

June 26, 1998

## MEMORANDUM OF ECONOMIC POLICIES

### I. INTRODUCTION

1. Chronic high inflation has plagued Turkey for over two decades. Past programs designed to fight inflation have never been successfully carried through, or were subsequently reversed. Inflation imposes a heavy burden on the economy and society, worsening the inequality of incomes, exacerbating social tensions, and distorting the planning horizons of investors and savers. In consequence, the economy operates under the constant threat of instability, discouraging foreign and domestic investment. Even worse, the chronic weakness in the public finances, resulting from an inflation-eroded tax base, has limited spending on basic education, health, and infrastructure.
2. Large budget deficits lie at the heart of the inflation process. The financing of these deficits has accelerated money growth, as well as imposing high real interest rates. The pressure of government borrowing, in turn, has locked in inflation expectations and projected them forward in the form of high interest rates. Basing increases in public sector wages and agricultural support prices on past inflation has contributed to inflation inertia. The policy of safeguarding the real exchange rate and expanding the money supply in line with expected inflation further reinforces the process. Changing this entrenched pattern of behavior requires concerted action on many fronts.
3. Since taking office, the government has applied measures to rebalance the economy and reduce inflation, and has devised a three-year program that is designed to bring down inflation on a lasting basis. With the announcement of the 1998 program, and in light of the first and second quarter results, we are confident that the program is operating as designed. The autonomy of the central bank is fully respected. The Treasury has ceased to borrow from the central bank, and the central bank, Treasury, and the Ministry of Finance have published their respective quarterly program targets. To date, all targets have been met and in some cases surpassed. Support for the program from the private sector and the labor and employers' unions continues, with an ongoing dialogue maintained at all times. The government is strongly committed to ensuring transparency and adhering to market policies.