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REENGINEERING THE TURKISH ECONOMY

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Bulent Aliriza:

I am the Director of the CSIS Turkey Project and I would like thank you all for coming and especially to thank Minister Babacan for coming. He is in Washington for the annual meeting of the International Monetary Fund and the World Bank and he was kind enough to make time in his busy schedule for CSIS.

As most of you know, CSIS has taken a very close interest in the Turkish economy and, as some of you may know, we are in the second year of our joint project with the Turkish Chambers of Commerce, TOBB, to promote closer economic relations between Turkey and the United States. Prime Minister Erdogan was here in January in that context talking specifically about direct foreign investment in Turkey and Minister Babacan accompanied him on that trip.

He is no stranger to Washington or CSIS. In fact, this is his third trip to CSIS. He first came here in January 2002, soon after the Justice and Development Party (JDP), of which he is a founding member, was formed and we met in the next room with a much smaller group.

Minister Babacan is a graduate of the Middle East Technical University. He has a Master's degree in Business Administration from the Kellogg School of Management at Northwestern University. Prior to becoming a founding member of the JDP, he worked for a financial consulting company in Chicago and as chief advisor to the mayor of Ankara. He has been the Turkish Economy Minister since November 2002.

Before proceeding to Minister Babacan's presentation, I give the floor to the CSIS President, Dr. Hamre.

Dr. John Hamre:

Thank you. I have no role here today because you are really here to hear the Minister. I stepped out of an advisory board that I am chairing for the FAA but I wanted to come down just to say, first of all, a word of welcome to you, Minister. And then just probably say something I should not say, but I can't stand it any longer. You know, we are really coming up on a very pivotal time and it is a question of how the United States and the West in general is going to face up to the kind of world that we are all predicting is in front of us and how we are going to solve it.

I have heard so much rhetoric in this town about dealing with radical Islam as well as the long-term struggle and challenge that we've got. At the same time I see the same rhetoric about why you can't let Turkey into the European Union. Well, you cannot square these two agendas. You have to decide whether we are going to put our arms around and embrace the most constructive agenda that I have seen coming out of any country trying to wrestle with the problems that we think are really at the core of the turmoil in the Middle East. It is not acceptable for us to just put the EU decision into a little narrow box and to think that this is a very technical issue about whether Turkey is ready or not.

Turkey has worked more aggressively and systematically to deal with many big problems that we wouldn't even put on the table in the U.S. They have been working through them very aggressively and quite creatively. We should not find any more excuses and say: "Well, but there are new challenges and bigger problems such as the recent discussions on the adultery law."

This is about whether we are going to embrace a country, which is going to find a way to engineer the new world that we all say we want. And I am really grateful that the Minister is here so that he could bring our attention to the fore about how big this issue is for all of us and why it is our responsibility to listen carefully. That does not mean that you do not come back and ask hard questions in response. You do that because you honor the leadership and the friendship that this country has given to the United States for the last 45 years.

But there is a lot more at stake and there is a lot more that is on the table than this very little, narrow question of whether or not Turkey is precisely ready for the EU. The real question is: are we ready to really embrace a solution we know we have to have and are we ready to embrace a country that is willing to do it?

I thank you for coming and making us a part of your program. I know you have got a lot going on in Washington right now and for you to take some time out to talk with these distinguished people who are all committed to understanding better and working these issues which are very important for us. I am glad you are here.

Minister Babacan:

Ladies and gentlemen, I am delighted to be with such a distinguished audience and I would like to mention my sincere thanks to CSIS, the Chairman and also to Mr. Bulent Aliriza for arranging this occasion.

As most of you know, Turkey has entered into a phenomenal transition and transformation era. Given the geo-strategic importance of Turkey, this transformation process has been very closely monitored by the countries in Europe and the Middle East as well as by the United States. I would like to briefly discuss this transition that Turkey is going through and also maybe leave more time for questions and answers at the end of the session.

As you know, we are a new government in Turkey, two years in power so far. However, in two years' time, we have been doing a significant amount of reforms. I must admit that the pace of reforms in such a short time was difficult to follow. Not just our economy, but also our political system and political values are going through an enormous change.

On the political side, in order to have a better functioning democratic system in Turkey, in which human rights and freedoms are fully respected, the reforms were concentrated on the main issues of democratization, the rule of law, human rights and freedom.

The economic reforms were also directed towards resolving the chronic

problems of the Turkish government. Through structural changes, the aim is to prevent these chronic problems in the long term until we have an enduring macroeconomic stability.

Even before the elections in November 2002, we were very transparent and meticulous in terms of laying out our platform with respect to what we intended to do. It was just a few months after we founded our party, we visited European capitals and we also came to Washington. We had lots of meetings in order to communicate what our party stands for and what we plan to do for Turkey.

Again, prior to the November 2002 elections, we declared our economic program in detail relating to what kind of economic policies we would like to implement and what we were going to do and what we were not going to do. When you look at what we have been doing during the two years of our government, it is exactly what it was declared before the elections. This has brought a considerable amount of predictability, which is very valuable but was missing in Turkish politics and economy, in terms of what to expect from our government.

Our political reforms have been pursued mainly within the context of the EU accession criteria. So far we have passed eight reform packages through our parliament. One-third of our constitution was amended and the critical mass in terms of the political reforms has already been surpassed.

We believe that the political criteria and the political values of the European Union are universal values. These values are not specific to any culture or any religion. We also believe that Turkey will bring diversity into the union and, with its young and dynamic population as well as its natural resources, it will be the growth engine of the union.

After the September 11 attacks, the change in our region has been inevitable. How this change is going to happen and to which direction it is going to go is of utmost importance for the rest of the world.

If we can prove that a country, which has 98 percent Muslim population with a very well functioning democratic system, could also become a full member of the European Union by sharing the democratic political criteria of the Western world, then it is going to mean a lot in terms of how the civilizations will evolve in

the future.

The clash of civilizations was broadly discussed following the September 11 attacks. We believe that when a country like Turkey becomes part of the EU, it is going to prove that it is possible to have different cultures co-existing and being centered on universal values. This is going to make a lot of difference for Europe's stability and security in the future.

The reform process in Turkey has been receiving huge public support. A strong political will together with a very strong public support were the main drivers behind this reform process. Whatever the reforms we have been doing so far, we believe in them and we own the reform process itself. We did not do these reforms just because the EU asks for them, but because we truly believe in them. Only being more and more of an open society and open economy could help Turkey.

We have been continuously conducting public opinion polls, even before we established our party back in 2001. For three, four years, we have been asking Turkish people different questions about what they think and how they feel about different issues such as the EU accession process. Nowadays, in any poll in Turkey, we see that more than 70 percent of Turkish people want Turkey to become a full member of the Union. Three, four years ago when you asked people about the reasons of why they want the EU membership, you would get answers like: "I want the EU because I want better standards of life, better income and so forth." However, recently, we are getting answers like: "I want Turkey to be a part of the EU because I want my human rights and my freedoms to be respected, or because I want a very good democratic system in my country."

These kinds of answers are becoming more and more predominant, which make us very happy because we are gladly observing that Turkish people are becoming more and more educated about what the EU values stand for.

We have finished almost everything in terms of legislation in order to fulfill the Copenhagen criteria. What is important for us at the moment is implementation, which will be the key area of focus.

We have an important date in front of us, which is December 17 when the decision about whether Turkey should be given a date to start accession

negotiations with the EU is going to be made. Before then, the EU commission report will come out on October 6, which will make a suggestion about Turkey's stance in terms of how far Turkey was able to meet the political criteria. We are quite positive since we tried to leave no excuses. What are important for us in the EU accession process are three things: being on the right track, hitting the milestones as we go along and starting the negotiations. We know that the full membership will take some time.

In terms of our economic reforms, Turkey had big and chronic economic problems, most important of all, inflation and debt stock. Before the November 2002 elections, the average inflation of the past ten years was 70 percent and, at the end of 2001, public net debt stock to GNP ratio reached to 91 percent, which is a very high figure by any measure. The interest rates for domestic borrowing before the elections were 34 percent. This is a real interest rate, not nominal.

What we did is that in order to bring down the debt stock, we have followed very tight fiscal policies and very prudent tight monetary policies. This was in a way trying to do sacrifices in the short term in order to make sure that we were going to be fine in the long term. We have been generating primary surpluses of 6.5 percent of our GNP. Even in many other developed nations, this kind of a high primary surplus is very rare. And we have generated this primary surplus two years in a row, in 2003 and 2004.

As a result of these policies our inflation came down to 18.4 percent as of end of last year. Our target was 20 percent, so we hit even below the target. Our target for this year is 12 percent but it is very likely that we are again going to hit a figure below 12 percent. Furthermore, public net debt stock to GNP ratio came down to 71 percent, as of end of 2003, and we expect this to decline further. Our interest rates for both domestic and foreign borrowing also decreased considerably. They are still high, but compared to where we came from, the reduction was quite considerable.

The external trade volume of Turkey is increasing tremendously. This year, we are expecting a total trade volume of close to \$160 billion, of which more than \$60 billion is going to be for exports and more than \$90 billion, we believe, for imports. Especially imported machinery and equipment is of big interest for us since private sector investments are up considerably and, just for the first six months of this year, more than \$20 billion of private sector investments have been

made.

Growth was another area where the Turkish economy struggled. For the ten years before the elections, the average growth rate was around 2 percent. Last year, we targeted 5 percent and we hit 5.9 percent of growth. This year, our target was another 5 percent, but it is going to be way above 5 percent. It could be a record growth figure this year and Turkey could easily be the fastest growing country in the world in 2004. We don't know the exact figures yet since it's going to be announced later but according to the leading indicators we watch, that seems to be the case.

If you ask me what is the one key element behind the success of our economic policies and if I would have to answer by just one word, it is confidence. No matter how technically perfect an economic program is and no matter how much financing is available, if there is no confidence in policies and policy implementation, if there is no confidence in the government which is going to implement this program, success is almost impossible.

We put a very high emphasis on continuity and consistency. We don't change policies overnight. We are very consistent with what we declare and what we implement. As a result this approach brought a lot of credibility to our economy overall and these will continue to be the key aspects of our policies in the future.

Presently, we are working on a new three-year economic program, covering the years of 2005, 2006 and 2007. It is going to be our pre-accession economic program, which then will be submitted to the EU authorities. The main aspects of this program will be structural reforms in various areas such as social security, taxation, financial sector and agriculture.

In terms of fiscal policies, we will have to continue to have tight fiscal policies until Turkey's public debt stock becomes no more of a concern for the business community.

Our independent central bank will continue to implement monetary policies around price stability. The number one priority of the central bank is price stability and implementation of the monetary policies with this target in mind.

Our next economic program will not be reliant on any funds that could be

coming from the EU. We will declare our economic program before December 17 at a time the EU decision will be announced. No matter what happens on the EU side, we are going to implement this program. I am not saying this because we have some doubts about the EU process but even under less likely and pessimistic scenarios, our economic program will be there and will be implemented strongly.

Turkish people have extended enormous support to our government and to what we have done so far. In the November 2002 elections, we got 34 percent of the votes. We had local elections in March this year and the support increased to 42 percent. In any poll that you look at right now, the support seems to be higher than what we got in March elections.

We are not an elitist government. We are a government, which truly represents the Turkish nation and Turkish people. When our people look at our deputies in parliament and when they look at our government, they see themselves. We do not owe anything to anyone, which makes our life very easy in terms of doing whatever necessary for our country.

Whatever we do is for the sake of Turkey's development and for making sure that Turkey becomes a country which is more and more shown as an important example of what could be achieved if there is strong political will and public support.

As I said, I do not want to take more of your time by just doing a monologue; maybe we should open the floor for questions or comments.

Thank you.

Bulent Aliriza:

Thank you very much, Mr. Minister.

Mr. Minister, the one thing you did not mention was the IMF. There has been speculation in the Turkish press about the relationship with the IMF and I noticed that when you were at the party get-together at Kizilcahamam recently there were apparently questions directed to you by the JDP members about the continuation of the relationship with the IMF.

You did not create the economic problems that existed, you inherited them, but you also inherited the relationship with the IMF and the standby agreement. You talked about continuing with a tight fiscal policy. Do you worry that in your third year - after all you are a government that wants to help the people, especially the public sector employees, who voted for you - that a continuation of the tight fiscal policy with a new agreement with the IMF may create problems for you as you try to help the people at the bottom of the economic scale?

Minister Babacan:

When we declared our economic program before the 2002 elections, we wrote very detailed policies. We were very explicit in saying that Turkey needs to generate high primary surpluses in order to make sure that debt stock comes down. When we declared these policies, we were not even meeting with the IMF officials back at that time. It was only after the elections and after we founded our government, we started interacting and negotiating with them.

And whatever we did in terms of our economic policies, we believed in it and we owned the economic reform process. In terms of what we are doing right now is that we have been working on our new economic program, a three-year program, which is prepared by our colleagues in our economic team. And once we came to a point where most of the targets and parameters as well as the main ingredients were there, it was only then we invited the IMF team to Turkey last August to have a look into our program. We told them: "Okay, this is what we intend to do and what we have developed." Their initial reaction was quite positive. They said that they thought this was the right process for Turkey and it was only after then that we went ahead and said: "We are right now ready to start official negotiations for a new standby arrangement with the Fund."

We are currently in the middle of the negotiations. I am saying negotiations because it is a technical term. In fact, it is just discussions, not negotiations since this is not take or give kind of an approach. Anything we have to do, we are going to do for Turkey and the Turkish economy. Our program will be a pre-accession program and a standby arrangement will be just designed on top of this program. As I said, the basis will be our own program.

The reason why we decided to start talking about a new standby arrangement is because we wanted an international endorsement for our economic program.

Once we have a program and once this program is approved and supported by the World Bank or by the IMF, then the credibility of the program becomes much higher than otherwise. Since program credibility is quite important, this international endorsement was the key aspect of why we sought another standby arrangement.

One important aspect of this new standby arrangement will be that when we look at the period from 1999 to 2001, Turkey had always been a net borrower from the IMF, so our debt to IMF had continuously increased and reached a peak during the middle of 2002. However, since November 2002 up until now, we have been a net debt payer to IMF and our debt to IMF has been declining since we have been paying more than what we borrowed. Our new economic program and the standby arrangement, which is going to be on top of it, is likely to have some financing in it. However, what we are going to pay back to IMF will be much more than what we are going to borrow, so that our debt stock will continue to decline significantly. Therefore, in the next three years, we would like to see our exposure with the Fund decrease significantly.

Bulent Aliriza:

With respect to social programs and helping people in economic difficulties, will the new program allow greater expenditures by the government?

Minister Babacan:

Although we have tight budget constraints, it is only a matter of political choice in terms of where to spend government money. So far, we have increased the share of our social expenditure. When you look at the total share of our social expenses in our budget, it has increased as a percentage of total budget expenditure and even as a percentage of our GNP. And it will continue to do so.

Therefore, if spent carefully and to the target, even restricted budgets can do a lot of good things. We have started lots of new social programs and, more importantly, I think the most obvious social benefit of our program has been the reflection of macroeconomic developments to the people who have lower income.

As I said before, the inflation figures in Turkey have decreased considerably; especially prices in food and clothing sectors decreased further and

inflation in these areas were even lower than average inflation, which has been around 3 to 4 percent for the first seven or eight months of this year.

In terms of unemployment figures, the unemployment rate in Turkey was 10 percent during the second quarter of 2003 and in the second quarter of 2004 the rates dropped to 9.3 percent. The number of employed people increased almost by half a million because the private sector is very active in Turkey. Once the government is very careful with its finances and spending and once the government is doing its job, then it leaves more room for the private sector to operate. Thus, we have observed a very strong crowding in effect in our economy, which means that the government is taking less and less of a share in the overall economic activity, thus leaving more room for private sector expansion.

Private sector investments, as I mentioned before, are dramatically growing in Turkey and productivity in our private sector is also increasing noticeably, which, in turn, leads to the creation of new jobs. Therefore making sure that our macro economic stability gets stronger and stronger is helping our poor people.

Unavoidably, in any economic crisis, the segment of the society, which is affected most, are those people who have low income. However, once you start coming out of those crisis periods and start having a healthier macro economic environment overall, people start to get better off.

Question:

Mr. Minister, as you know, the IMF had a generally positive and optimistic forecast for the world economy in 2005 and even more so for Turkey, but the Fund also recognized the vulnerability of the oil markets and warned about the possibility of oil shocks.

As far as I know, I think there was a 5 percent increase in the oil and gas prices in Turkey today. I am wondering what would be Turkey's buffer if such a scenario actually takes place, given that Turkey is an oil importing country with a high debt stock. Are you talking to the IMF in your negotiations about putting in certain contingencies for an oil shock within the program? Will there be any new policies introduced to keep the domestic demand in check?

Minister Babacan:

In terms of economic environments in general, the two important areas which we have to be careful about in next few years are oil prices and interest rates since it is very likely that the US Federal Reserve is going to continue to increase the interest rates. Consequently, these two areas are the areas, which we have to be very careful about and our new economic program is going to compensate for any difficulties caused by either of these issues.

I think the world is experiencing an oil shock right now. One year ago, nobody would believe the oil prices would reach \$50. This is already a difficult time for the whole world. For Turkey, being a developing country as well as an oil importing country, we have to be careful about oil prices, but it is not something that cannot be managed. If we set our program by taking into account all these externalities, then we believe that it's not going to pose any difficulties.

For example, this year's inflation target is going to be met and we are even going to hit below the target despite high oil prices. The way we did the pricing mechanism in Turkey was quite helpful in terms of absorbing the shock and helping our inflation overall.

Question:

Mr. Minister, what are your expectations about foreign investments in the next three year period?

Minister Babacan:

FDI is an area, which we are working on and we are observing very carefully portfolio investments, as long as things are looking good, are very easy to come in. However, right now we have a floating exchange rate mechanism, which kind of controls the pace of capital inflows and outflows because the floating exchange rate mechanism adjusts immediately so that the fast inflows or fast outflows are not quite easy.

For years and years, the amount of FDI inflow to Turkey has been around \$1 billion, with one exceptional year. This is a very low number compared to the GNP of Turkey and its foreign trade volume. Lack of macro economic and political stability were the two reasons why FDI did not come to Turkey.

We have also been working on micro issues. Political stability and macro economic stability are important, but micro issues are also important. And in terms of the micro issues, what we did first is that we passed a new FDI law, which makes the establishment of foreign companies in Turkey very easy. Right now, there is no longer a differentiation between foreign and domestic companies. They are treated identically.

As long as a company is incorporated in Turkey, we do not care who the shareholders are. Moreover, there are no permission or minimum capital requirements. We made it very easy to start a company in Turkey. Currently, it does not take more than one business day to start a company.

When we look at the number of foreign capital companies in Turkey, until June 2003, prior to the passage of the new FDI law, it was 6,600, a cumulative number in the history of the Republic. However, when we now look at how many new companies were founded after we passed the law, the number is 2,300. Thus, 6,600 in seventy or eighty years versus 2,300 in just over a year is an important sign that things are changing in Turkey.

Let's also look at the figures of FDI inflow to Turkey. During the first seven months of 2004, the inflow figure was \$1.8 billion. When we compare this to the first seven months of 2003, it is more than threefold. Nowadays, numerous industrial companies are coming to Turkey, as well as their CEOs, checking out what is going on by asking questions and doing inquiries. Apparently, there is lots of interest, which makes us quite hopeful about the future FDI inflow into Turkey.

In addition, there is also another important subject, which might be too technical. Because of the tax regime in Turkey, foreign capital companies prefer to receive long-term credits in Turkey rather than putting capital in their companies, so the official FDI figures reflect actually less than what is actually going on. We see some of those inflows in our long-term financing figures in the balance of payments.

Therefore, enhancing the investment environment is one of the key areas that we are currently working on. We have a new initiative called investment advisory council, composed of twenty CEOs from ten different countries and ten different sectors. These CEOs meet once a year to assess the investment environment in

Turkey and to come up with recommendations in regard to what needs to be done to improve the conditions.

The first meeting was held in March of this year and the second will be held next spring. This will be a permanent group of CEOs who advise our government about what needs to be done. We have selected those people since they already have investments in thirty or forty different countries and they know other countries very well and they also know Turkey quite well. This is going to be an ongoing study as we go along.

Bulent Aliriza:

Just to follow that one up, when the Prime Minister came here he talked about direct foreign investment and he was very much involved with this investment council back in Istanbul.

Now, as you make your projections at the macro level, the theory being that the greater direct foreign investment that you can attract, the less borrowing you will have to do abroad, have you got a figure in mind over the next three or five year? You are talking about a new program, how much FDI at the end of the three-year program do you hope will be coming to Turkey?

Minister Babacan:

We have not yet finished the exact targets and parameters of the new three-year program. We are about to finish it maybe in a month's time or so. Therefore, it is difficult for me to give exact figures right now. However, we are going to be realistic because when we look at the overall FDI flows all around the world, it is decreasing very rapidly and most of these flows are going to developed countries. Just a few years ago, it was more than \$1 trillion, but in 2003, the figure was down to \$500 billion or maybe \$500 billion plus.

When we look at developing countries, most of the flows are going into Asia, especially to China. The share of FDI inflow that Eastern Europe and our region are getting from the overall pie is unfortunately not that big. Consequently, we have to be realistic about that. In comparison to a figure like \$1 billion in a year, which occurs historically, it should not be very difficult for Turkey to attract much more significant figures in the near future.

Bulent Aliriza:

But you do not have a figure?

Minister Babacan:

I am reluctant to give one because we have not yet declared our program. Not that I do not know the draft, but because we have not officially announced it.

Question:

Mr. Minister, regarding Turkey's debt servicing, the IMF has projected 6.5 percent primary budget surplus for Turkey next year. Is this figure a magical number or, in your talks with the IMF, are you trying to persuade them to a lower figure?

Minister Babacan:

Of course, debt sustainability is a concern, but not to the IMF, it is our own concern. Whatever the primary surplus figure, we need to make sure that our debt dynamics move in a favorable direction and that kind of primary surplus be maintained. It is just about arithmetic, it is not a magic or psychological issue.

As of the end of September, we are going to look at our economic indicators as to where we are right now and what we might expect. We are also going to revise our projections. And whatever the primary surplus figure is needed for our debt sustainability, we are going to generate this primary surplus.

As I said, our talks with the IMF is not about taking or giving something, but it is about finding the best program for Turkey. Therefore, it is going to be a very high primary surplus. Nobody should expect 4 or 5 percent. It is going to be a much higher figure. After setting the high primary surplus as a political target, as I said, it is solely a matter of arithmetic.

Additionally, in terms of creating jobs, the jobs will be created by the private sector, not by the government. In order to make sure that the private sector does

create jobs, we need to have higher level of investments and more investments in Turkey. As you know, more investments are possible in an environment where interest rates are lower. In order to decrease interest rates, we need to generate high primary surpluses so that the debt stock is not something that people are concerned about. We believe that job creation works just the other way around. With high primary surpluses our private sector will create more jobs since we do not believe in creating jobs through public sector activity. We believe in private sector-oriented and private sector-led growth.

I think this whole primary surplus subject is being made too big of a concern. As I said before, it is going to be a high figure, not just because someone asks for it, but because we believe in it. We do not want our debt stock to be of concern to anyone. Thus, it is not just the Fund's or others' concern, but we are also concerned and that is how we look at this matter.

December 1 is the deadline before which we have to submit our pre-accession program to the EU authorities. The standby arrangement is going to be built on top of this. Therefore, it is difficult to give an exact deadline for the standby arrangement although we don't want to wait until December 1 and we would very much like to finish everything before that date.

Question:

On energy prices, I was wondering if you could comment on the impact of current high prices on the Turkish economy that you have already seen and also specify what oil price are you assuming in your pre-accession budget?

Minister Babacan:

The oil prices did impact Turkey in terms of the current account balance. Our current account deficit is higher than what is projected and one of the reasons why it happened like that is the high oil prices. On the other hand, it did not affect our inflation targets. In regard to oil price estimates, before finishing and wrapping up the new program, it is difficult for me to give exact figures.

Question:

According to government statistical institute official figures, 750,000

government employees are living under the poverty level. What are you planning to do for those people, helping them to a better situation and do you have any plan to correct the country's unjust income distribution?

Minister Babacan:

Per capita GNP of Turkey this year is going to be around \$4,000 and when we adjust this by personal parity, it is going to be something like \$8,000 or so. However, when we look at how this income is distributed, it is not even. There is income discrepancy in Turkey. On the other hand, when we have stronger and stronger macroeconomic stability and the right tax reforms are in place, and given that the problem of corruption in Turkey is diminishing quite fast, I believe that we will have a better income distribution in Turkey.

In terms of the poverty measures, there are lots of different standards and settings. I am not quite sure which poverty line you mentioned, but in Turkey we do not have people who are classified as seriously poor and there is no problem of hunger in Turkey. The Turkish population, in terms of the segment of the society with a very low-income, is better off than a lot of countries.

However, the income of civil servants in Turkey is not as high as we would like to see. When we look at the case that almost 40 percent of our budget expense, I should say primary budget expense, are salaries, then it becomes an important area where we have to be very careful about. If the budget targets are not met and fiscal discipline is not observed, then not only the civil servants but also the whole 70 million people will be affected adversely.

It is a matter of priorities and we put a very high priority on macroeconomic stability since, in the long term, macroeconomic stability, as well as a good tax code and reducing corruption, are the key methods of making sure that income discrepancy is diminished and income is more favorably distributed overall.

Question:

Mr. Minister, you have recently made couple of statements regarding Turkey's current accounts deficit by saying that it should not be scared of it since it could be tackled without difficulty. However, on the other hand, IMF officials have said that current accounts deficit of Turkey are very big, in fact, alarming. Could

you please comment on this?

Minister Babacan:

I do not think they have used any word like alarming but the current accounts deficit is turning out to be higher than what we projected at the beginning of this year. We projected 5 percent growth and 3 percent current accounts deficit. The growth, without mentioning the figure, is going to be very high. When we take into account this very high growth and look at the current accounts deficit, which was due to high growth, it is understandable. It is not something that came as a surprise. And when we look at everything in the big picture, not just official statistics since Turkey does have an informal economy and the official statistics do not always say everything about the economy, we have always been saying that current accounts balance is something that needs to be watched carefully. However, we are not worried about it because we do take measures if and whenever necessary.

Until now, we have been observing very carefully and have been taking measures. We are going to continue to do the same thing. That is why we are not afraid since we are the ones who take measures. It is being very closely monitored.

Question:

I just wanted to congratulate you on your program and the success of the economic program, but I wondered if you might touch briefly on the privatization process and the part it might play in driving FDI flows into Turkey.

Minister Babacan:

The strength of the political will behind our privatization efforts has never been that strong in the history of Turkey. There is a very strong political push behind the privatization efforts and we have had, from January 2004 up until now, \$1.4 billion in privatization revenues. This is cash revenue because when we do privatizations, it is sometimes cash, sometimes six months of payments and so forth. This is the amount of cash that we got so far this year.

But we had three major incidents during our privatization efforts, which were Petkim, Tupras, and state-owned tobacco business. These are big-ticket items

but three failures. We had bureaucratic and legal problems. There were major privatization efforts but these three failures, unfortunately, gave a wrong and bad perception about how we do our privatization.

This year we have been doing lots of privatizations worth around \$50 million. There was a \$300 million one but most are in the \$20, \$10, \$5 million range. The effort will be very strong. The privatization of those sectors will be tried again. Nobody, I think, questions the strength of our wish and willingness to do it. It will happen sooner or later.

Question:

What is the situation in terms of economic relations between Turkey and Iraq and how do the beheadings of the Turkish workers affect the Turkish investment in Iraq currently?

Minister Babacan:

Iraq is a close neighbor of Turkey and it has a very big potential. In 1979, the per capita income of Iraq was \$9,000 and this are in the dollars of 1979. Iraq is a country, which has the second largest oil reserves in the world. It also has big natural gas reserves. Therefore, the potential is very big.

As soon as we have a stable situation in Iraq, we believe that the progress will be significant. Throughout the war things were quite difficult but after the peak of the war, although things are still not stabilized, there has been a lot of trade between Iraq and Turkey. Approximately 3,000 trucks come in and out of Iraq every day. Turkish companies are trying to be more and more active in Iraq even though American and British companies, as expected, are getting the big contracts for the reconstruction of Iraq.

The stability of Iraq will definitely help not only the Turkish economy, but also the whole region. Once the situation in Iraq is stabilized and once the situation in Israel cools down, the economic situation in the region will be very different from how it is like right now. We believe that this region has a huge potential but stability is essential to make sure that the potential is used.

Bulent Aliriza:

Considering that Iraq was such an important component of Turkish trade in the 1980s, if it does recover, you may have to upgrade your figures, but we are certainly not at that point yet.

It was fascinating and enlightening presentation. Thank you again for coming.

Minister Babacan:

Thank you.