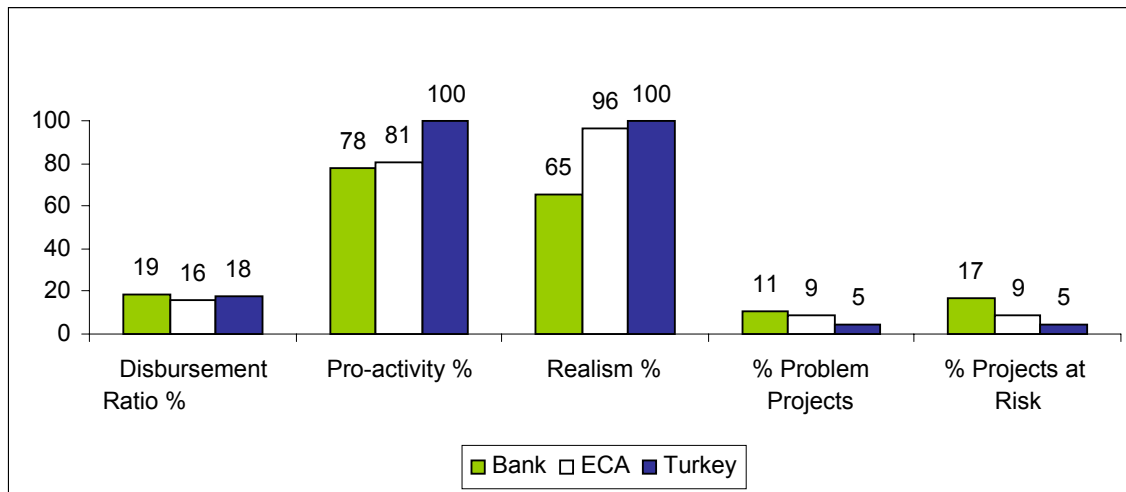


III. TURKEY-WORLD BANK GROUP PARTNERSHIP

A. Past Bank Group Assistance

53. **Turkey is the largest borrower in the Europe and Central Asia Region and it has been the third largest World Bank borrower in terms of new commitments of over US\$1.5 billion during the last three years.** The original, FY04-06 CAS envisaged a low-case scenario with a lending volume of up to US\$1.3 billion and a high-case scenario with a lending program of US\$4.5 billion. Under the CAS Progress Report at the end of 2005, an additional year was added to the program and the overall envelope was increased to US\$6.6 billion for the four-year period. The solid lending program has been supported by an active AAA program which has responded to the Government's needs for knowledge and technical assistance and included flagship reports on EU accession, labor markets, education, and significant advisory work by a panel of experts in the energy sector. A focused World Bank Institute (WBI) program, aligned with the Country Assistance Strategy (CAS), has complemented the Bank's Analytical and Advisory Activities (AAA) work. The quality of the portfolio has been good, with performance indicators which are generally in line with or better than regional and Bank-wide averages, with one area requiring sustained attention is the disbursement ratio (see chart below).

Figure 4: Turkey Portfolio Indicators vs. Bank and ECA (FY07)



54. **A strong International Finance Corporation (IFC) program contributed to the achievement of the CAS objectives.** During FY05-06, IFC has committed over US\$917 million for its own account and mobilized US\$329 million through syndicated banks, compared to US\$443 million and US\$112 respectively during FY01-FY03. During FY07 only, IFC has committed US\$551 million for its own account and mobilized US\$413 million through syndicated banks, the highest IFC financing ever in Turkey. IFC's investments have been well diversified across sectors with projects in manufacturing, the financial sector, information technology, oil and gas, health and education, and infrastructure. IFC has increasingly supported Turkish companies to become more competitive, diversify risk through increased exports and outward

investments, and to develop into regional players. During FY04-07, IFC has financed about US\$200 million with Turkish companies engaging in south-south investments, including in Bosnia and Herzegovina, Bulgaria, Egypt, Georgia and Russia.

55. **Finally, the Multilateral Investment Guarantee Agency (MIGA) has also been active in Turkey.** It has provided guarantees both for investments in Turkey and to Turkish investors investing abroad, including under the newly established Small Investment Program. MIGA has one outstanding guarantee for infrastructure projects (US\$135 million total gross exposure) and has issued guarantees to Turkish investors abroad.

56. **The expected FY04-07 CAS outcomes and WBG benchmarks have been largely achieved, as shown in Table 4 below.** A detailed assessment of CAS implementation and lessons learned is included in the attached CAS Completion Report (CAS CR).

B. Lessons Learned

57. **Three main lessons emerge from the draft CAS CR, prepared in close collaboration with the authorities, and the Independent Evaluation Group (IEG's) Country Assistance Evaluation (CAE) , covering the 1993-2004 period:**

- **The programmatic approach to development policy lending has proven useful** in light of the (longer term and institutional) nature of the reforms supported by the Development Policy Loans (DPLs) and the fact that the authorities are keen to maintain full ownership of these reforms. The program perhaps could have had fewer DPLs but larger individual loan amounts.
- **High quality analytical work has been critical for helping the policy dialogue in-country** on such key issues as education, energy and labor market reforms and for assisting the authorities to prioritize the economic agenda for Turkey's EU accession. Collaborative preparation of economic and sector work, wide and participatory dissemination and engagement with country counterparts on the findings, and workshops of international practitioners, supported by WBI, have proven particularly effective.
- **Looking ahead, ownership and flexibility will be essential for the effectiveness of the new CPS: (i) rely on the leadership** of the authorities in defining the program, while seeking to enhance civil society engagement in the consultation process; (ii) **allow increased flexibility** in terms of lending levels and instruments, content to respond to emerging priorities, and portfolio implementation; (iii) **envisage greater support for private sector development** to help create jobs and alleviate poverty; and (iv) aim at **deepening the engagement in environment protection.**

Table 4: Strategic Goals and FY04-06 CAS Framework

Turkey's Long-term Strategic Goals			
A. Transform economic and social structure	B. Raise level of health and education, improve income distribution	C. Strengthen scientific and technological capacity, enhance infrastructure	D. Protect the environment
↓ ↓			
CAS Development Themes			
a. Sound Macroeconomics and Governance	b. Equitable Human and Social Development	c. Attractive Business Climate and Knowledge	d. Strong Environmental Management and Disaster Prevention
↓ ↓			
Expected CAS Key Outcomes			
<ul style="list-style-type: none"> Stabilization of public creditworthiness indicators at sustainable levels Less volatile economic growth in the range of 5% Single digit inflation 	<ul style="list-style-type: none"> Low extreme poverty (1.8%) maintained and vulnerability reduced from 15% in 2001 to 12% in 2006 Net enrollment rate in basic education maintained at not less than 99%; girls' enrollment increased, especially in secondary education: male/female ratio improved from 1.20 to 1.15 by 2006 Child mortality reduced and maternal health improved 	<ul style="list-style-type: none"> Exports growth rate exceeds GNP growth rate FDI reaches US\$1.5 billion on average during the CAS period Stability of financial markets improved 	<ul style="list-style-type: none"> Significant convergence with EU environmental standards Disaster prevention and management system improved
<i>Achieved</i>	<i>Largely Achieved</i>	<i>Achieved</i>	<i>Partially Achieved</i>
↓ ↓			
Expected World Bank Key Benchmarks			
<ul style="list-style-type: none"> Satisfactory macroeconomic and fiscal framework consistent with the key outcomes Implementation of public sector reforms 	<ul style="list-style-type: none"> Public expenditure on health, education and social protection sustained at pre-crisis levels Implementation of (i) the CCT program to benefit over 1 million children, and (ii) at least 1,500 local initiative (LI) projects to support vulnerable people Renovation and modernization of schools Improvements in access and quality of basic health provision 	<ul style="list-style-type: none"> Increase in export capacity of enterprises Improvements in the overall investment climate, implementation of the new FDI law, establishment of an Investment Promotion Agency (IPA) Continued independence of financial markets regulatory agencies Completion of privatization of state banks; passage of new Bankruptcy Law and Commercial Code; implementation of non-bank financial institutions reform 	<ul style="list-style-type: none"> Environmental sector priorities updated in the EU context Introduction of mandatory insurance cover of private housing units; creation of a strict and enforced construction code enforcement system, and strengthening of emergency preparedness
<i>Achieved</i>	<i>Achieved</i>	<i>Largely Achieved</i>	<i>Partially Achieved</i>

C. Strategic Objectives and Results Framework of the New Country Partnership Strategy (CPS)

58. **The goal of the CPS is to help unlock Turkey’s potential for fast and sustained growth while establishing equal opportunity and allowing more citizens to share in the benefits of growth, through reforms that also facilitate Turkey’s EU accession.** This overarching goal is fully in line with the Government’s priorities as expressed in various Government programs, and in particular in the Ninth Development Plan. In order to support the achievement of this goal, the new Bank Group program will aim at contributing to the three identified pillars: improved competitiveness and employment, equitable human and social development, and efficient provision of high-quality public services, with emphasis on the reduction of regional differences. The EU accession agenda will remain a cross-cutting theme in the design and implementation of the WBG program. The track record of the authorities during the past five years and the much improved economic fundamentals bode well for the continuation of a successful program.

59. **The results framework for the CPS is shaped by Turkey’s own development goals and country indicators** (see Annex A1). The framework juxtaposes key objectives set out in Turkey’s Ninth Development Plan and the 60th government’s program and the indicative program of activities on which the WBG will collaborate with Turkey as a partner in helping achieve these objectives. Naturally, many of the objectives to which the CPS aims to contribute have a longer time horizon than the CPS and depend on other factors in addition to those to which the CPS contributes.

60. **In several areas, the sound implementation of the portfolio, rather than new activities, is expected to contribute to the achievement of key milestones.** Effective monitoring and evaluation of portfolio implementation and of the achievement of the objectives of ongoing projects and programs will therefore be critical. The Government has requested the Bank’s support in strengthening its capacity in monitoring and evaluation. The authorities and the Bank have agreed to conduct periodic joint high-level reviews of portfolio implementation and country program performance, and to focus on the outcome and impacts of projects and programs in those reviews. The reviews will build on the successful Joint Portfolio Performance Review in 2007 (see Box 2).

61. **The results framework for the CPS is adapted to the nature of the WBG engagement with Turkey, which calls for greater flexibility.** First, there is a trade-off between pre-defined outcomes and the required flexibility of WBG engagement. Turkey is an advanced MIC that is fully integrated in the global economy, and flexibility in adapting targets, milestones, policies and programs to evolving country and global conditions is essential for success. The results framework will be adjusted as the CPS program evolves and the CAS Progress Report will reflect these adjustments. Second, the CPS is a strategy of partnership where the WBG engagement represents a small share of Turkey’s public external financing, public expenditures, private sector financing and overall economic agenda. To illustrate, the International Bank for Reconstruction and

Development (IBRD) financing accounted for about 10 percent of public external financing in 2006, and the share of IBRD investment financing in total public sector investment was 2.2 percent in the same period. Consequently, the CPS program will be one of many factors that will be contributing to development results in Turkey, as such, its contributions, while being important, will be limited.

62. **Turkey's statistical system generally provides reliable and timely data for policy making.** The country subscribes to the Special Data Dissemination Standard (SDDS), and data collection and dissemination of core economic and monetary statistics are being carried out according to established international standards and methodology. TURKSTAT has been receiving significant support from Eurostat and EU member countries. The current statistical capacity allows for effective monitoring and evaluation of most development priorities, and in areas where further capacity building is needed, the Bank stands ready to collaborate with the authorities and other development partners to establish such a capacity.

Box 2: Joint Portfolio Performance Review (JPPR) Lessons Learned

Overall assessment: The JPPR confirmed the strong Government/World Bank partnership at the highest levels, and a joint determination to strengthen it further. Key issues highlighted and proposed actions are summarized as follows:

Ownership: The success of projects/programs depends on "ownership." Ownership starts with project proposals prepared by the line agencies, based on their own assessment of priorities and issues and through the participation of all stakeholders.

Simplification: Choosing the simplest possible project design is critical. This is a challenge for the line agencies, Treasury, the State Planning Organization, and the Bank alike. In this regard, the Turkish authorities' experience has been that sector-focused programs can successfully realize ultimate project objectives with a sustained impact more often than ambitious projects involving many agencies.

Flexibility: Flexibility in designing and implementing programs/projects is key. This will entail:

- Limiting linkages between investment operations and legislative reforms, with the latter preferably supported through dialogue, AAA, or development lending
- Using innovative financial and operational instruments
- Reviewing/harmonizing Government and Bank requirements (such as feasibility studies) to speed up preparation and limit bottlenecks

Capacity building: Development of institutional capacity in line agencies is an important shared goal. Full integration of project implementation by Government employees within line agencies will contribute to achieving this goal. The use of consultants in Project Implementation Units (PIUs) will ideally be minimal.

Monitoring & Evaluation (M&E): Line agencies will strive to strengthen capacity in M&E and focus on outcomes, not inputs. The Bank has M&E expertise and is ready to provide support in this regard.

Implementation arrangements: Realistic project implementation timeframes and assessment of local capacity will help reduce the need for project restructurings, extensions and amendments.

D. Overall Approach

63. **The emphasis will be on partnership with the Government to help address complex development challenges.** In doing so, the WBG will seek to mobilize the best available technical expertise, international experience, and a wide range of instruments that the Bank Group can deliver. WBG teams will work across sectors to develop integrated development solutions together with the authorities.

64. **The design and implementation of the program will be flexible and demand-driven.** In line with the Bank Group's MIC agenda, the CPS provides flexibility to respond to evolving priorities in a timely fashion, with an appropriate mix of instruments. The Government's priorities will drive the program, and the WBG's engagement will focus on finding and supporting the best development solutions through dialogue, AAA and financing. The Bank offers Turkey a full menu of AAA and financing—including free-standing and programmatic economic and sector work, just-in-time TA and advice, WBI capacity building, investment and policy lending at the project, program, sector, local, and country level, contingent financing tools (such as for catastrophic risks) and banking advisory services. IFC also expects to provide a wide variety of products and services in Turkey—including loans, equity, quasi equity, and syndicated loans. Some of IFC's long-term products such as equity and subordinated debt are not easily available from other commercial sources of financing. MIGA guarantees are available as well.

65. **Development policy lending is expected to play an important role.** The authorities expressed strong interest in DPLs to accompany and support Turkey's ongoing reform agenda, primarily because of the Bank's comparative advantage in policy advice and support linked to flexible budget financing.

66. **Reflecting the authorities' preferences, Bank investment financing under the CPS will focus on helping Turkey address complex development challenges, with a heightened emphasis on results.** The authorities expressed their interest in exploring the design of investment lending operations that link the disbursement of Bank funds directly to performance or service delivery. Such programs could play an important role in supporting reforms, for example in the social sectors. The implementation of Bank financed projects is expected to continue relying largely on the capacity of line agencies and civil servants or regular staff from independent entities (such as Halkbank and TSKB)—thus helping ensure the sustainability of project outcomes over time.

67. **A continued strong IFC engagement is planned for the next four years.** IFC will continue focusing on helping Turkey become more competitive, improve its infrastructure, improve the quality of health and education and reduce regional development inequalities. During the FY08-11 CPS period, IFC anticipates to commit US\$1.6-2.0 billion for its own account. Turkey is currently IFC's fifth largest exposure after Russia, India, China and Brazil. As of September 2007, IFC's committed portfolio totaled US\$1.6 billion.

68. **PPPs, such as in health, education, energy, and infrastructure, privatization in the energy sector, and financial sector development, including micro-finance are likely areas of IBRD-IFC complementarity in the CPS.** The Bank’s analytical work and dialogue on the investment climate aims to contribute to an improved business environment, facilitating private investments, including, but not limited to, IFC. Work on the overall PPP framework, at the request of the authorities, is being closely coordinated within the WBG. Group work on PPPs is expected to help the authorities create a solid policy and institutional framework for PPPs, while offering a comprehensive set of instruments that the authorities may want to draw on in addressing the most pressing investment needs. For the Private Sector Development Strategy: see Annex 3.

E. Areas of Engagement

69. **The envisaged WBG operational program is mapped into the three main development themes of the CPS, which reflect Turkey’s overarching development objectives and the Government’s program and action plan (see Tables 5 and 6 below).** Naturally, several activities will contribute to the achievement of more than one development objective.

a) Improved Competitiveness and Employment Opportunities

70. Under this pillar, the key objectives are to:

- Maintain macroeconomic stability and sustain economic growth
- Improve the investment climate and decrease the informality of the economy
- Increase labor market flexibility and improve skills
- Maintain soundness of the financial system, and improve access to finance
- Enhance technology adoption and innovation
- Meet Turkey’s growing demand in efficient and sustainable energy.
- Promote off-farm employment creation and increase the competitiveness of farm and off-farm sectors

71. **The backbone of this part of the WBG program will be the planned Programmatic Competitiveness and Employment Development Policy Loans (CEDPLs).** The CEDPL series supports a sustained medium-term process of legal, institutional, and structural development that promotes growth and the creation of more and better jobs in Turkey by: (i) maintaining the enabling macroeconomic framework; (ii) improving the investment climate – including a vast program of privatization of state owned enterprises, (iii) increasing labor market flexibility, (iv) enhancing access to investment capital, and (v) promoting the generation of knowledge and innovation, the adoption of new technologies, and upgrading the skills of the labor force.

Table 5: Turkey's Ninth Development Plan Shapes the World Bank Group CPS

<i>Vision: Turkey, a Country with an Information Society, Growing in Stability, Sharing More Equitably, Globally Competitive and Fully Compliant with the European Union</i>		
The Strategy of the Ninth Development Plan (2007-2013): Five Economic and Social Development Axes		World Bank Group Country Partnership Strategy (CPS): Three Pillars
<p>1) Increasing Competitiveness:</p> <ul style="list-style-type: none"> ○ Making Macroeconomic Stability Permanent ○ Improving the Business Environment ○ Reducing the Informal Economy ○ Improving the Financial System ○ Improving the Energy and Transportation Infrastructure ○ Protecting the Environment and Improving the Urban Infrastructure ○ Improving R&D and Innovation ○ Disseminating Information and Communications Technologies ○ Improving Efficiency of the Agricultural Structure ○ Ensuring the Shift to High Value-Added Production Structure in Industry and Services 	▶	<p style="text-align: center;"><u>Pillar I:</u> Improved Competitiveness and Employment Opportunities</p> <ol style="list-style-type: none"> 1. Sustained Economic Stability and Sustained Economic Growth 2. Increased Private Investment, Improved Financial Intermediation, Deeper and Broader Financial Sector 3. Increased Employment 4. Reliable and Efficient Energy Supply and Improved Transportation Infrastructure
<p>2) Increasing Employment:</p> <ul style="list-style-type: none"> ○ Improving the Labor Market ○ Increasing the Sensitivity of Education to Labor Demand ○ Developing Active Labor Policies 		
<p>3) Strengthening Human Development and Social Solidarity:</p> <ul style="list-style-type: none"> ○ Enhancing the Educational System ○ Making the Health System Effective ○ Improving Income Distribution, Social Inclusion and Fight against Poverty ○ Increasing Effectiveness of the Social Security System ○ Protecting and Improving Culture and Strengthening Social Dialogue 	▶	<p style="text-align: center;"><u>Pillar II:</u> Equitable Human and Social Development</p> <ol style="list-style-type: none"> 1. Increasing Effectiveness and Sustainability of the Social Security System 2. Health Care System has Improved Governance, Efficiency, User and Provider Satisfaction, and Long-Term Sustainability 3. Enhancing the Educational System and Increasing the Sensitivity of Education to Labor Demand
<p>4) Ensuring Regional Development:</p> <ul style="list-style-type: none"> ○ Making Regional Development Policy Effective at the Central Level ○ Ensuring Development Based on local Dynamics and Internal Potential ○ Increasing Institutional Capacity at the Local Level ○ Ensuring Development in Rural Areas 		
<p>5) Increasing Quality and Effectiveness in Public Services:</p> <ul style="list-style-type: none"> ○ Rationalizing powers and Responsibilities Between Institutions ○ Increasing Policy Making and Implementation Capacity ○ Developing Human Resources in the Public Sector ○ Ensuring the Dissemination and Effectiveness of e-Government Applications ○ Improving the Justice System ○ Making Security Services Effective 	▶	<p style="text-align: center;"><u>Pillar III:</u> Efficient Provision of High Quality Public Services</p> <ol style="list-style-type: none"> 1. Public Expenditures Rationalized and Well Structured 2. Public Sector Governance Strengthened 3. Improved Local Service Delivery and Disaster Preparedness

Table 6: Turkey—Indicative CPS Program FY 08-11

FY08 Financing		FY09 Financing		FY10/11 Financing	
Development Policy Lending in one or more of three areas:	500-800	Development Policy Lending in one or more of three areas:	600-900	Development Policy Lending in areas such as competitiveness & employment, public sector reform, human capital development & social protection, and environmental protection	1000-1400
<ul style="list-style-type: none"> • Programmatic Public Sector Development (PPDPL series) • Competitiveness and Employment (CEDPL series) • Energy 		<ul style="list-style-type: none"> • PPDPL series • Competitiveness and Employment (CEDPL series) • Energy 			
<ul style="list-style-type: none"> • Export Finance (additional credit line financing) 	300-500	<ul style="list-style-type: none"> • Private Sector Renewable Energy and Energy Efficiency (credit line) • Energy Investment Loan (incl. transmission) • Energy Supply Security Sector Investment Program (incl. generation) 	700-900	<ul style="list-style-type: none"> • SME Productivity & Competitiveness (credit line) • Energy Efficiency/ Supply Security • Railways APL II 	
<ul style="list-style-type: none"> • Municipal Services II (additional financing) 	300			<ul style="list-style-type: none"> • Municipal Infrastructure (Metropolitan Cities) • Environment & Natural Resources incl. GEF from Investment Fund for the Mediterranean Sea Large Marine Ecosystem Partnership • Irrigation SWAp • Education ^{2/} • Social Inclusion & Employment Program 	
<ul style="list-style-type: none"> • Cadastre Modernization 	200	<ul style="list-style-type: none"> • Health (UHI Implementation) ^{2/} • Health Reform and Social Security (APL Phase II) 	200-300		
Total ^{1/}	1800	Total ^{1/}	1800	Total ^{1/}	2600

Further to the specific projects and programs indicated in the table, the Turkish authorities and the World Bank have identified the following additional areas for possible World Bank financing during the CPS period: (i) natural disaster contingent/insurance or prevention investment financing; (ii) combined private-public financing of skill training and employment; (iii) road maintenance; and (iv) judicial reform.

^{1/} The CPS envisages Bank financing equivalent to new commitments up to US\$6.2 billion during FY08-11, with an expected share of around 50 percent in development policy lending (DPLs). Bank financing up to these levels—assuming Turkey's historical disbursement and amortization schedules—is projected to increase the Bank's exposure to Turkey between end-FY07 and FY11 by up to US\$4.5 billion—reflecting both the demand of the Government of Turkey for Bank financing and IBRD financial considerations. The phasing of Bank financing and the mix of DPLs and investment financing will be flexible. Thus, Bank financing may be front-loaded, back-loaded, or evenly phased, and the share of DPLs may exceed or fall short of the expected 50 percent average, in any one year and over the 4-year CPS period—depending on the economic circumstances in Turkey and the substantive content and pace of implementation of the Turkish authorities' economic reform and investment programs. The total amounts of US\$1.8 billion each in FY08 and FY09 and US\$2.6 billion during FY10-11 are indicative of the extent to which the Turkish authorities expect possible frontloading of IBRD financing during the CPS period.

^{2/} The planned health and education investment projects in FY09 and FY10 are expected to involve output/performance based disbursements to the extent possible. Their sequencing will depend on country and sector developments—either project might proceed in FY09 and the other in FY10.

Table 6 (contd.): Turkey—Indicative CPS Program FY 08-11		
FY08 Analytic and Advisory Services (completed or ongoing)	FY09 Analytic and Advisory Services	FY10-11 Analytic and Advisory Services
<ul style="list-style-type: none"> ○ CEM II ○ Policy Notes ○ CEM on selected growth issues, e.g., informality ○ Investment Climate Assessment (ICA) ○ Financial Sector Assessment follow-up ○ Youth Employment ○ Youth Policy ○ Programmatic Social Insurance Non-Lending TA (social security modeling) ○ Health Sector Integrated Fiduciary Assessment ○ Programmatic Welfare & Social Policy ○ Programmatic Energy (incl. expert panel) ○ PPP Advisory Work + TA (consultant study) ○ ESMAP-supporting electricity market ○ Istanbul Municipal Development 	<ul style="list-style-type: none"> ○ World Water Forum ○ Country Economic Work (selected issues) ○ Public Expenditure and Finance Work ○ Programmatic Welfare and Social Policy AAA (ctd.) ○ Programmatic Energy (ctd.) ○ Judicial Reform AAA 	<ul style="list-style-type: none"> ○ Country Economic Work (selected issues) ○ Programmatic Welfare and Social Policy AAA (ctd.) ○ Investment Climate Work
<ul style="list-style-type: none"> ○ Technology adoption, research and development, and innovation: FY08-09 ○ Health Sector Assessment (joint with OECD): FY08-FY09. ○ Female Labor Force Participation: FY08-FY09 ○ Education quality: beginning FY08 ○ PPP- implementation of legislation: FY08-FY09 ○ Municipal Financing & Regional Development—Selected Issues: FY08-FY09 		
		○ Natural disaster risk assessment: FY09 or FY10

72. **The CEDPL series is designed around five expected program areas in support of competitiveness and employment which will evolve and be elaborated or modified in line with country circumstances and priorities:**

- Maintenance of the macroeconomic framework which has underpinned Turkey’s recovery following the 2001 crisis as well as the ongoing sustained rapid economic growth that began in 2002.
- Improving the investment climate to foster the investment and productivity growth necessary to maintain rapid economic growth and generate enough formal sector jobs to absorb the growing supply of labor arising from Turkey’s demographics and the transformation of agriculture.
- Laying the foundation for overhauling labor market regulations so hiring formal sector workers becomes more attractive for the private sector and working in the formal sector also becomes more attractive for workers.
- Consolidating the soundness of the financial sector and increasing access to investment credit and other forms of investment capital.

- Increasing private sector capacity to innovate, adopt new technologies and quality standards, as well as a diagnosis of the policies needed for endowing the labor force with better skills to enhance the competitiveness of the private sector.

73. **The CEDPL series will be accompanied by investment operations and IFC investment financing.** Building on the successful completion of the Industrial Technology Development Project, further IBRD investment financing is being considered—to support the sustained implementation of policy reforms launched under the CEDPLs, foster innovation and technology adoption, and help address existing regional productivity, growth and employment gaps. The CPS also envisages continued long-term financing to exporters and Small and Medium Enterprises (SMEs), such as through additional credit line financing or new Bank and/or IFC operations—reflecting lessons from the recent Investment Climate Assessment and contributing to increased competitiveness. Private sector credit line financing is also being considered to help achieve objectives with public good elements, such as energy efficiency, pollution abatement, or food safety. Finally, an operation supporting the creation of job opportunities in poor rural upland communities is under consideration. IFC investments will focus on (i) local banks to broaden their reach and market penetration and to improve their financial products delivery to SMEs and microfinance, (ii) second tier Turkish companies to become more competitive through implementing modern technology to diversify risk through increased exports and to reach out to less privileged parts of the country, (iii) companies investing outside Turkey diversifying market risk and becoming competitive regional players, and (iv) rural employment generation mainly through support for the agribusiness sector like second-tier food processing companies with a potential of expanding exports.

74. **The CEDPLs and accompanying investment operations will be underpinned by substantial analytical work and dialogue.** These AAAs are expected to build on the recently completed Country Economic Memorandum (CEM) and CEM2 on sustaining rapid growth with equity, the investment climate assessment, and labor market and education studies. Issues of informality and youth and women’s employment will also be likely focus areas.

75. **The Bank Group will continue its strong partnership with Turkey to support the development of a sustainable energy sector. The CPS envisages substantial Bank Group financing in the energy sector, with private sector development playing a central role.** The emphasis on the energy sector reflects the importance of energy security and energy efficiency for the economy, as well as the priority the Government places on the energy sector and on continued substantial Bank Group engagement.

- Dialogue and analytic and advisory work will continue on achieving an efficient, sustainable and secure supply of energy to meet Turkey’s growing energy demand, as well as strengthening the financial viability of the sector, improving the functioning of the electricity market, and mitigating adverse environmental and social effects.
- Bank Group financed energy projects are under implementation in electricity generation, transmission and distribution, in the gas sector and in the area of renewable energy. New Bank Group financing is expected for investments in generation rehabilitation, energy efficiency improvements, renewable energy, and

in the electricity and gas transmission networks—through a mix of individual public and private investment projects.

- IBRD financing, in addition to individual investment projects, may be in the form of adaptable program lending, a sector-wide approach (SWAp), and possible development policy lending to support critical sector reforms.
- Privatization of distribution, further increase in private generation capacity, and privatization of existing generation (including financing environmental retrofits) could be supported through IFC investments and, depending on demand, possible IBRD partial risk and MIGA guarantees.
- Specifically, IFC intends to support the power sector demonstrating that, properly structured, private generation projects can represent feasible and financially attractive investments for foreign investors in the recently restructured and competitive power sector. Depending on the Government’s evolving priorities as well as market appetite, IFC would also consider pre-privatization support through convertible loans or equity financing—with a view to increasing the valuation of assets by providing additional comfort to potential investors. Working directly with the private sector, IFC is prepared to take long-term merchant-risk in the electricity sector in selected cases.

76. **Infrastructure, especially transport, is expected to be a priority area for IFC financing, while Bank support for the railway sector is expected to continue.** IFC will work in tandem with the Bank as a partner with Turkey in moving toward an effective mix of private and state infrastructure services, as is characteristic of efficient higher income economies. Specifically, IFC will look for opportunities to support private sector investments in ports, airports and logistics facilities. IFC plans to make a number of investments to support private sector entry into the transport sector in Turkey during the CPS period. The Bank stands ready to provide continued support for the restructuring of the railway sector to help alleviate the fiscal burden of subsidies and reduce transport logistics costs to improve competitiveness. However, any such additional Bank support hinges on sufficient progress in the creation of a proper legislative framework for the railway sector and the company, and the implementation of initial restructuring actions as envisaged under the ongoing Railways Restructuring Project. In addition, IFC will seek opportunities for financing urban transport projects on a commercial project-finance basis at the sub-sovereign level through structures acceptable to the Government in the overall context of sub-sovereign borrowing.

b) Equitable Human and Social Development

77. The CPS aims to contribute to three key country development objectives under the Equitable Human and Social Development pillar:

- Increasing the effectiveness of the social security system and making the health system more effective;
- Enhancing the educational system and increasing the sensitivity of education to labor demand; and
- Improving income distribution, social inclusion and fighting poverty.

78. Implementation of the social security reform and continued support for the Health Transformation Program will remain a key priority in the CPS period. Parametric and institutional changes in the pension system and the introduction of a fiscally sustainable universal health insurance system are expected to improve the long-term financial sustainability and equity of the social security system, and dramatically increase access to health services for the most vulnerable groups of the population. Bank support for implementation of key health services delivery and public health reforms, as well as monitoring and evaluation of these interventions, is expected to continue during the CPS period. These interventions aim to improve the cost-effectiveness of health services and make health services responsive to population needs (e.g., integration of health promotion and public health into primary health care). Implementation of the social security reforms, including health reforms, will continue to be supported in the context of development policy lending, complemented by a planned investment operation, possibly a SWAp, as a follow-up to the Health Transition Project. Continued TA in pensions, just-in-time policy notes on health sector reform (possibly including the evaluation of the impact of universal health insurance and the impact of health reforms on access to and equity, efficiency and quality of health services) and the continuation of WBI's health reform flagship program will complement lending. IFC is expected to continue to contribute to increased private sector provision of health services. Based on its previous experience in the health sector, IFC will focus on supporting: (i) companies that plan to become national healthcare service providers or expand their domestic or foreign operations; (ii) companies seeking to establish specialized centers of excellence; (iii) smaller hospitals and clinics, through a wholesale approach in cooperation with domestic banks.

79. In view of the critical importance of skills to improve competitiveness and employment, and its role in reducing inequalities, education will be an important element of the CPS. The implementation of the Secondary Education Project is expected to contribute to the achievement of the Government's strategic target of considerably increasing the net enrollment rate in secondary education and improving the quality of secondary education by updating curriculum, providing effective use of ICT and raising qualification of teachers. The Bank stands ready to provide on-demand technical assistance and advice to the Government, drawing on a significant body of recently completed analytical work, covering all levels of education. Planned new sector work will likely focus in areas such as early childhood development, equity in education, higher education financing, and vocational and technical higher education. In such sector work, the Bank plans to engage young people actively as key stakeholders. Links established through the JSDF grant for youth development and social inclusion (implemented through the Youth General Directorate in the Ministry of Labor) as well as the Youth Voices group (a group of youth supported by the Bank for three years) could be used as entries in for such engagement. Collaborative AAA, a deep engagement on the findings and conclusions of the analysis, and a broad dialogue on policy options will be particularly important in the education sector. Capacity constraints of implementation of both policies and investments, and the social sensitivities should not be underestimated. This is an area where the Bank consciously plans to take a relatively high risk because of the critical importance of education for Turkey's future.

80. The CPS envisages possible new Bank financing in education. Likely focus areas of such work include: (i) the improvement of the quality of primary education and human capital development of poor and vulnerable children, including before they start elementary school through pre-school and early childhood development; (ii) life skills and school-to-

work transition through upgrading secondary and technical education, promoting life skills and entrepreneurship amongst youth; and (iii) development of a competency-based skill-building system, based on actual demand, for new labor market entrants and today's workers, especially the poor and unemployed. Financing instruments could vary from traditional investment lending through SWAPs to a possible DPL. IFC expects to continue promoting high quality private education at the tertiary level, and it may support vocational and technical education that is better linked to the needs of the private sector. Accordingly, IFC will consider financing the establishment of private universities and the introduction of university student loans.

81. Reducing poverty and inequality and promoting social inclusion are explicit goals in the Government's Development Plan. The Bank aims to accompany the Government in this endeavor through a major, programmatic AAA—in large part jointly with Government entities. In this work, the Government and the Bank will together aspire to develop policy options on social assistance and welfare policy, but also options for sharing the benefits of economic growth, that is, for making economic growth pro-poor and equitable. An important part of this programmatic work will likely be to explore options for active employment policies and for the inclusion of vulnerable groups in the Turkish society. This analytical work could lead to the preparation of a social protection project later in the CPS period, with a focus on labor market activation and on facilitating the full participation in the labor market of disadvantaged and vulnerable groups.

Box 3: WBI in Turkey: An Integrated Multi-Year Capacity-Building Program

WBI pursues a selective approach in Turkey, focusing on four areas that complement the Bank's analytic and financing services in support of Turkey's development objectives. The **Legal and Judicial Reform program** supports the Government's strategy to improve administrative governance in the public sector. Linked to the Bank's Istanbul Seismic Risk Mitigation and Emergency Preparedness Project (ISMEP) and expected to support the Istanbul Municipal Infrastructure Project, WBI's **Disaster Risk Management (DRM)** program contributes to strengthening the capacity of universities and municipalities to use customized DRM teaching materials and formulate comprehensive policies on DRM.

The **EU Accession Leadership Support program** uses the power of peer to peer knowledge exchanges where WBI brings leaders and practitioners from other EU member countries to share their experience with designing and implementing reforms required for convergence with the EU. The **Health Reform program** has been responsible for the successful implementation of one of the components of the Bank's Health Transition Project - "Strengthening the School of Public Health." The aim is to support the school of Public Health to become a center of excellence for continuing education in health system development and advocacy.

These multi-year capacity building programs have resulted in: (i) institutions that are strengthened to implement policy reforms, (ii) better trained practitioners, (iii) a larger cadre of trainers who ensure the sustainability of the capacity building efforts in Turkey, and (iv) peer to peer knowledge sharing between leaders of Turkey and other EU member states. WBI also enabled Turkey to share its experience with developing a National Development Plan to senior Government representatives from Bosnia and Herzegovina and facilitated other South/South knowledge exchanges where Turkey shared its experience on Migration with Russia and on disaster risk management with India.

In FY09, WBI will transition to support the new areas of focus in the CPS. New programs include: (1) **Education** to support reforms in a knowledge-based economy necessary for improved employment generation; (2) **PPP** in support of knowledge transfer and hands-on technical assistance to PPP agencies to establish the enabling policy, regulatory and institutional environments required for PPP development in line with the Bank's policy dialogue; and (3) **Social Protection** and **Risk Management** capacity building aimed at increasing security, reducing vulnerability and extreme poverty for improved regional development. WBI expects to continue its Judicial Reform and Disaster Risk management programs during the CPS period.

c) Efficient Provision of High Quality Public Services

82. Under this pillar, the key objectives are to:

- Improve the effectiveness of public expenditures
- Enhance the efficiency of public expenditure management
- Strengthen public sector governance
- Reduce regional disparities
- Putting into practice the e-Government
- Improve local delivery of public services
- Strengthen environment protection, and emergency preparedness and disaster management

83. **The Bank's partnership with Turkey in support of continued public sector reforms is expected to constitute a key component of the CPS.** Bank advice and financing for public sector reform under the CPS will aim to contribute to the achievement of Turkey's objectives of strengthened public administration and governance and improved public service

delivery and social protection, with the ultimate goal of sustained economic growth. The CPS program envisages continued DPL financing under the Programmatic Public Sector Development Policy Loan (PPDPL) series. The PPDPL series supports the Government's program to (i) improve the quality of fiscal expenditures, (ii) enhance the efficiency of public expenditure management, including the public investment program (PIP) and alternative financing mechanisms for the PIP such as Public Private Partnerships; (iii) improve public sector governance, (iv) reduce regional disparities, and (v) improve the local delivery of public services. PPDPLs during the CPS period and will likely focus on:

- Support to the macroeconomic-fiscal framework that has underpinned Turkey's recovery and strong growth after the 2001 crisis, with an aim to ensure sustainability of growth and mitigate the risks arising from a complex and dynamic external environment.
- Improvement of the quality of fiscal expenditures, through reduction of the deficit of the social security system, implementation of systemic reform for long-term fiscal sustainability and administrative reform to strengthen the capacity of the social security administration, and efficiency-increasing and cost-saving measures in the health system in order to contain pressures in health expenditures.
- Support to the sustained implementation of the public financial management and control law that has underpinned the outstanding improvements in the public expenditure management system in Turkey.
- Support for improvements in the administration and governance of the public sector through actions intended to reduce regional disparities, improve local administrations and the financing structure for municipalities through Iller Bank and improve the justice system.

84. **Reform of Turkey's cadastre and the judiciary system is an important priority.** Bank financing is envisaged through investment lending for the automation of land administration to allow improved property valuation and taxation, and urban development. Possible financing support for judicial reform will be decided on the basis of analytic work planned for FY09. The AAA program underpinning and complementing lending in support of public sector reforms includes the recent PER and CEM with a special focus on public sector reform, IDF-grant supported TA and a WBI program for judicial reform, work on fiscal decentralization, and a JSDF grant to strengthen the role of Turkish civil society in local governance. The Grant is predicated on the belief that participatory decision making through greater transparency and accountability can lead to better access to and quality of locally provided public services. Additional AAA work is envisaged on regional development and fiscal decentralization, while a new PER could be undertaken in the second part of the CPS period.

85. The development of municipal infrastructure is necessary for improved competitiveness, better service delivery at the local level and environmental sustainability. The cluster of activities in this area will include further lending to metropolitan municipalities, as well as to small- and medium-sized municipalities that are financially less affluent. In the area of sub-national financing, IFC aims to support the Government in fostering increased participation of commercial lenders in municipal finance, to complement the limited pool of available concessional resources, to increase gradually access to credit for 2nd tier municipalities, and to build up local credit appraisal capacity, while contributing to the commercialization of public sector domestic banks which currently dominate the municipal finance market. The CPS also envisages further exploration of the possible use of the joint WB-IFC Sub-national Financing Facility, which provides financing to sub-sovereign public entities without sovereign guarantees and potential WBG support for PPPs. IFC will try to develop a wholesale approach to reach a wider market of creditworthy sub-national entities, in partnership with interested local financial institutions through risk sharing or other arrangements.

86. Finally, the CPS envisages continued Bank engagement in strengthening environment protection, and emergency preparedness and disaster management. Consistent with the CAE recommendations, the Bank is ready to intensify its engagement in environment protection—in a manner responsive to, and depending on, specific demand and interest by the authorities, and where complementary to assistance from other sources, especially the EC.

- Turkey has completely phased out methyl bromide ahead of the 2010 target under the ODS Phase-Out 2 Project. Building on this success, Turkey and the Bank consider launching an ODS 3 project targeting the phase-out of hydrochlorofluorocarbons (HCFCs).
- Ongoing and future planned municipal infrastructure investments are focusing on environmental improvements in water supply, wastewater and solid waste management, and operations supporting renewable energy investments.
- The CPS envisages new Bank financing in the second half of the CPS period for an environment and natural resource management project which would provide support for improved rural service delivery to poor communities in upland catchments affected by serious problems of land degradation and soil erosion. The focus of these efforts would be to scale up to the basin level some of the lessons learned from earlier investments, by coupling income generating activities with land rehabilitation efforts in remote rural areas.
- Additional sources of funding, for example from the GEF-financed Mediterranean Investment Fund, could complement these investments.
- Provided funds are available and can be allocated from the GEF 4 Replenishment, Global Environment Facility (GEF) support will be sought to assist Turkey, once it has ratified the Stockholm Convention on Persistent Organic Pollutants (POPs), to manage and reduce its toxic POPs stockpiles.

- Depending on Government demand, the Bank stands ready to offer new financing for emergency preparedness (e.g., the seismic retrofitting of buildings) and disaster management, including through innovative tools of contingent/insurance catastrophe financing for public expenditures in case of a major natural disaster. Turkey is eligible for technical assistance from the Global Facility for Disaster Reduction and Recovery for sector work and project preparation for risk mitigation investments.
- Finally, Turkey has the potential of becoming a regional leader in assisting other countries to build their disaster response and mitigation capacities as part of the South Eastern Europe Disaster Risk Reduction and Adaptation Program.

F. Working with Other Development Partners

87. **Collaboration with the IMF will continue to focus on public sector and financial sector reforms**, along with macroeconomic monitoring. The work on public sector management and governance has aimed at the strengthening of public expenditure management system while maintaining fiscal discipline. The Fund has taken the lead in the short-term measures needed for the fiscal adjustment such as incomes policy, urgent revenue and expenditure measures, and budget monitoring. The Bank has taken the lead in assisting the Government on the medium-term public expenditure management strategy, rationalization of the public investment program, public procurement reform, accounting reform, and public liability management. The collaboration has been especially strong in the area of social security reform, including the containment of health expenditures. As for the financial sector, both the Fund and the Bank have supported the strengthening of banking supervision and the privatization of public banks; a joint financial sector assessment (FSAP) has been recently completed. While it is expected that the collaboration with the Fund will continue in the area of public sector and financial sector reforms, the three-year Stand-by Arrangement of about US\$10 billion will come to an end in the spring of 2008. The nature of Turkey's future relationship with the IMF is yet to be decided by the authorities.

88. **The EU is a particularly important development partner of Turkey, because of the process of Turkey's EU membership accession and the significant volume of EU financial assistance on grant terms as well as through EIB.** The EU's Instrument of Pre-Accession Assistance (IPA) is expected to amount to EUR 2.25 billion (US\$ 3.31 billion) during 2007-2010. The EU will support (i) institution building and cross-border cooperation, (ii) regional development, (iii) human resources development, and (iv) rural development. Programming of Bank and EU assistance is coordinated on a regular basis, and strategic joint agendas include education, financial and public sector reforms, including governance. EIB has become a major source of long-term finance both for the public and private sectors, especially in transport, SME financing and energy. Co-financing opportunities are likely to emerge in municipal infrastructure, environment, seismic risk mitigation and social sectors. Continued dialogue with the Government and the EIB will be important to identify the two institutions' respective comparative advantage and areas of complementarity, including specific opportunities of co-financing.

89. **The Bank has become more fully engaged with the members of the United Nations (UN) system.** Partnership with the UN system has been particularly close in the social sectors (United Nations Children's Fund UNICEF, World Health Organization

(WHO)) and in poverty alleviation and local development/participation (United Nations Development Programme (UNDP)). The Bank has chaired and will continue to play a leading role in the UN thematic group on youth, and the Bank and UN collaborate on gender issues. Further areas of possible operational collaboration are being explored, in particular with UNDP.

90. **In addition to the European Union, UN agencies, IMF, and World Bank Group, the Islamic Development Bank and the Montreal Protocol provide significant development support to Turkey, as do a number of countries on a bilateral basis --** including France, Germany, Japan, Korea, the Netherlands, Spain, Switzerland, the United Arab Emirates, the United Kingdom, and the United States. Most such support focuses on infrastructure and on sustainable social and environmental development. Annex 2 provides an overview of major development partners' activities and support to Turkey.

Box 4: CPS – Civil Society Consultations

A consultations event with civil society representatives on the new CPS took place in Istanbul. Main observations included requests for (i) stronger financial and institutional cooperation with civil society through direct support mechanisms to NGOs; (ii) more emphasis on capacity building measures strengthening Turkish NGOs; (iii) more Bank involvement in education, labor, gender, social work, youth, migration and transparency issues; (iv) more attention to special education needs, including education programs for the handicapped, early childhood development, gender equality and entrepreneurship programs for women and skills upgrading programs for youth, (v) advocacy for an increased role of civil society in social sectors and request for consultative role for NGOs in every stage of project implementation, and (vi) creating a support mechanism to the NGO community via a project or a newly created NGO consultative body.

G. Bank Financing

91. **The CPS envisages Bank financing equivalent to new commitments up to US\$ 6.2 billion during FY08-11, with an expected share of around fifty percent development policy lending (DPLs).** Bank financing up to these levels—assuming Turkey's historical disbursement and amortization schedules—is projected to increase the Bank's exposure to Turkey between end-FY07 and end-FY11 by up to US\$4.5 billion—reflecting both the demand of the Government of Turkey for Bank financing and IBRD financial considerations.

92. **The phasing of Bank financing and the mix of DPLs and investment financing will be flexible. Thus, Bank financing may be front-loaded, back-loaded, or evenly phased, and the share of DPLs may exceed or fall short of the expected fifty percent average in any one year and over the 4-year CPS period—depending on the economic circumstances in Turkey and the substantive content and pace of implementation of the Turkish authorities' economic reform and investment programs.** Recognizing the importance of continuity and predictability, the Bank will nonetheless aim, working with the authorities, to manage Bank financing in a way consistent with a broadly even distribution of

new commitments over the CPS period.¹⁷ The two main reasons for flexibility in the instrument mix and phasing of Bank financing, reflecting the Turkish authorities' preference, are the intrinsic and persistent uncertainties and volatility in global financial markets and the rapid evolution of the Turkish economy. Such flexibility in instrument choice is also consistent with the implementation of the Bank Group's MIC Strategy.¹⁸

93. The scale of available Bank financing and its phasing over the CPS period will be regulated by the Bank's review and approval of each new loan commitment. The Bank's review will focus on the maintenance of sound macroeconomic management, financial sector stability, and progress in the three CPS development areas, namely (a) improved competitiveness and employment opportunities, (b) equitable human and social development, and (c) the efficient provision of high quality public services. Bank funds account for only a fraction of Turkey's budget and external financing, and the levels of actual Bank financing will depend substantially on other available financing, such as from the EIB, EU, and other development partners, and on the competitiveness of the Bank's financial and non-financial terms of funding.

94. Specifically, the Bank will assess Turkey's macroeconomic management and financial sector stability and performance in the three CPS development areas by considering public policy action triggering progress in the following six reform areas:

- **Continued good macroeconomic policies**, through the implementation of a satisfactory macroeconomic framework broadly in line with the scenario presented in the CPS document.
- **Continued good financial sector policies**, designed to enhance financial sector stability through improved efficiency of the financial sector, including public sector banks.
- **Improved investment climate and reduced informality** through measures such as the enactment of the new commercial code, further simplification/reform of the income tax system, and development of a strategy for combating informality.
- **Improved functioning of the labor market** including through the enactment of legislation aimed at increasing labor market flexibility and participation, especially for women and youth, reducing non-wage labor costs, and increasing the protection for workers relative to protection of jobs.
- **Implementation of sustainable and more equitable social security** through measures such as the enactment and initial implementation of a revised social security and universal health insurance law that addresses the Constitutional Court decision while maintaining the twin objectives of long-term fiscal sustainability and

¹⁷ At the outset of the CPS, the authorities envisage moderate frontloading of IBRD financing—with new commitments up to US\$1.8 billion per year on average in FY08-09, and US\$1.3 billion per year on average during FY10-11.

¹⁸ Strengthening the World Bank's engagement with IBRD partner countries (DC2006-0014), September 7, 2006 and Strengthening the World Bank's engagement with IBRD partner Countries (DC2007-0022), October 9, 2007

equitability of the social security system, continuation of targeted benefits to poor families, and adoption of a new social assistance law.

- **Improved effectiveness of public expenditures**, through measures such as the enactment of appropriate state aid legislation in conformity with EU directives, budget implementation consistent with the medium-term framework, continued implementation of the Public Financial Management and Control Law, and the adoption of a new law on the Turkish Court of Accounts.

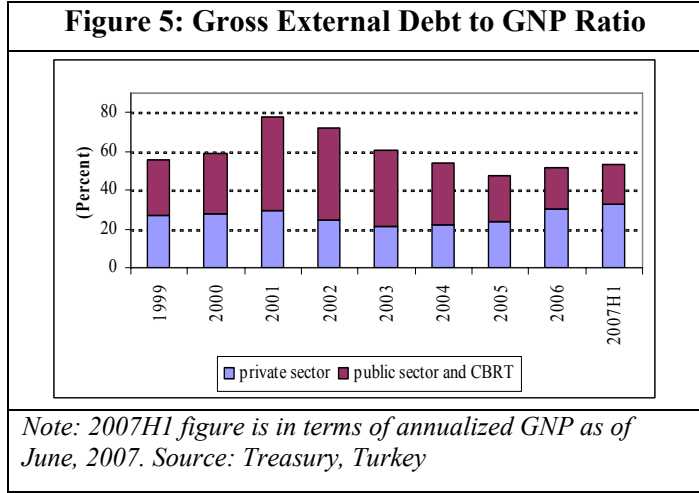
95. **High levels of Bank financing would reflect both strong overall policy performance and progress in the six reform areas—although not necessarily even progress in all areas and over time—and continuing high demand for Bank financing.** Levels of Bank financing close to or at the CPS ceiling assume, in particular, a sound macroeconomic framework commensurate with continued improvements in creditworthiness, as characterized by, *inter alia*, sustainable current account deficits, improvements in the structure of public debt, and trends in public sector and external debt ratios.

96. **The amount and phasing of development policy lending will likely be a key determinant of the level of total Bank financing in line with Turkey’s policies and reforms over the course of the CPS period.** Consistent with Bank operational policy, an appropriate macroeconomic framework is a prerequisite for development policy lending. With overall strong policies and reforms, development policy lending is expected to play a significant role as an instrument of Bank financing, and Turkey will likely make substantial progress toward the desired country outcomes in this case. By contrast, a combination of inadequate macroeconomic management, backtracking on past reforms, and prolonged periods of political uncertainty over the time horizon of the CPS, by reducing domestic and international confidence, would likely result in stagnating progress toward Turkey’s own goals of rapid growth and income convergence with the European Union. In such a scenario, Bank financing would not include development policy lending and would be managed so that exposure at the end of the CPS period would not exceed the level that would result from new commitments averaging US\$500 million per year.

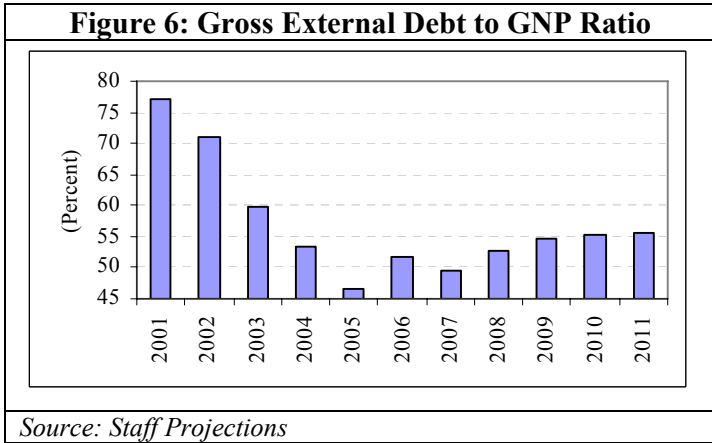
97. **CPS Progress Report in FY10.** A CPS Progress Report is envisaged to be submitted to the Board of Executive Directors in FY10.

H. External Debt Sustainability and Bank Exposure

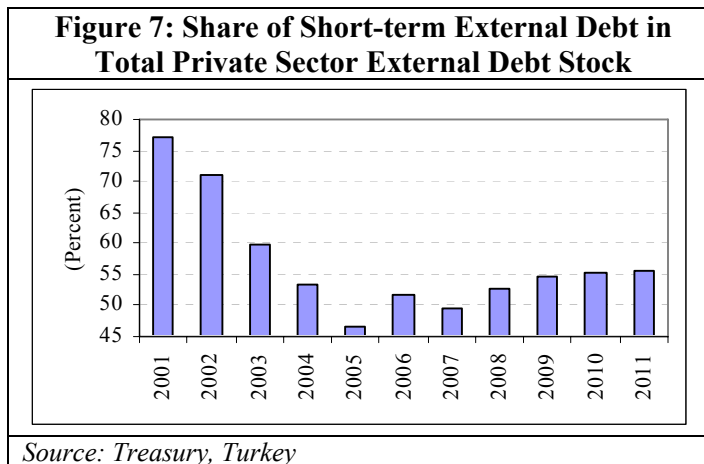
98. **The external debt to GNP ratio declined from 77 percent in 2001 to 52 percent in 2006.** After falling to 47 percent in 2005, the external debt to GNP ratio rose to 52 percent in 2006 and remained at this level in the first half of 2007, - mostly due to increased corporate sector borrowing from foreign sources. Private sector debt accounted for more than 60 percent of the total external debt stock as of June 2007, compared to less than 30 percent in end-2001 (see Figure 5).



99. **With Turkey’s current National Accounts and GDP methodology and statistics taken as a given, the external debt to GNP ratio is projected to be on an upward path in the period 2008-2011, reaching almost 56 percent in 2011** (see Figure 6). This projected path in part reflects the expected widening in the CAD in 2008 because of the evolution in domestic demand, slowing global growth, high oil prices, and the recent appreciation of the YTL. In addition, FDI flows to Turkey may be adversely affected by a slowdown in global growth and delays in the completion of privatizations in the medium-term.



100. **Similarly to recent years, private sector external borrowing is expected to be the main driver of the projected increase in Turkey’s gross external debt stock in the period 2008-2011.** By contrast, the public sector is projected to make net external debt repayments in this period. The private sector has been behind the economic expansion of recent years, and this expansion has been associated with a considerable increase in its external borrowing. On the one hand, the private sector’s reliance on external borrowing has increased its exposure to exchange rate risks. On the other hand, the surge in corporate sector’s FOREX denominated assets and increasing export revenues have partly mitigated this risk. The share of short-term private sector external debt in total private sector debt has been decreasing since 2004 – increasing its resilience to shocks (see Figure 7). In addition, the maturity of almost the entire external debt stock of the public sector was medium or long term as of June 2007.



101. **With high Bank financing, close to the CPS ceiling, Bank exposure might reach around US\$11.4 billion.** The strong Bank lending program during the past CAS period led to an increase in Turkey’s disbursed and outstanding debt (DOD) to IBRD from about US\$5.4 to close to US\$6.9 billion,¹⁹ putting Turkey among IBRD’s largest borrowers by exposure.

IV. RISKS

102. **Turkey’s economic program and its Bank Group support continues to entail non-negligible risks. Some risks can be reduced by sustained implementation of reforms and by managing Bank financing accordingly.** Other risks are outside Turkey’s and the Bank’s control. The main risks factors include: (i) political economy risks, (ii) external vulnerabilities, (iii) risk of natural disasters, and (iv) implementation risks.

103. **Political economy risks.** After a victory of the governing Justice and Development Party in the twin Parliamentary and Presidential elections in the summer of 2007, risks of political uncertainty have declined substantially. The new Government received a strong mandate to continue reforms with vigor. The recent passage of the mortgage law and the continued efforts to pursue the social security reform show the authorities’ commitment to continued reforms. The most important remaining political risks relate to the process of constitutional reform and the border tensions with Iraq. One important factor mitigating political economy risks remains the EU accession anchor which, notwithstanding the ups and downs, has been and is expected to remain a major unifying force behind political and economic reforms. As for the Bank, the main mitigating factor will be the use of

¹⁹ CY02 to CY06