GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED
BOP/R/207
28 April 1993
Limited distribution

Committee on Balance-of-Payments Restrictions

REPORT ON THE FULL CONSULTATION UNDER ARTICLE XVIII:12(b) WITH TURKEY

1. The Committee met on 1 April 1993, under the Chairmanship of Mr P. Witt (Germany) to conduct a full consultation with Turkey, pursuant to the provisions of Article XVIII:12(b) and the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The International Monetary Fund was invited to participate in the consultation, pursuant to the provisions of Article XV:2.

2. The Committee had the following documents before it:

Basic document supplied by Turkey	BOP/314
Background paper by the Secretariat	BOP/W/149
International Monetary Fund, Recent Economic Developments, dated 5 February 1993.	

3. The opening statement by the representative of Turkey is contained in Annex I.

4. The statement by the representative of the IMF is contained in Annex II.

(i) Balance-of-payments position and prospects; alternative measures to restore equilibrium

5. Members of the Committee expressed their appreciation for the economic and trade reforms undertaken by Turkey to date. Economic growth in the past year, at 5 per cent, was impressive, and Turkey appeared to have made a good recovery from the Gulf crisis. Certain members considered that the recently-signed Free trade Agreement between Turkey and the EFTA countries would give extra impetus to economic growth.

6. Nevertheless, the maintenance of macroeconomic stability was a major concern. Members noted that slow progress had been made with fiscal adjustment and reform of the public sector, including privatization. Plans for the reduction of the Public Sector Borrowing Requirement had not been fulfilled, and State Economic Enterprises were still a serious drain on the exchequer. Inflation remained high. Thus, the environment for pursuit of sound monetary and fiscal policies was increasingly difficult. Members stated that fiscal reform, including a reduction in monetary financing of the public sector, and the reduction of inflation should be priority objectives for the Turkish authorities. It was recognized that the balance-of-payments situation was likely to be sustainable, provided that sound macroeconomic policies prevail.

heel of the economy. As to fiscal management, reduction of the PSBR was the top macroeconomic priority for the 1993 fiscal year. Proposals for tax reform were currently under study, and would be submitted to Parliament in the near future. Privatization was proceeding: in 1991-92, eighteen companies had been privatized, yielding US$420 million in revenue, compared to US$860 million for the five year period 1986-91.

(ii) System, methods and effects of restrictions

8. Members complimented Turkey on the trade liberalization undertaken. Import licensing had been abolished; however, in this connection, one member raised questions concerning procedures for approval of certain imports, including organic chemicals, office equipment, and goods requiring spare parts. Other taxes and charges previously imposed on imports had been abolished or folded into the Mass Housing Fund levy.

9. Members sought clarification from the representative of Turkey concerning the statement, contained in the Secretariat background document, that Turkey did not maintain any measures justified under Article XVIII:B. It was questioned whether, in these circumstances, it was necessary for Turkey to continue invoking the GATT balance-of-payments provisions.

10. Particular attention was paid to the Mass Housing Fund charge. Members noted that the coverage of the levy had increased substantially, from 5,518 eight-digit HS tariff items at its introduction in 1984, to over 16,000 items. The combined incidence of the levy and the tariff exceeded Turkey's GATT bindings in a considerable number of cases. Members asked why the increase in coverage had been necessary and requested clarification on the rates at which the charge was levied; the share of State revenues represented; and its effect on Turkey's competitiveness.

11. Members also questioned the justification, under GATT, for the Mass Housing Fund charge. Most members doubted whether it could be justified as a balance-of-payments measure under Article XVIII:B. They sought further information on Turkey's plans to remove the charge, particularly on items where its combined incidence with the tariff exceeded bound rates.

12. Members also asked whether Turkey's planned alignment of its tariff with the EC's Common Customs Tariff by 1995 applied to bound or applied rates; sought the justification for, and information on the elimination of, the surcharge applied to imported minerals, and the basis for the maintenance of import monopolies.

13. In reply, the representative of Turkey said that a major liberalization had been made with the introduction of the 1993 Import Régime. All additional taxes previously applied had been abolished. The only remaining import taxes were the customs tariff and the Mass Housing Fund (MHF) charge. This had notably increased the transparency of the import régime and simplified the calculation of the total taxes applied to imports. The rate of MHF had not been increased, but rather had been reduced by a weighted average of 7 per cent. Further reductions were in the pipeline. In sixty per cent of bound tariff lines (on an eight-digit level), the combined incidence of the tariff and the MHF charge was below the GATT binding; in a further 28 per cent, it was equal to the binding; in only 12 per cent of cases was it above. It was, however, not possible to give exact figures for the incidence of the MHF charge, as this varied from item to item. The MHF was regarded as a temporary measure: as stated, Turkey was committed to its elimination by 1998. Turkey would be in a position to disinvoke Article XVIII:B when it had reduced all above-binding combined rates to the bound level.

14. The representative of Turkey also stated that the minerals surcharge led to an excess over Turkey's GATT bindings only on two items. The Minerals Law was currently under review, and this could imply changes. The only remaining State monopoly was on liquor; in all other cases, such as those on salt, sugar, tea and tobacco, trade had been opened up to the private sector. The licensing provisions referred to by one member were the few remnants of the previously highly protective system; Turkey was making all attempts to phase out these remaining measures.

(iii) Conclusions

15. The Committee noted that the liberalization of the Turkish economy in recent years had contributed to buoyant export performance, an improvement in the balance-of-payments position and an increase in international reserves. It welcomed and commended the widespread trade liberalization undertaken by Turkey since the previous consultation, including the abolition of the stamp duty, municipal tax and transport infrastructure tax on imports and the termination of payments to the Price Support and Stabilization Fund. Moreover, all quantitative import restrictions had already been abolished. However, in order to gain the full benefits of the liberalization and adjustment programme, the Committee encouraged the continuation of the privatization process and stressed the need for steady reduction of the fiscal deficit and for continuity in, and consolidation of, fiscal and monetary policies, including greater discipline over the financing of State economic enterprises.

16. The Committee recognized that Turkey was committed to a programme of progressive reduction and phasing-out of the Mass Housing Fund. The Committee noted that, even in the newly introduced import régime, the combination of import duties with payments to the Mass Housing Fund led to total charges on imports exceeding GATT-bound levels for 12 per cent of tariff lines in Turkey's schedule of concessions; members, while not querying the broader purpose of this measure, questioned whether this was justified under Article XVIII:B.

17. The Committee recognised that the basic aim of the Mass Housing Fund is not for balance-of-payments purposes. It therefore welcomed Turkey's readiness to notify in the coming weeks all tariff lines on which the combined incidence of the tariff and the Mass Housing Fund charge exceeds bound rates, and to implement the envisaged reduction. The Committee took note of Turkey's declared intention to disinvoke Article XVIII:B in the foreseeable future.

ANNEX I

OPENING STATEMENT BY THE DELEGATION OF TURKEY

(Consultation under Article XIII:(b)

It is a pleasure to be here for a full consultation on the balance of payments of the Republic of Turkey.

We have already presented to the Secretariat for their review, a report on developments in the economy since the latest consultation. I understand that the Secretariat distributed its report to the members of the Committee on March 16th.

I will, with your permission and as is customary, give you a brief description of the recent economic developments and update you both on ours as well as the Secretariat's report as some figures pertinent to the economic performance in 1992 are now final.

The successive Turkish Governments have given particular attention to maintaining the momentum of reforms in the economy. In spite of exogenous factors like the Gulf Crisis during 1990-91, and the bad weather conditions, like the drought in 1989, both of which hampered the smooth continuation of the adjustment process, I have the pleasure of informing you that the process of restructuring of the economy and necessary institutional reforms are underway.

I would like to start by elaborating the developments during 1991, which I consider a critical period both from external and internal points of view. At the outset of 1991, the Turkish economy was under the adverse effects of the uncertainties and unfavourable external conditions related to the Gulf War which led to a sharp contraction in economic activity in the first half of the year. The mid-year change of government and the announcement of an early general election aggravated prevailing uncertainties.

Although there was a shift toward expansionary policies in the second half of the year and a corresponding up-turn in the manufacturing industry, the economy registered a mere 0.3 per cent growth rate.

Uncertainties, wage pressures and considerable deterioration in fiscal performance played a significant rôle in increasing inflationary pressures. Rise in the wages and salaries, interest payments on domestic debt and other transfers in the public sector led to the increase in the ratio of public sector borrowing requirement to GNP to 14.4 per cent from 10.5 per cent in 1990, and, 7.1 per cent in 1989. As a result of this and also of the contribution of the sharply increasing labour costs, the annual rate of increase was 59.2 per cent in the wholesale price index and 71.1 per cent in the consumer price index by the end of 1991.

On the balance of payments side, a smaller trade deficit and the grants related to the Gulf Crisis contributed to the swing of the current account into a surplus of 275 million dollars in 1991 from a deficit of 2.6 billion dollars in 1990. Official foreign exchange reserves declined by 1 billion US dollars mostly due to the extraordinary demand for liquid foreign exchange holdings during the Gulf War until April 1991.

However, the combination of current account surplus, continued foreign capital inflows and partial reflow of Funds into the foreign exchange deposit accounts contributed to the replenishment of the official foreign exchange reserves throughout the year.

In sum, Turkey entered 1992 with a new Government, near zero growth and such structural problems as an upward inflationary trend and a deteriorating public sector borrowing requirement under the varying degree of influence of these developments on the internal and external economy.

Against this background what Turkey has achieved with respect to its balance of payments and economic growth can be considered a success.

Less successful has been however her efforts to reduce inflation and the public sector deficit. In growth, if nine month figures are taken into account, it is very likely that original growth target fixed as 5.5 per cent will be achieved for 1992. The final figures for growth in 1992 will only be available at the end of this month.

While capacity utilization and productivity were increased in the agricultural, industrial, and services sectors, GNP received a considerable impetus on the demand side from increased private consumption. The balance of payments position was reinforced thanks to higher exports resulting from the increased output of manufactured goods, keeping imports in line with the program and increased tourism revenues.

The final figures for 1992 indicate that exports have risen to 14.7 billion dollars and imports to 22.9 billion dollars, leading to a trade deficit of nearly 8.2 billion dollars which is 900 million dollars higher than the one in 1991. The invisible account reflected also a current account deficit of 943 million dollars. The inflows through the capital account were adequate to cover the financing requirements.

In external financing, Turkey continued to diversify its resources in the international bond markets, and successfully issued bonds worth around 2.5 billion dollars in the United States, Europe and Japanese markets.

As a result of this performance in the external account, Turkey was able to increase it gross international reserves to 16.5 billion dollars during 1992.

Inflationary pressures continued in the course of 1992. Although declining agricultural prices during the summer helped reduce inflation, the upward trend in prices showed up again in the last quarter of 1992, reaching 61.4 per cent in wholesale prices and 66 per cent in consumer prices by the year's end.

In spite of the fact that the acceleration of inflation in 1992 was contained and price increases remained at around the previous year's level, the improvement in the PSBR (which is a main parameter of inflation) was not sufficient to achieve the targeted slowdown in the inflation.

Although the external account maintained a relatively strong position in 1992, public finance continued to be a source of concern.

However, there were some improvements on the fiscal side;

Firstly, the consolidated budget deficit was realized lower than expected. This was mainly due to lower than estimated expenditures, higher clawbacks from extra-budgetary funds to the consolidated budget, and increased efficiency in tax collection.

Secondly, the SEE's deficit is estimated to decline from 4.4 per cent of GNP in 1991 to 3.0 per cent in 1992.

Thirdly, 18 State owned companies were privatized in 1992, providing a revenue of 424 million dollars in comparison with 862 million dollars of privatization earnings during the 1986-1991 period.

The ongoing process of privatization will be accelerated through public offerings and strategic sales. For 1993, the target is to get a total amount of 1.5 billion dollars through privatization.

In the 1993 annual programme, the PSBR/GNP ratio is targeted to be around 9 per cent. This reduction will be achieved through real increase in the public revenues and containing expenditures at 1992 levels.

Both in 1991 and 1992, the Central Bank pursued a policy of maintaining the stability of exchange rates while keeping foreign reserves at a certain level. To achieve this, the Central Bank used open market operations as the major sterilization instrument, to withdraw the excessive liquidity from the market.

In 1993, the Central Bank is more likely to continue to control the reserve money growth rather than any other monetary aggregate in order to maintain the stability in the foreign exchange markets.

Reduction in the need of public deficit financing in 1993 will enable the Central Bank to conduct monetary policy more in line with its medium term objectives.

As of the end of September 1992 foreign debt stands at a level of 56.0 billion dollars. At the same date the share of long and medium term liabilities in the foreign debt stock is 79.1 per cent, while short-term liabilities amount to 20.9 per cent.

The debt owed to multilateral institutions dropped from 24.4 per cent in 1987 to 18.1 per cent in September 1992. Due to the increased access to the capital markets the share of medium and long-term private lendings to Turkey increased from 34.1 per cent in 1987 to 41.8 per cent as of the third quarter of 1992.

The ratio of total international reserves to total external debt improved considerably. Whereas that ratio had been 13 per cent in 1987, it increased to 28.2 per cent. Also the ratio of external debt service to foreign exchange revenues dropped to 27.7 per cent in September 1992, from 32.6 per cent in 1987.

On the other hand, there is a slight increase of around 2 per cent in the level of short-term debt which is mainly due to the further liberalization of the capital movements in Turkey starting from 1990. Private and public entities have since been able to borrow in international capital markets.

When we discuss the balance of payments issue, an important development to be emphasized here is, Turkey's acceptance of the International Monetary Fund's Article VIII conditions regarding the concept of convertibility. In this context measures were taken for the removal of the restrictive

clauses in the foreign exchange régime in 1989 and 1990. That liberalization was coupled with the reforms in the financial market and liberalization of capital movements to which I have already referred. The main features of this plan also included the opening up of domestic equity market to foreign investors, enabling them to invest in this market directly. The liberalization of current and capital accounts has played an important rôle in the subsequent increases in foreign capital inflows.

Now, I would like to focus on the trade liberalization process and review the progress in this field.

Firstly, in 1990, the list of goods subject to Import Permission was abolished leading to full liberalization in this respect.

Another important step was taken also in 1990, with the abolition of the advance import guarantee deposit system which also cleared the way to the process of accepting the IMF convertibility conditions.

Turkey adopted the Harmonized System of Tariff Classification at the beginning of 1989. Accordingly, the Turkish Customs Tariff Schedule was rearranged to assure conformity with the new system, and parallel amendments were also made in the Import Régime. Here, it should be underlined that the consequent rise in the number of sub-items in the Turkish Customs Tariff has technically resulted in the increased number of items subject to Mass Housing Fund.

As we mentioned in our report, various adjustments were made in the import régime in the form of non-discriminatory measures aiming at full liberalization.

The Turkish Government introduced the new import régime at the beginning of this year which represented a very import step towards further liberalization and transparency. Turkey's obligations and commitments towards the completion of the Customs Union with the European Community as well as the agreement with EFTA members have been taken into consideration during the preparations of this system. Such measures included the abolition of taxes with equivalent effect i.e. the Stamp Duty, the Municipal Tax, and the Transport Infrastructure Tax.

Accordingly, payments to the Price Support and Stabilization Fund are terminated. So, the cost of importation into Turkey in terms of collectible charges within the scope of the new Import Régime will solely consist of the sum of Customs Duties and payments to Mass Housing Fund.

In sum. we should state that the current import régime excludes all kinds of quantitative restrictions or licensing systems.

Given that the protection rate of 12 per cent of the products bound to GATT (which correspond, only to 5 per cent of the total imports in 1991) is above the set levels, 28 per cent is at par and the rest 60 per cent is lower than the bound levels, not much remains on the agenda for the achievement of liberalization in the near future.

It should also be kept in mind that all these efforts have been exerted while the domestic economy was subject to severe exogenous and indigenous factors.

I would like to reiterate that, the Turkish Government will continue to comply with its commitments in the field of liberalization, being conscious that no nation could thrive individually in a world where the global interdependence is more important than ever.

In view of the present performance of the world trade, I would like to conclude my statement by encouraging all the countries to persist in pursuing the liberalization process through which it will be possible to contribute to the reversal of the prevailing recessionary trends in the global economy.

ANNEX II

STATEMENT BY THE FUND REPRESENTATIVE TO THE GATT BALANCE OF PAYMENTS COMMITTEE

Since the last full balance of payments consultation conducted by this Committee in 1988, the Turkish authorities have pursued steadily their program of market-oriented structural reform, including further liberalization of the exchange and trade systems and of the financial sector. The sweeping liberalization of the economy, begun in the 1980s, has contributed to an overall growth performance well above the OECD average, sustained by a buoyant export sector. The strength of the export performance, reflecting both structural reforms and a flexible exchange rate policy, in turn, induced a marked increase of investment, which has bolstered competitiveness and allowed employment to keep up with a rapidly growing labour force. The success of this strategy provided the necessary robustness to both the economy and the determination of the authorities to live through the Gulf crisis period while eschewing trade and exchange restrictions.

The solid policy stance on deregulating and opening the economy, however, was not matched by a parallel performance in macroeconomic and public sector policies, particularly with respect to the management of the state economic enterprises (SEEs). Loose monetary and fiscal policies led to a worsening of the inflation environment, with the inflation rate - as measured by the Consumer Price Index - soaring from 35 per cent in 1986 to over 70 per cent in 1992. Even so, the private saving rate rose continuously over the period, preventing the growing fiscal imbalances from spilling over into the external accounts.

During 1991, the uncertainties created by the lax macroeconomic policies were compounded by the Gulf crisis, the midyear change in Government and the subsequent parliamentary elections. Inflation expectations, already high given the absence of adjustment on the fiscal side, were fuelled further by generous wage increases, particularly in the pre-election period. Rising inflation expectations and the general climate of uncertainty brought about a decline in private fixed investment, which, in combination with a fall in agricultural production, led to a marked slowdown in GDP growth. Economic activity picked up momentum in the course of 1992, with GDP growth estimated at about 5½ per cent for the year as a whole. This performance, however, reflected mostly an expansion of consumption triggered by successive large wage settlements, while investment continued weak. Partly because of the adverse relative cyclical position of Turkey, the contribution of the external sector to growth turned slightly negative in 1992, but export performance remained buoyant, with Turkish manufactured goods gaining strength in industrial countries, a recovery of Turkey's traditional markets in the Middle East, and the development of new markets in the republics of the former Soviet Union. Also, earnings from tourism have bounced back from the war-related shock of 1990-91. The strong growth of imports, particularly of automobiles and other industrial products, sluggishness of workers' remittances from industrial countries, and the phasing-out of Gulf crisis-related transfers contributed to the re-emergence of the current account deficit, estimated at around 1 per cent of GDP in 1992. After some real appreciation at the beginning of 1992, as domestic inflation accelerated, the real exchange rate has returned to its 1990-91 level. Official foreign exchange reserves, after a sharp drop in the first quarter of 1992, increased to US$6 billion, or three months of imports.

Chronically high inflation continues to be the most serious economic problem faced by Turkey, threatening to curb an economic growth potential, that has been enhanced by years of market-oriented structural reforms. The size of the Public Sector Borrowing Requirement (PSBR) and the attendant

pressures for monetary financing are at the root of the problem. At the same time, the continuing process of currency substitution - notwithstanding the return of a positive real interest rate differential in favour of domestic assets - is likely to reinforce inflationary pressures, making fiscal consolidation all the more urgent. After some tightening in 1989-90, monetary policy was loosened anew under the pressures of a growing PSBR, while the exchange rate moved broadly in line with rising domestic inflation. This, while protecting the external balance from the effects of a deteriorating fiscal performance, has left Turkey without a firm nominal anchor.

A greater complementarity of financial and structural policies, based on a major and durable reduction of the PSBR, is required to bring down inflation permanently. To that end, there is a need to shift from year-to-year fiscal management to a clear and well-formulated medium-term program, in which the structural weaknesses of the public sector can be properly addressed, foremost among the problems of the loss-making public enterprises. Further securitization of Central Bank claims on the Treasury and tighter and binding constraints on direct monetary financing of the public sector are also necessary to strengthen monetary control, which has been complicated by the continuing process of currency substitution and by the proliferation of new financial instruments associated with financial liberalization.

So far, the inflationary environment has not interfered with the continued liberalization of the trading system. The latter was simplified at the beginning of this year, with the integration, in line with GATT principles, of most stamp duties and other import charges, including those levied by extrabudgetary funds, into custom duties. Effective protection rates have been kept broadly unchanged. Rationalization of export incentives continued with the gradual replacement of direct subsidies and tax incentives by export credit and guarantee facilities administered by the Eximbank. Such facilities have been established with several countries in the former Soviet Union. In addition, under the agreements with the European Community and EFTA, customs duties were reduced by a further 10 per cent from January 1993, bringing total reduction under the agreements to 70-80 per cent. Turkey does not maintain payment restrictions except in accordance with relevant UN resolutions.

The major and steadfast liberalization on the external side also allowed Turkey to commit to the obligations of the Fund's Article VIII, governing currency convertibility, in March 1990 and played an important rôle in sustaining inward foreign direct investment and in the resilience of the external accounts in recent years. As regards the near-term outlook, the economic weakness projected for several of Turkey's main EC trading partners is likely to hold export growth below the 12.3 per cent projected by the authorities. At the same time, with a continued rapid expansion of domestic demand, rapid import growth is likely to persist. In all, projections point to an external current account deficit of about 1½ per cent of GDP in 1993. Funding this deficit from external sources should not present major difficulties in the near-term, as long as domestic interest rates are allowed to reflect market forces. Under current policies, the current account deficit should remain broadly unchanged over the medium-term, but should decline under a program of fiscal retrenchment. In either case, it should prove possible for the authorities to move forward with trade liberalization and the reduction of effective rates of protection. Obviously, the success of a further liberalization of the trade system will require that protectionist measures applied to Turkey's exports by its trading partners be lifted in tandem.