until August 1990 real interest rates were negative. This caused a further rise in the currency/deposit ratio and in the share of reserve money in broad money (M2).

Balance of payments (Table 1)

31. Turkey's overall balance of payments surplus increased in 1988 to $1.2 billion. The current account showed a surplus for the first time since 1973. These developments more than offset a shift to a net outflow in the capital account. International reserves (excluding gold) rose to more than $2.3 billion, the equivalent of about 2 months of merchandise imports (Graph 3). In 1989 the balance of payments again recorded a sizable surplus, this time of more than $2.7 billion. The current account surplus was smaller but net capital inflows were positive, with the result that the stock of international reserves attained a significantly higher level of almost $4.9 billion (3.7 months of merchandise imports). The current account swung back strongly into deficit in the first eight months of 1990 (deteriorating by over US$2 billion) but there was a major turn-around in the short-term capital account. As a result, international reserves continued to rise, reaching $6.5 billion (3.8 months of merchandise imports) by August 1990.

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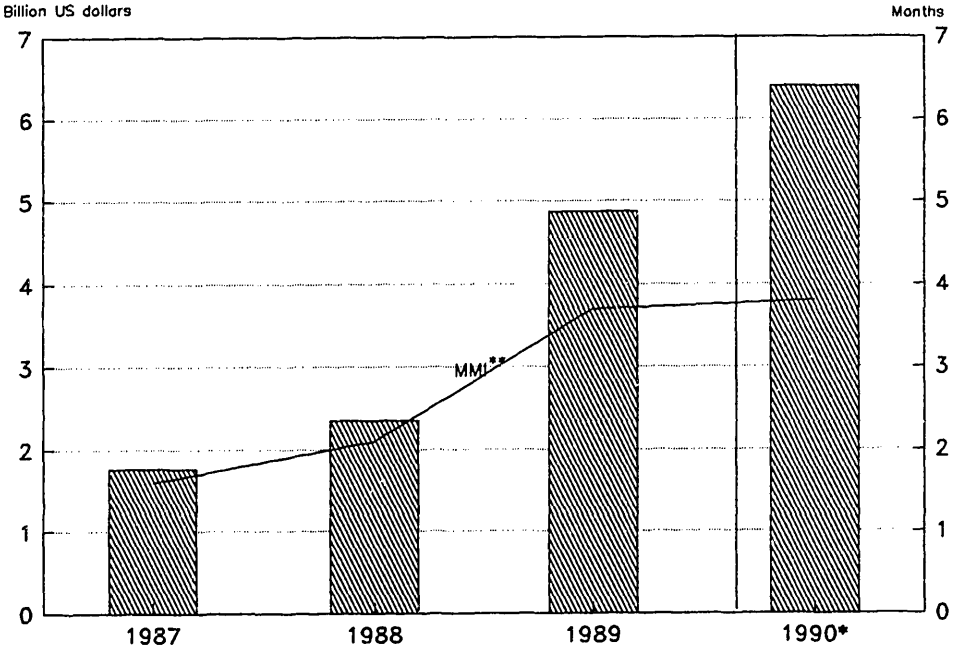
[4]Comparison of monetary developments in Turkey before and after October 1988 is complicated due to the reclassification of deposits of the social security funds and other agencies.

Graph 3 – Turkey – International reserves (excluding gold)



*September 1990 **MMI refers to equivalent months of merchandise imports.
Source:International Financial Statistics, IMF, January 1991

The current account

32. In 1988, Turkey's current account balance recorded a surplus of US$1.6 billion, equivalent to more than 2 per cent of GNP (Graph 4). The trade deficit declined to less than $1.8 billion, while an increase in service receipts produced a surplus of $1.2 billion in the services account. Contractionary fiscal and monetary policies (together with a decline in the velocity of money and despite the government's increased difficulty in placing its bonds at the prevailing interest rates) were behind this shift from deficit to surplus in the current account. In 1989 the current account surplus dropped to less than $1 billion despite a rise in workers' remittances, largely due to a significant widening in the trade deficit under the spur of more expansionary fiscal and monetary policy stances. A further sizeable increase in the budget deficit was largely associated with the decline of more than one-third in Turkey's current account surplus in 1990 - a development which occurred in spite of monetary restraint and an increased willingness of the public to hold government bonds.

33. In 1988, the value of merchandise exports on a customs basis grew by more than 14 per cent, with volume growth of almost 12 per cent. The tendency was, however, for export growth to decline. This resulted mainly from a reduction in direct subsidies for exports. In 1989 the dollar value and volume of merchandise exports dropped by 0.3 per cent, due in part to a real exchange rate appreciation of more than 9 per cent (Graph 5). This trend was reversed in the first eight months of 1990, as merchandise exports increased more than 6 per cent with respect to the same period of 1989.

Table 1 - Turkey - Balance of payments
(Million US dollars)

	1987	1988	1989	January-August 1989	January-August 1990
Trade balance	-3 229	-1 777	-4 201	-2 806	-5 887
- Merchandise exports	10 322	11 929	11 771	7 077	7 536
- Merchandise imports	-13 551	-13 706	-15 972	-9 883	-13 423
Other goods, services & income (cred.)	4 195	6 026	7 083	4 474	5 771
of which: Travel	1 476	2 355	2 557	1 637	2 382
Other goods, services & income (deb.)	-4 162	-4 812	-5 474	-3 482	-4 126
of which: Interest payments	-2 387	-2 799	-2 907	-1 920	-1 983
Private and official unreq. transfers	2 390	2 159	3 558	2 273	2 417
of which: Worker's remittances	2 021	1 766	3 040	1 914	2 083
Current account	-806	1 596	966	459	-1 825
Direct investment	106	354	663	298	536
Portfolio investment	282	1 178	1 586	861	557
Other long-term capital	1 453	-209	-920	-614	-421
Other short-term capital	50	-2 281	-554	-782	2 207
Capital account	1 891	-958	775	-237	2 879
Net errors and omissions	-506	515	974	967	536
OVERALL BALANCE	579	1 153	2 715	1 189	1 590

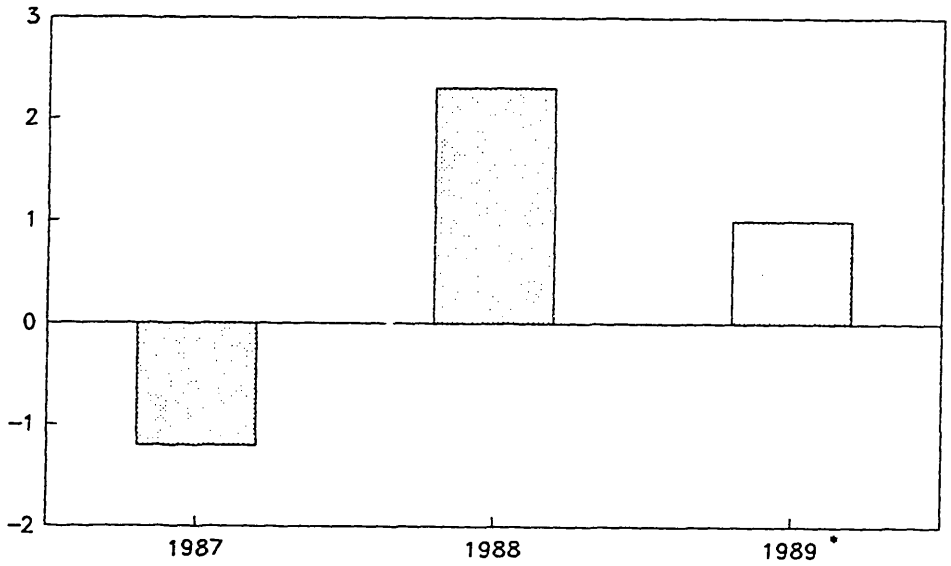
Source: IMF

34. Merchandise imports on a customs basis were almost stagnant in 1988. This resulted from depressed domestic economic activity and increased import control measures. Merchandise imports of oil benefit from the oil price decline which allowed a smaller import bill and increased volume of imports. Merchandise imports rose 10 per cent in value and almost 9 per cent in volume in 1989. In the first eight months of 1990, merchandise imports grew by almost 36 per cent with respect to the same period of the previous year.

35. The main merchandise exports of Turkey in 1989 were industrial products, which accounted for more than three quarters of the total, followed by agricultural products (Table 2). Textiles, iron and steel represented together nearly 42 per cent of Turkish merchandise exports in 1989. The principal merchandise imports of Turkey in 1989 were industrial products, which represented almost three quarters of the total (Table 3).

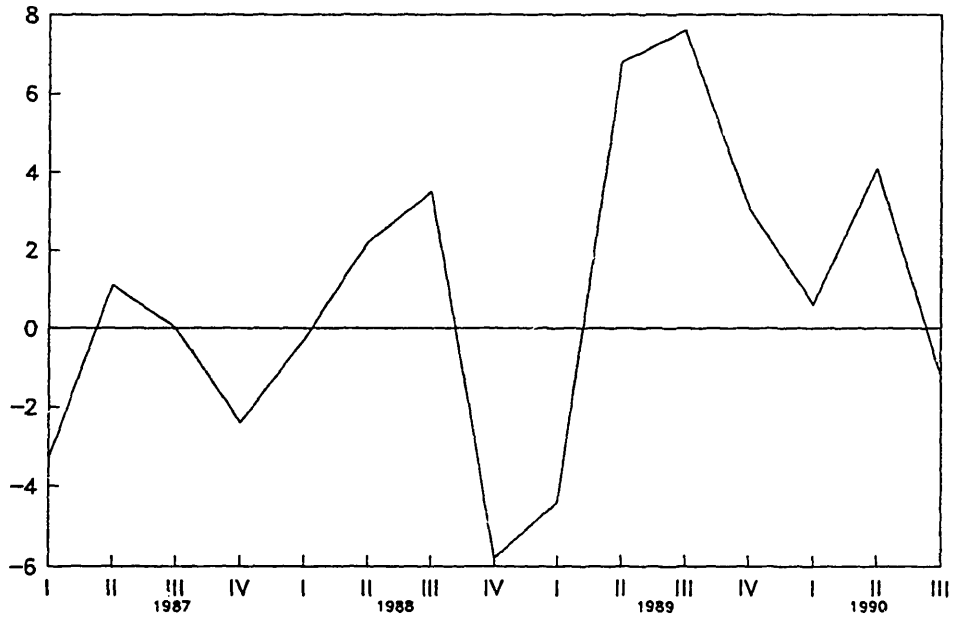
36. Almost half of the turn-around in the current account in 1988 took the form of a surplus in the service account. This was largely the result of increased net travel receipts, which helped to offset a rise in interest payments on foreign debt and a reduction in workers' remittances. The movements in the latter were largely affected by fluctuations of the dollar-Deutsche mark exchange rate since most of workers' remittances are accounted for by Turkish workers resident in Germany. Figures for the year 1989 show a further rise in the surplus on the service account. There was a significant increase in workers' remittances, a large part of which is again to be attributed to exchange rate developments.

Graph 4 – Turkey – Current account balance
(Percentage of GNP)



Source: IMF, GATT Secretariat
*Preliminary.

Graph 5 – Turkey – Real effective exchange rate
(Period averages;quarterly)



Note: Trade weighted index used for information notice system. Real effective exchange rate based on changes in relative consumer prices. Percent change denotes change from previous quarter. Source: IMF.

Table 2 - Turkey - Principal merchandise exports
(Percentage shares)

	1988	1989
Agriculture and livestock	20.1	18.3
Crops	17.1	15.3
of which:		
Hazelnuts	3.1	2.3
Tobacco	2.3	4.1
Livestock products	2.5	2.4
Fishery products	0.4	0.5
Mining and quarry products	3.2	3.6
Industrial products	76.7	78.2
of which:		
Agricultural-based processed products	7.6	7.9
Textiles	27.5	30.2
Chemicals	6.3	6.7
Petroleum products	2.8	2.2
Iron and steel	12.5	11.6
Metal products and machinery	3.3	1.9
Electrical appliances	2.5	2.0
Total	100.0	100.0

Source: IMF

Table 3 - Turkey - Principal merchandise imports
(Percentage shares)

	1988	1989
Agriculture and livestock	3.5	6.6
Mining and quarry products	20.0	18.4
of which:		
Fuels	18.7	17.1
Industrial products	76.6	74.9
of which:		
Agricultural-based processed products	5.1	5.3
Chemicals, rubber and plastic	17.5	16.4
Petroleum products	2.4	3.1
Non-ferrous metals	2.9	2.7
Iron and steel	11.5	14.1
Metal products and machinery	17.2	14.2
Electrical appliances	7.5	6.5
Motor vehicles	4.8	5.0
Total	100.0	100.0

Source: IMF

The capital account and international indebtedness

37. In 1988, Turkey's capital account recorded a net outflow of almost $2.3 billion of short-term capital, in part because commercial banks accumulated foreign exchange reserves. Long-term capital flows were also negative largely as a result of lower project-related inflows. Large debt repayments were somewhat offset by credit from international organizations and some bilateral sources. Moreover, there was a significant rise in portfolio investment inflows. In 1989, net outflows of short-term capital decreased significantly as the growth of commercial bank reserves slowed and short-term liabilities continued to fall. On the contrary, net outflows of long-term capital increased due mostly to higher debt repayments. Portfolio investment inflows continued to grow. In the first eight months of 1990, a large inflow of short-term capital was recorded, as a consequence of the tight monetary policy and the effects of the liberalization of capital movements introduced in August 1989 and February 1990.

38. Recently, the Turkish authorities have sought to change the term structure of the total external debt of the country ($40.9 billion at the end of 1988) in order to increase the share of medium- and long-term sources of financing. In 1988, the ratio of total Turkish external debt (in US dollar terms) to GNP declined to 57.7 from 59.3 per cent in 1987,

largely as a result of the appreciation of the United States' dollar. Although the total external debt of Turkey at the end of December 1989 was slightly higher than in December 1988, the downward trend in the ratio to GNP continued. Debt servicing obligations have fluctuated in recent years. The debt service ratio was almost 38 per cent in 1988 (it was 36 percent in 1987), then declined in 1989 to just above 32 per cent.