

AN OVERVIEW OF THE EXTERNAL FINANCING MECHANISM OF THE TURKISH ECONOMY *

Baran TUNCER

INTRODUCTION

Turkey has been the recipient of economic assistance on a more or less continuous basis since the Marshall Plan days in the late 1940's. The bulk of this assistance was U. S. grants and credits throughout the 1950's. Financing received from European sources, however, was basically suppliers credits and multilateral sources did not contribute significantly. Due to faulty management of economic resources the Turkish Governments soon found themselves in a foreign payments squeeze which they foolhardily tried to procure by continuously resorting to suppliers credits with very unfavorable terms. A foreign exchange crisis came to a sudden head in 1958. With a number of stabilization measures and a foreign exchange devaluation, also a coordinated assistance effort was made by Turkey's donors - the United States, some Western European countries, as well as the IMF and the EPU - more in the nature of a rescue operation.

Turkey continued to receive development assistance in the 1960's at an increased level. The more significant characteristics of this era is on one hand the coordination of the use of foreign financing in Turkey with the establishment of a State Planning Organization and the implementation of the Five-Year Development Plans, and on the other hand, the coordination among the donor countries and various international organizations that extend credits to Turkey. During this decade the major contributor - the U. S. - substantially increased the volume of her credits, with the Germans becoming the second largest contributor.

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The Turkey Consortium came into existence in July, 1962, in the form of a resolution of the Council of the OECD. A working party was established to study Turkey's long-term development problems with the ultimate objective of establishing a consortium to meet Turkey's needs for development assistance. The Turkey Consortium met with nine member countries for the first time in October, 1962. Today, the following fourteen countries are members of the Consortium: Austria, Belgium, Canada, France, the Federal Republic of Germany, Italy, Luxembourg, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom, and the United States. The World Bank, the IMF and the EIB attend the Consortium meetings as observers.

AN OVERALL VIEW OF EXTERNAL FINANCING

Before going into the operation of the Consortium, it would be appropriate to pause here and explain the various sources of external financing and development assistance programs to Turkey, at present. The following list is prepared to show the mechanism of aid management and the place of the Turkey Consortium within this context. Also shown in the list are the coordinating agencies within Turkey.

<i>Type of Financing</i>	<i>Coordinating Agency(ies) in Turkey*</i>
A. Bilateral Credits	
1. Consortium Credits	Ministry of Finance, State Planning Organisation (SPO)
	Ministry of Foreign Affairs
2. Non-Consortium Credits (Russian, other Eastern Bloc countries and Japanese)	Ministry of Foreign Affairs Ministry of Finance, SPO
B. Multilateral Credits	Ministry of Finance, SPO, Central Bank of Turkey
1. International Monetary Organizations (IMF, EMA)	

* Listing of the agencies represents the order of involvement

2. Other multilateral creditors
(EPU, IDA, IBRD, IFC,
EIB)
- C. Syndicate Financing Ministry of Finance, SPO,
 Ministry of Foreign Affairs,
 1. Keban Syndicate Related agencies
 2. Bosphorus Bridge
 Syndicate
- D. Technical Assistance SPO, Ministry of Foreign
 Affairs, Ministry of Finance
- E. Foreign Private Investments SPO, Ministry of Commerce,
 Ministry of Finance

A closer examination of the types of financing reveals that despite a visible coordination, there are also some significant exceptions. Bilateral credits from Russia, other Eastern Bloc countries and Japan are outside the Consortium efforts. Also, the Keban and Bosphorus Bridge syndicates as will be shown later are unique cases. Multilateral credits are often included in the Consortium exercise but deserve separate treatment. Despite efforts to incorporate the technical assistance programs and foreign private investment activities they also are more out of the Consortium than they are in.

CONSORTIUM CREDITS

In the six years the Turkey Consortium has been in operation (1963-68), agreements have been signed for 1.774 million dollars between Turkey and her creditors. On the other hand actual disbursements were 1.448 million dollars during the same period. Some 50% of the total disbursements were in terms of program assistance and another 20% was debt relief. The remaining 30% was tied to various projects. And the majority of the assistance is tied to the country of origin. On the other hand, with some minor exceptions these credits carry a less than 4% rate of interest with over twenty years of maturity and some grace period. This latter point is of course not relevant to short-

term financing from EMA and IMF sources, resorting to which became a common practice of the Consortium in meeting Turkey's development financing requirements.

The Consortium meets three times a year in the OECD headquarters in Paris. The first meeting takes place sometime in December, during which a Turkish delegation, made up of the Ministry of Finance and SPO officials with the members of the permanent Turkish delegation to OECD, present the requirements for the coming year. Also, the Consortium Secretariat presents a report on the Turkish program which lays the groundwork for the discussion. It is not until the second meeting, which takes place one to three months later, that the pledges by the members of the Consortium are made. It has been the regular practice of the Consortium not to complete the pledging during this session. Needless to say, it would be more convenient for the Turkish officials to be assured regarding forthcoming assistance during this session, for it still takes some time to negotiate with the donors and finally sign the agreement. Nevertheless, a large number of the members do not commit themselves fully at this stage. Thus, part of the pledging is postponed regularly until the third meeting of the year which takes place in mid-summer. At this meeting the performance of the Turkish economy is also discussed at length. This practice inconveniences the utilization of the program assistance during the year it is expected to flow and denies the comfort to the Turkish administration of managing and planning the scarce foreign exchange even in the short run.

The Turkish Consortium has also employed the procedure of working groups to deal with special problems and issues. One working group, for instance, studied the problem of debt relief; another worked on the problem of project assistance in 1966.

In order to utilize the project assistance more profitably, the Turkish Government attempts to take as many projects as possible to international bidding. Then the project credits offered by a country are utilized when and if the firm that make the lowest bid for a particular project is a national of that country.

OTHER BILATERAL CREDITS

Bilateral credits from non-Consortium sources has had a more recent history and they are only in terms of project credits. Agreements were reached with the Soviet Union to build several plants, including an iron and steel complex, within Turkey amounting to 200 million dollars. These credits carry a 2.5% rate of interest and 15 years maturity. What is unique about this undertaking is the fact that Turkey will repay the whole debt with her exports - over and above what she normally sells to Russia - valued at international prices. Discussions have been going on with some other Eastern Bloc countries on similar ventures and with one exception they have not been concluded yet. On the other hand, even though Japan is a regular member of the OECD, she is not a member of the Turkey Consortium and the projects financed by the Japanese government are treated separately and bilaterally.

MULTILATERAL CREDITS

Turkey is a member of a number of multilateral institutions. Also, her being a part of the European community provides membership in various European institutions as well. The IBRD made six loan agreements with Turkey in the early 1950's but relations were severed after 1954, because World Bank officials refused to make new loans to Turkey on the ground that the Turkish economy could not support additional borrowing; nevertheless, the existing commitments continued. Another twelve years passed before the IBRD made another loan to Turkey in 1966. However, Turkey has borrowed from IDA sources since 1962. These carry very soft terms - 0.75% rate of interest, 40 years maturity, and a ten - year grace period.

Turkey was accepted in the European Economic Community as an associate member in December, 1963. The terms of the agreement envisaged a five-year preparatory period during which Turkey would receive a total of 175 million dollars credit through the European Investment Bank. Accordingly, one-fifth of this total (35 million dollars) has been made available to Turkey annually for the period December, 1964 to December, 1969. Again,

these credits have been of project type and tied. They carried a rate of interest 3.0-4.5%, 30 years maturity, including a seven-year grace period.

Credits from the EMA are basically designed for short-term financing requirements of the member countries. Nevertheless, it has been a common practice in the Consortium to resort to EMA sources to bridge the gap between Turkey's development assistance requirements and the Consortium pledges. This type of financing amounted to 200 million dollars during 1963-68 and has been used either as program assistance or debt relief. This amount is included in the total given for the Consortium as well as the contributions from the World Bank Group.

SYNDICATE FINANCING

In order to find long-term financing for some large projects a new technique called "syndicate" has been developed in recent years. Turkey has made two attempts to employ this technique; once for the Keban hydroelectric dam and the other for the bridge to be built across the Bosphorus to link Europe and Asia in Istanbul. For the Keban project two multilateral institutions - IBRD and EIB - and four governments - the U. S., Germany, France and Italy - pledged a total of 135 million dollars with the understanding that one-fourth of this total would be utilized to meet the local cost of the project. The work started on the dam site in 1966 and the construction contract has been awarded to a French-Italian company. The Keban syndicate has worked rather satisfactorily, except the Turkish government has been unable to procure the credits in full to cover the local expenditures.

Turkish Government entered into a second experience with the syndicates in 1968, when it sought foreign financing for a bridge to be built on the Bosphorus. In this second syndicate EIB, the U.K., Germany, France, Italy and Japan took part with a total pledge of 76 million dollars, again one-fourth of which will cover the local financing requirements.

TECHNICAL ASSISTANCE

Turkey receives technical assistance from multilateral institutions such as UNDP, OECD, NATO, and CENTO as well as

bilaterally from the U. S., Germany, the U. K., France and other European countries. The United Nations Development Program assistance flows through three channels: the Expanded Program of Technical Assistance provides financing for consultants and fellowships; the Special Fund support pre-investment studies and various research centers; the Regular Programs of the specialized UN agencies facilitates participation in international seminars, conferences, and symposiums. The OECD technical assistance concentrates on projects directly involved in economic development and management in industry.

The U. S. technical assistance programs have been in existence since 1950. Today they are channelled through the Agency for International Development and they cover a variety of activities in the fields of education, agriculture, industry, mining, communication, manpower, and sanitation, averaging 4 million dollars annually. Most of the technical assistance provided bilaterally from West European countries are connected with individual projects.

DOMESTIC COORDINATION OF EXTERNAL FINANCING

The listing of the agencies coordinating the external financing activities reveals that the Ministry of Finance occupies a central position. Until 1960, the Ministry of Foreign Affairs coordinated the external assistance programs of Turkey. The blame was put on the ill-preparedness of this Ministry for the poor utilization of the external resources and the responsibility was passed on to the Ministry of Finance. The functions of the General Directorate of the Treasury was enlarged and a new department, the International Economic Cooperation Agency, was organized within the same department. The Treasury department maintains a permanent delegation in Paris and in Washington, D. C. and has been represented in Bonn, London, Rome, and the NATO. The task of the Paris delegation has become more significant with the establishment of the Consortium.

There are a number of exceptions to the above. For instance, Turkey is represented in the European Economic Community by a permanent delegation in Belgium headed by an ambassador and staffed mainly from the Ministry of Foreign Affairs. The

Ministry of Foreign Affairs also took the initiative in the negotiations in the bilateral agreements with Russia and Japan.

Nevertheless, legislation was passed in early 1969 to transfer the power of representation to the Ministry of Foreign Affairs from the Ministry of Finance. Accordingly Foreign Service diplomats will head the economic missions and will carry out the foreign loan negotiations. On the other hand Ministry of Finance personnel will continue to staff these missions and will deal with the technical details.

As will be explained in the next paragraph, even though the SPO has an advisory capacity within the Turkish Administration and is charged with the Plan and Program preparation, in certain instances, it has taken the lead in aid activities and negotiations. Both in Keban and Bosphorus bridge syndicates it was the undersecretary of the SPO who carried out the negotiations while leading a team of experts from various agencies.

The external financing requirements of the Turkish economy are estimated by the SPO and presented in the Five-Year Plans and in the Annual Programs that put the Development Plan into effect. In Plan preparation both the saving gap and the trade gap of the Turkish economy are estimated and they together determine Turkey's requirements, but it is basically the foreign exchange requirements that give shape to the external financing needs in the Annual Programs.

The SPO is in a central position to allocate the investment funds within the public sector and thus knows the project financing requirements within that sector. It also estimates the program financing requirements. Thus the document presented to the Consortium each year is an SPO product, exclusively. This presentation consists of (1) total external financing requirements of the economy, (2) the expected project financing utilization both from the continuing projects and new projects, (3) a list of new projects for which foreign financing is being sought and, (4) requirements for financing the present import program.

In general, the projects of the State Economic Enterprises and various government agencies are financed with the project credits. The allocation and servicing of these credits are made through the State Investment Bank, a government-owned agency.

This Bank generally charges the borrowing agency the rates at which the government borrows. But more recently the State Investment Bank adopted a new procedure on certain projects, called two-step-procedures. In such cases the rate of interest charged to the domestic agency is somewhat higher than the cost of the credit to the government.

Again, more recently, some of the Consortium credits are allocated to the private sector through the Industrial Development Bank of Turkey, which has a private status. The so-called two-step-procedure is also applied for the credits extended through this Bank. Also the approval of the State Planning Organization is essential for the financing of those projects submitted to the Bank that are more than a certain size.

Since 1962 the SPO has been the coordinating agency for all technical assistance programs. It screens and evaluates the proposals made by different ministries according to criteria derived from the targets, capacity estimates and manpower requirements shown in the Development Plan, and Annual Programs. The execution of the approved programs are carried out by the Ministry of Foreign Affairs and the Ministry of Finance, the former being responsible for the UN, NATO, CENTO, RCD, and bilateral programs, while the latter is in charge of the OECD, AID, and IBRD programs.

AN APPRAISAL

Turkey has had a longer experience with external financing problems than most of the developing countries. Also, in more recent years with the establishment and operation of an aid consortium, and application of syndicate and other techniques, the Turkish experience should make an interesting case study in the evaluation of the assistance programs. On the other hand, after a haphazard approach to aid administration in the 1950's, Turkey made genuine efforts towards coordination and rational allocation of external resources, a fact which makes the Turkish experience all the more important.

Once a development strategy based on external financing is accepted, Turkey can be considered a successful country, on

account of her success in receiving relatively large amounts of capital on concessionary terms. No doubt not one but a host of factors played a role in this outcome; her occupying a strategically important geographical location on the world map, being a party to various European organizations, the commercial interests of some of the large Western countries are all contributing factors in aid diplomacy. Nevertheless, the coordinated efforts of the Turkish administration, especially during this decade made its impact in achieving the results.

One important aspect of the Turkish experience is the Turkey Consortium. The Turkey Consortium is similar to Indian and Pakistani Consortia in its broader appearance, but is rather different in its structure and functioning. OECD is the international body that sponsors and maintains the Consortium but it is not a member of the Consortium and is not a lending agency itself as the World Bank is in the two Consortia mentioned above. The Turks wanted a Consortium in early 1960's to secure long-term assistance for the implementation of the newly designed Development Plan. This attempt concided with a willingness on the donor's part, because this was a time when the aid programs were enjoying widespread public support. Probably more important than this in the Turkish case though was the fact that Western countries realized that unless a mutually controlled effort was made, the unhappy experience of the 1950's would be repeated and thus it would be preferable to be in control of the events and prevent Turkey from borrowing haphazardly, so long as Turkey could continue to borrow on account of her strategically privileged position and the commercial interests of the West European countries. The events of the 1950's had led to an explosive political situation and then to a military take-over of the government. OECD management was willing to support this new experience because all of Turkey's donors were members of this organization and also because in 1961 OECD had replaced OEEC and had declared development among its objectives and this was a good opportunity to prove it.

The working of the Turkey Consortium has not always been a smooth operation. Until 1965, the whole exercise was literally on the rocks. Even though Turkey had prepared a Development Plan, she did not have the necessary projects which presented a

serious bottleneck in project financing; but more serious than this was the fact that the members were not prepared to finance a long-term development plan. They often tended to put the blame on the Turkish administration for the delays and the slow operation of the Consortium. Since 1966, the Consortium operation is much smoother; nevertheless, the following points warrant comment:

a. The Consortium members continue to find it convenient to consider Turkey's external financing requirements on an annual basis. This makes long-term planning difficult, because of the uncertainties originating from a tight foreign exchange situation. The head of the World Bank Mission to Turkey in 1965 made this point very clear in a Consortium meeting. Even though Turkey reasonably expects the continuation of concessionary credits at least until the early 1970's, for the Consortium exercise to be more fruitful, members organized with a specific purpose should be in a position for some longer-term commitments, despite budgetary and legislative difficulties in their respective countries.

b. In fulfilling Turkey's external financing requirements, the Consortium made it a regular practice to resort to the short-term resources of some purely financial institutions such of the IMF and EMA. Needless to say, these sources are not suitable for development financing and create a continuous pressure on Turkey's delicate balance of payments situation.

c. Even after six years of experience, the detailed procedure of the Consortium activities continue to take several months and even with the program assistance the requirements of a given year is never fully met even if the full financing is pledged.

The notion that Consortium has not contributed significantly to Turkey's external financing is rather widespread within the Turkish bureaucracy. Some resentment prevails because from the beginning the Consortium continuously wanted to assume a critical position of Turkey's policies and assume a tutelary role in the Turkish economy. On the other hand, Turkey's donors, united, have been in control of the developments, having an easy access to the Turkish economic policy details (for instance, they learn all the details concerning the Russian credits) and main-

taining a continuous pressure on Turkey's foreign exchange position, they influence the domestic policy and also the priorities in Turkey. One factor that might contribute to this feeling is the fact that Turkey is not a member of the Consortium. On the other hand, the same Turkish circles believe that, given the interest and involvement of the various countries, Turkey could have done better without having to put up with the cumbersome procedures of the Consortium. It is also argued that an international lending institution such as the World Bank would have been much more appropriate than the OECD as the sponsoring agency. It is maintained that even though they carry a relatively higher rate of interest IBRD credits would have been more profitable in the long run, because they are not tied to any country.

Even though there are exceptions, satisfactory coordination of external financing has been accomplished within Turkey. Basically the establishment of a Planning Organization has contributed to this end. Unlike the 1950's, at present no public agency can individually enter into negotiations with any foreign financing source. Projects of all the investing institutions and the demands of various agencies are screened and evaluated by the Planning Organization and only those projects that appear in the Annual Programs compete for external financing. At times friction has arisen between the SPO and the Ministry of Finance on certain details; nevertheless a division of labor has been maintained between the two, the latter being entirely in charge of the credit negotiations and aid administration.

There are two additional points that prove to be important in the light of the Turkish experience. One of them is the necessity and importance of the availability of a list of well-prepared projects ready for financing. On a worldwide scale, as the trend for more project financing continues as against the program type of credits, the non-availability of such projects may cost time and resources. This was the Turkish experience during the earlier years of the Consortium.

The other point is the synchronization that has to be accomplished between the external and domestic financing of the projects. The domestic financing has to be assured for an effective use of external financing. As has been the case in Turkey with

some projects, unnecessary delays and cost increases may occur unless these two types of expenditures are fully synchronized.

As a last point, we should remember that no mention has been made in this paper of the external debts and the problems associated with it. At present, the Turkish economy is pressed by a relatively heavy debt burden, servicing of which runs approximately 20-30% of export earnings; a situation which very heavily influences her external financing requirements and the flexibility in aid administration.