

Report No. 41611-TR

TURKEY

INVESTMENT CLIMATE ASSESSMENT

(In Two Volumes) Volume I: Overview of Findings and Recommendations

November 8, 2007

Finance and Private Sector Development Department
Europe and Central Asia Region



tepav
Economic Policy Research Foundation of Turkey

Turkey

Investment Climate Assessment

(In Two Volumes) Volume I:
Overview of Findings and Recommendations

November 8, 2007

Finance and Private Sector Development Department
Europe and Central Asia Region



Document of the World Bank



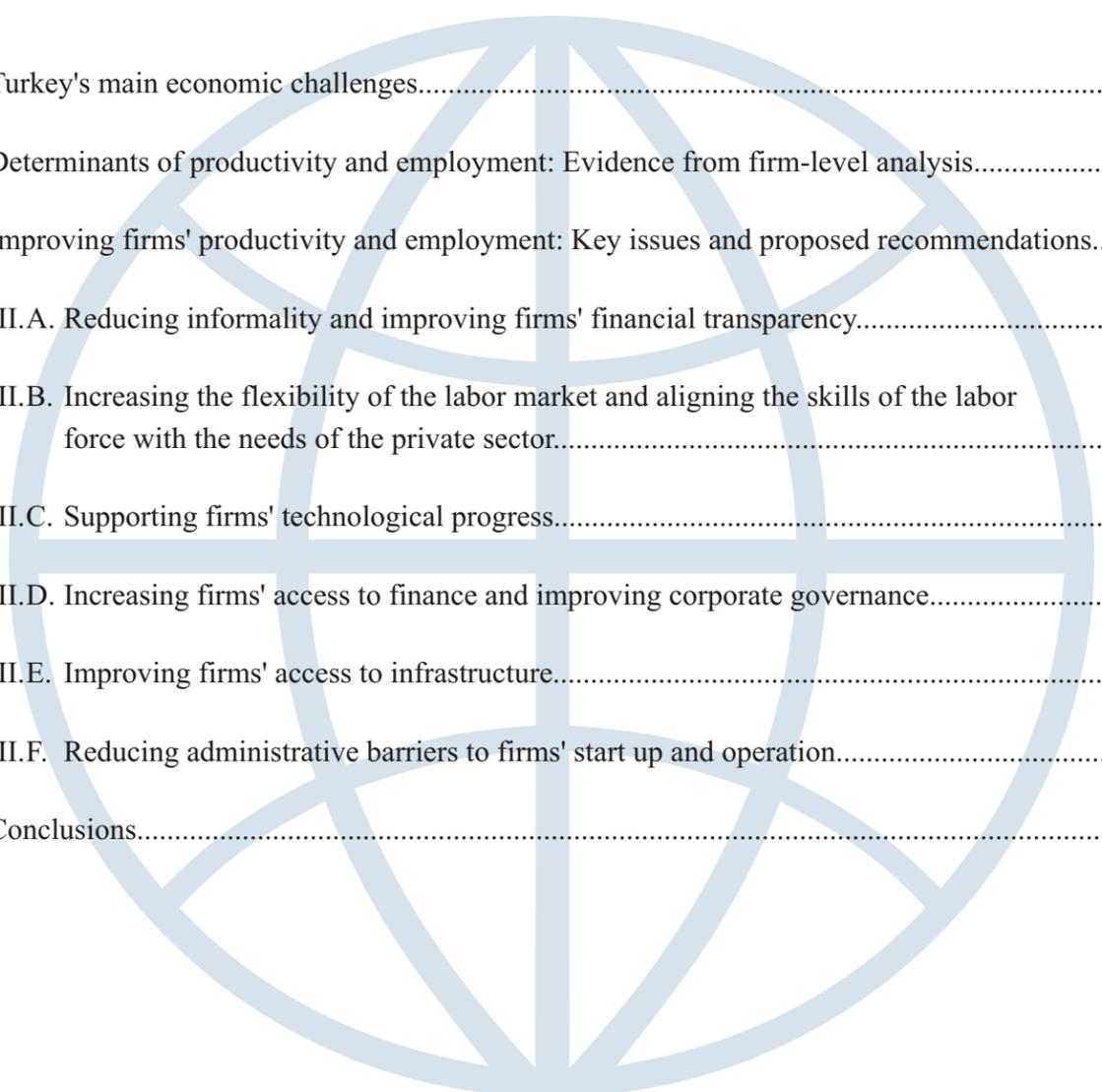
CURRENCY EQUIVALENTS
(Exchange rate effective October 6, 2006)
Currency Unit: New Turkish Lira
US\$1 = 1.4955

GOVERNMENT FISCAL YEAR
January 1 - December 31

WEIGHTS AND MEASURES
Metric System

Vice President: Shigeo Katsu
Country Director: Andrew Vorkink; Ulrich Zachau (from Jan. 15, 2007)
Sector Director: Fernando Montes-Negret
Sector Manager: Gerardo Corrochano
Lead Economist: Rodrigo Chaves
Task Manager: Marialisa Motta

Table of Contents



I. Turkey's main economic challenges.....	1
II. Determinants of productivity and employment: Evidence from firm-level analysis.....	3
III. Improving firms' productivity and employment: Key issues and proposed recommendations.....	6
III.A. Reducing informality and improving firms' financial transparency.....	6
III.B. Increasing the flexibility of the labor market and aligning the skills of the labor force with the needs of the private sector.....	7
III.C. Supporting firms' technological progress.....	9
III.D. Increasing firms' access to finance and improving corporate governance.....	12
III.E. Improving firms' access to infrastructure.....	14
III.F. Reducing administrative barriers to firms' start up and operation.....	15
IV. Conclusions.....	17



ACKNOWLEDGEMENTS

The Turkey Investment Climate report was prepared by a World Bank Team in collaboration with the Economic Policy Research Foundation of Turkey (TEPAV). The World Bank team was led by Marialisa Motta and composed of Gokhan Akinci (FIAS), Mehmet Can Atacik, Michel Audige, Eric Bartelsman, Gordon Betcherman, Steen Byskov, Rodrigo Chaves, Daniel Chodos, Alvaro Escribano, Vinod Goel, Shweta Jain, Natasha Kapil, Arvo Kuddo, Aarre Laakso, Ranjit Lamech, Martha Lawrence, Gareth Locksley, Smita Kuriakose, Maureen McLaughlin, Emanuel Salinas Muñoz, Jorge Pena, Jean-Louis Racine, Susan Rutledge, Isabel Sánchez García, Jose Luis Guasch, Naomi Halewood, Stefano Scarpetta, Sameer Shukla, Gaetane Tracz and Sumter Lee Travers. The TEPAV team was led by Guven Sak and composed of Ozan Acar, Burcu Afyonoglu, Esen Caglar, Can Cetin, Emre Deliveli, Sarp Kalkan, Savas Kus, Onur Mumcu, Haki Pamuk, Ussal Şahbaz and Bengisu Vural. Cara Zappala, Fatiha Amar and Cristina Velazco-Weiss provided outstanding document and production support.

At various stages, the team received invaluable guidance from Marie-Helene Bricknell, Gerardo Corrochano, Michael Edwards, Andras Horvai, Roberta Gatti, Fernando Montes-Negret, Axel Peuker and Andrew Vorkink. The investment climate survey was designed by an Investment Climate Department team composed by Jorge Rodríguez-Meza and Mehnaz Safavian with inputs from FIAS and was implemented by a private firm under the supervision of the World Bank and TEPAV.

The report benefitted from background papers and notes prepared by Manuel Albaladejo, Melsa Ararat, Daniel Chodos, Alvaro Escribano, Jose Luis Guasch, Korkut Özkorkut, Daniel Lederman, Ira Lieberman, Margaret Miller, Jorge Pena, and the Center for the Economic Analysis of Law (CEAL). The report was prepared under the general supervision of Andrew Vorkink, Country Director for Turkey until November of 2007; Ulrich Zachau, Country Director for Turkey starting in January of 2007; and Fernando Montes-Negret, Director of the Finance and Private Sector Development Department of the European and Central Asia Region.

Peer reviewers are Luis Serven (DECRG, World Bank), Marc Dutz (SASFP, World Bank), Andrew Stone (MNSIF, World Bank) and Carl Dahlman (Georgetown University).

The World Bank and TEPAV team would like to thank the Turkish Treasury and SPO for the excellent comments submitted on the first draft of the report and for a fruitful discussion on the findings of the study held in Ankara in March 2007.



FOREWARD

Turkey's economic recovery following the 2001 crisis has been remarkable, and the sound macro policies and sectoral and structural reforms supporting the recovery have been laudable. The surge in FDI to almost 20 billion US\$ in 2006 is a testament to foreign investors' confidence in Turkey's commitment to continuing the economic reform process. However, it is also quite striking to see that in spite of very rapid GDP growth (2002-2006), unemployment remains stubbornly high (at around 10%) and that in a longer term perspective Turkey's per capita income has remained at 25 percent of that of the EU-15 since 1975. The lack of convergence reflects the lower productivity and the lower employment frequency of working age people.

Increasing productivity and employment is already a priority for Turkish authorities, who, accordingly, have implemented important measures over the last three years. This report, prepared by the Financial and Private Sector Development of the Europe and Central Asia Region of the World Bank with collaboration from TEPAV, offers a diagnosis aiming to pinpoint areas of micro-economic reforms to affect firms' productivity and growth, and thereby employment generation. The fundamental causes of per capita income stagnation relative to the EU-15 and other emerging markets are documented as reported by Turkish private sector companies. The report provides a menu of policy interventions that, if implemented, would over time significantly improve private sector productivity and employment.

There are three aspects of the Turkey Investment Climate Assessment (ICA) which differentiates it from others. First, out of the more than 45 ICAs implemented thus far, the Turkey ICA is one of the only three ICAs that have been jointly funded by the Bank and a local partner. We are particularly appreciative of the collaboration which speaks to the strong relations between the Turkish authorities, World Bank and TEPAV as well as other local institutions striving to improve Turkey's business environment. Second, this collaboration has allowed us to take a more comprehensive approach to analyzing the investment climate, covering a wider range of topics. Third, the Turkey ICA made extensive use of complementary sources (National Statistics Institute, International Financial Statistics, OECD surveys, statistics from EU and US patent bureaus, ILO and other UN Agency databases among others) which allowed us to triangulate the findings and fine-tune the recommendations.

All of this has led to set of recommendations and policy options that are backed by sound economic theory and econometric analysis, in addition to rich complementary evidence. We hope that its findings will be useful for the authorities and the Turkish private sector in their joint efforts to continue to improve Turkey's investment climate and contribute to raising the living standards of its citizens.

Fernando Montes-Negret
Director
Financial and Private Sector Development
Europe and Central Asia Vice-Presidency
World Bank



TURKEY INVESTMENT CLIMATE ASSESSMENT:

ABSTRACT

1. Turkey needs to increase productivity and employment to reach EU income levels and ensure continued political support for reforms. Turkey's per capita income has remained at 25 percent of that of the EU-15 since 1975. One important reason why Turkey has remained poorer than countries that are converging quickly with the EU-15 (such as Korea, Chile and Malaysia) is that the private sector is comparatively less productive and employs a lower share of working age people. Labor productivity is responsible for 80 percent of the income per capita gap between Turkey and the EU-15. Despite recent economic growth, employment in Turkey remains low - at 46 percent, it is far from the EU average of 64 percent and the Lisbon target of 70 percent. Increasing employment is essential not only to reduce Turkey's income gap with the EU and other emerging economies, but also to sustain political support for future reforms.

2. The Investment Climate Assessment (ICA) provides recommendations for promoting productivity and employment growth at the firm level. Increasing productivity and employment is a priority for Turkish authorities, who, accordingly, have implemented important measures over the last three years. The ICA documents the fundamental causes of per capita income stagnation relative to the EU-15 and other emerging markets, as reported by Turkish private sector companies. It also provides a menu of policy interventions that, if implemented, would significantly improve private sector productivity and employment.

3. The four top recommendations to improve Turkish firms' productivity and employment are: reducing informality; increasing the flexibility of the labor market; improving the skills of the labor force; and facilitating firms' technological progress. Increasing access to finance and improving the quality of infrastructure are also needed, while reducing red tape is a low cost complementary measure that could be pursued in the short term. The study finds that constraints on incumbent firms inhibit productivity and employment far more than those on potential entrants and incumbents exiting the market. Recommended measures to improve firms' growth are:

- First, reduce informality. The recent reduction of the corporate tax rate (from 30 to 20 percent) is expected to decrease informality. Reducing labor taxes, strengthening tax enforcement, and increasing firms' financial transparency – by improving accounting and auditing practices - are important measures to be pursued in the future.



- Second, increase the flexibility of the labor market with measures that protect workers instead of protecting jobs, such as extending unemployment insurance coverage, easing restrictive employment protection rules, and reducing payroll taxes and other labor-related costs.
- Third, align the skills of the labor force with the needs of the private sector by improving quality of education at all levels and increasing firm – provided training – including exploring the scope for private sector contributions to vocational education.
- Fourth, support firms' technological progress by improving the policy framework for innovation, increasing R&D commercialization, restructuring innovation programs, increasing firms' use of the Internet, and quality standards.
- Fifth, increase firms' access to finance by improving the movable collateral regime, firms' credit information, and, for larger listed firms, corporate governance practices.
- Sixth, improve firms' access to infrastructure by reforming the energy sector, improving the efficiency of customs administration, and improving road maintenance.

4. Complementary reforms include reducing administrative barriers to firms' entry, operation, and exit. Reforms that could be pursued at low cost and implemented in the short term include:

- Reduce registration costs by aligning registration fees with administrative costs of the public agencies that provide the services.
- Reduce the number of licenses required for operating a firm after registering, as well as the long times and high costs to obtain them, by reducing the number of agencies involved with licenses and replacing licenses with targeted inspections.
- Reduce the duration of bankruptcy proceedings and increasing recovery rates by revising bankruptcy legislation and streamlining procedures.

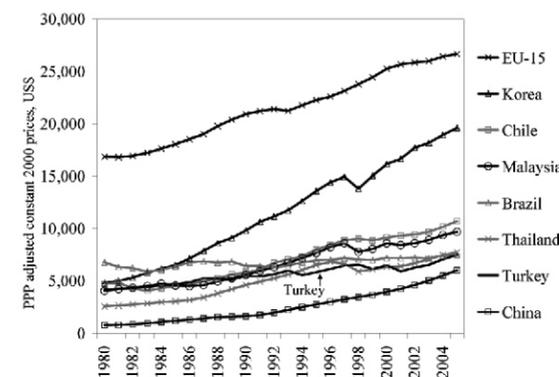
**TURKEY INVESTMENT CLIMATE ASSESSMENT:
OVERVIEW OF FINDINGS AND RECOMMENDATIONS**

I. TURKEY'S MAIN ECONOMIC CHALLENGES

1. The Turkish economy has grown at a healthy pace since the country emerged from the 2001 financial crisis, driven by the private sector and supported by a stable macroeconomic policy framework. GDP grew by 7 percent per year on average during 2002 - 2006, driven almost entirely by the private sector. The initial growth was partly the result of a rebound, but GDP exceeded the pre-crisis level by 2003 and continued growing briskly. Optimism in the business sector led to expansion of the capital stock, and private fixed investments grew on average 24 percent annually between 2002 and 2006. These investments helped firms expand capacity and improve labor productivity. While macroeconomic risks remain, the Government has maintained a stable framework, based on sound fiscal and monetary policies, that has supported recent growth.

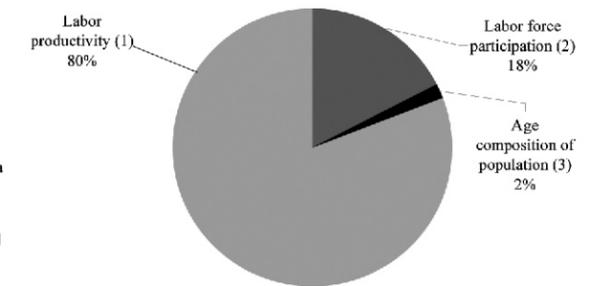
2. Turkey's overarching task for the near future is reducing its income per capita gap with EU countries and other emerging markets. Turkey's per capita GDP has grown rapidly in recent years. Over the longer term, however, Turkey's per capita GDP has been converging very slowly with those of the European countries and other emerging markets. Several countries - including Chile, Malaysia and Korea - had income per capita levels that were about the same as (or lower than) Turkey's in the 1980s, but have grown much faster than Turkey since then (Figure 1).

Figure 1: GDP per capita, international comparison



Source: WDI

Figure 2: Decomposition of the GDP per capita gap between Turkey and the EU-15, 2004



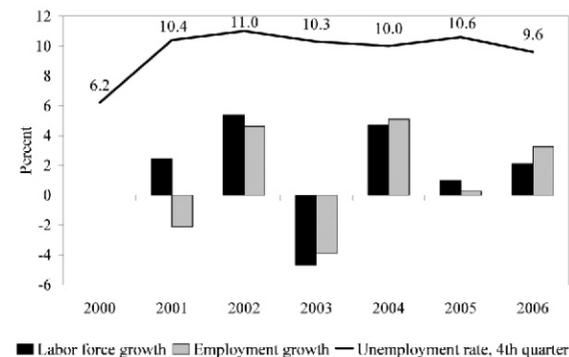
(1) GDP, purchasing power parity adjusted at constant 2000 international \$ / labor force.
(2) Labor force / population aged 15 to 64.
(3) Population aged 15-64 / total population.

Source: WDI and staff calculations

3. Convergence of Turkey's income per capita with that of EU countries requires - first and foremost - increasing labor productivity. *Labor productivity* accounts for 80 percent of the per capita income gap between Turkey and the EU-15 (Figure 2). Increasing it requires increasing *capital per laborer* (investments in physical assets such as machinery, infrastructure and buildings) and *total factor productivity or TFP* (the residual contribution from factors like technology adoption and improved labor skills).

4. Increasing labor force participation and employment is also essential to ensure convergence and political support for future reforms. Although employment contributes less than labor productivity to the income per capita gap, increasing it is essential, not only to support economic growth, but also to fulfill social expectations and sustain political support for reforms. In 2005, the employment rate was 46 percent - far from the EU average of 64 percent and the Lisbon target of 70 percent - and had not increased despite four years of economic expansion (Figure 3)¹. A rapidly growing labor force, low labor force participation, particularly among women, and migration from the agricultural sector contribute to high unemployment.

Figure 3: Labor supply and demand



Source: Turkstat through CBRT.

5. The Government has recently implemented important measures to increase productivity and employment and has put these objectives at the core of its strategy. In recent years, the Government has undertaken several actions to increase productivity and employment, including unprecedented privatization efforts in 2005 and 2006 generating revenues exceeding US\$17 billion, a reform of the banking sector to increase stability and firms' access to credit, and reduction of administrative barriers to facilitate firms' entry and operation. The Government's strategy is summarized

¹ This rate applies to the population 15-64 years of age (OECD 2006).

in the Ninth Development Plan for 2007 - 2013, which prioritizes competitiveness and employment. The competitiveness axis includes actions aimed at achieving permanent macroeconomic stability, improving the business environment, decreasing informality, and promoting productive R&D and innovation. The employment axis includes actions aimed at improving the performance of labor markets, balancing job security and flexibility, and increasing the alignment of the education system with the skills required by the market.

6. The Turkey Investment Climate Assessment (ICA) informs the Government's reform agenda by providing firm-level evidence on bottlenecks limiting labor productivity and employment as well as recommendations to reduce them. The main objectives of the Turkey Investment Climate Study (ICA) are to: (a) analyze constraints on productivity and employment using manufacturing firm-level data collected by the Turkish Statistical Institute and through an ad hoc survey of Turkish manufacturing firms; (b) provide recommendations, which can help shape the Government's growth reform agenda, on ways to reduce these constraints and (c) stimulate a dialogue between the public and the private sector on key areas for reform.

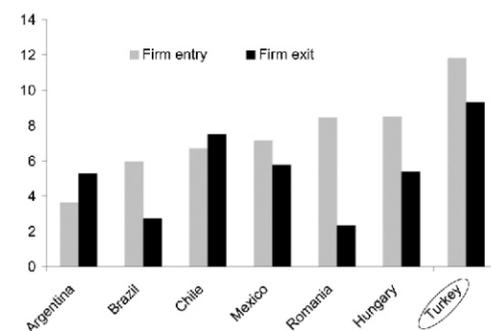
7. This Overview summarizes key findings of the study, which are then discussed in detail in Volume II. The Overview is organized as follows: Section II summarizes the findings of the firm-level analysis with a focus on: (a) the entry, growth and exit patterns of Turkish firms and their implications for productivity and employment, and (b) the effects of critical business environment and firm-level factors on productivity and employment. Section III analyzes Turkey's performance on the factors identified in Section II in more detail and provides policy recommendations. The matrices in Annex B summarize key issues and recommendations. Volume II includes a more detailed analysis of each aspect discussed in this Overview.

II. DETERMINANTS OF PRODUCTIVITY AND EMPLOYMENT: EVIDENCE FROM FIRM-LEVEL ANALYSIS

8. Firms' entry and exit and market selection are quite active in Turkey. Compared to other countries², Turkey has very high firm entry and exit rates (Figure 4). Market selection is also harsh (Figure 5), with about 40 percent of entering firms failing within the first two years and only half surviving after four years, versus 60 percent and 70 percent in Chile and Hungary, for example. This indicates that barriers to entry and exit are not insurmountable in Turkey, and that entrepreneurship thrives, although

² The analysis is based on data from the Turkish Statistical Institute (Turkstat), drawn from annual surveys of all Turkish manufacturing firms with more than 10 employees conducted between 1996 and 2001. It is representative of the whole population of manufacturing firms in Turkey. The data sources for comparator countries are National Statistical Institutes, business registers, social security databases and corporate tax registers. Additional information on the data is provided in Volume II and in the background paper by E. Bartelsman and S. Scarpetta (2006), prepared for the Turkey Investment Climate Study.

Figure 4: Entry and exit rates, percentage values, firms with more than 10 employees, 1990s.

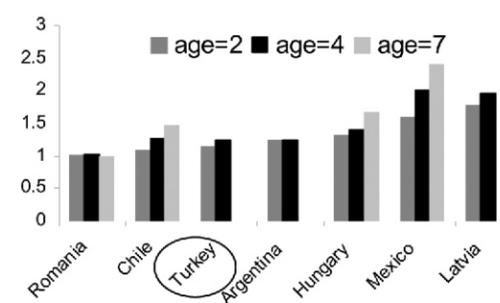


Entry rate = number of new firms divided by the total number of incumbent and entrants in a given year; *Exit rate* = number of firms exiting the market in a given year divided by the number of incumbents in the previous year.

Source: Bartelsman et al. (2005) and Turkstat.

9. Despite high turnover rates, Turkish firms do not grow as much as firms in comparator countries. Successful entrants – Turkish firms that enter the market and survive – do not grow as much as firms in comparator countries (Figure 6). While surviving firms in Mexico increase employment by 30 percent on average between the 2nd and 4th year of operation, Turkish firms increase employment by less than 10 percent. This indicates that Turkish firms face constraints on growth.

Figure 6: Employment growth of surviving firms

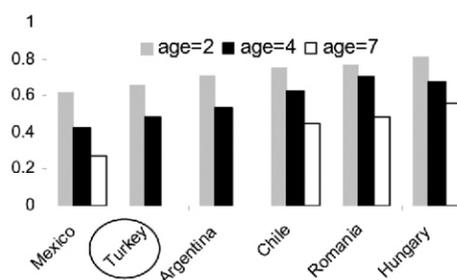


Number of employees after 2, 4 and 7 years compared to number of employees at entry.

Reference years: 1990s.

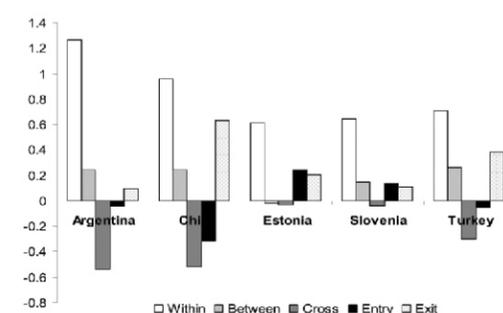
Source: Bartelsman et al. (2005) and Turkstat.

Figure 5: Proportion of firms from a cohort of entrants that still exist at a given age, 1990s.



Source: Bartelsman et al. (2005) and Turkstat.

Figure 7: Labor productivity decomposition



Within effect: productivity growth within each firm; *Between effect*: productivity growth driven by reallocation of output across existing firms; *Cross effect*: productivity growth associated with employment reduction; *Entry and exit effects*: productivity growth associated with entry of new firms and exit of existing firms

Source: Bartelsman et al. (2005) and Turkstat.

10. Incumbents in Turkey have traditionally boosted productivity more by downsizing and reallocating resources across existing enterprises than by investing and strategically expanding.

Figure 7 shows the impact of firms' entry, growth and exit patterns on labor productivity. Labor productivity in Turkey has been driven mostly by the growth of existing firms (the “within effect”), although less so than in non-European comparators (Argentina, Chile and Colombia³). The contribution that reallocation of resources between sectors makes to labor productivity (the “between effect”) is higher in Turkey than in all comparators. Finally, both the exit of less productive firms (the “exit effect”) and the downsizing of incumbents (the “cross effect”) had a significant impact on productivity in Turkey. In sum, compared to those in non-European countries, incumbent firms in Turkey boost productivity more by downsizing and reallocating resources across existing enterprises than by strategically expanding.

11. Strategic growth of incumbents should be at the center of Turkey's private sector development agenda. While reforms aimed at reducing start up barriers and improving bankruptcy procedures could have important effects in further promoting market selection and the exit of obsolete firms to release resources for new investments, the analysis of firms' dynamics indicates that initiatives aimed at removing barriers to firms' expansion are by far the most important in Turkey.

12. Improvements in the investment climate are significantly associated with increased productivity and employment among incumbent firms.⁴ The econometric analysis of firm data collected through the Turkey Investment Climate Survey (ICS) confirms that productivity and employment of Turkish firms are robustly associated with several aspects of the investment climate. In particular, productivity is strongly associated with lower informality and greater financial transparency. Productivity also has negative associations with crime⁵ and poor infrastructure, particularly power outages and long waiting times to clear customs. Greater education among firm staff and firm-provided employee training are positively associated with both productivity and employment, as are purchases of new technologies and use of the Internet. In turn, employment is also positively associated with increased access to finance and firms' use of quality standards, while management time spent on bureaucratic issues is negatively associated with both productivity and employment.⁶

13. Productivity and employment are also positively associated with exports and FDI, which in turn are affected by several investment climate factors, particularly the quality of labor force skills and firms' capacity to upgrade technology. More productive firms display better export performance and higher FDI. Employment is also positively associated with exports. The propensity of firms to export

³ Colombia is not shown in the chart.

⁴ This section includes findings from an econometric analysis based on the Investment Climate Survey (ICS), which was carried out in the summer of 2005 and covers a stratified sample of 1,323 firms in eight industries across five regions and 17 cities. Volume II contains additional information on the sample and the econometric analysis, which is described in more detail in the background paper by A. Escribano, L. Guasch, J. Pena, and M. Orte (2006), prepared for the Turkey Investment Climate Study.

⁵ Crime has a significant, large negative effect on productivity. While the study does not address this issue, more analysis is warranted in the future.

⁶ See Volume II and the background paper by Escribano et al. (op. cit.) for more information on the methodology and results of the econometric analysis.

is associated with shorter import customs delays, having externally audited financial reports, use of quality certifications, access to the Internet, availability of skilled labor, and training. Factors that are positively and strongly associated with foreign ownership include better-educated managers, internal training of staff, innovation via introduction of new products, and licensing of technology.

III. IMPROVING FIRMS' PRODUCTIVITY AND EMPLOYMENT: KEY ISSUES AND PROPOSED RECOMMENDATIONS

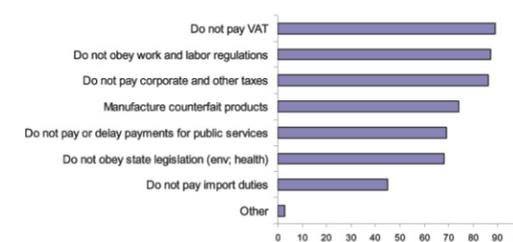
14. The four top recommendations to improve Turkish firms' productivity and employment are: reducing informality, increasing the flexibility of the labor market, improving the skills of the labor force, and facilitating firms' technological progress. Increasing access to finance and improving the quality of infrastructure are also needed, while reducing red tape is a low cost complementary measure that could be pursued in the short term. In light of the study's findings, the most important measures to improve firms' growth are: (1) reducing informality by reducing tax rates, strengthening tax enforcement and increasing firms' financial transparency, (2) increasing the flexibility of the labor market by protecting workers instead of jobs, (3) aligning the skills of the labor force with the needs of the private sector by improving education at all levels, and (4) supporting Turkish firms' technological progress by improving adoption of leading technologies and quality standards. Other important measures are increasing firms' access to finance and improving the quality of infrastructure, especially energy reliability and customs efficiency. Complementary reforms that could be pursued at low cost and implemented in the short term include reducing registration costs, reducing the number of licenses required to register and operate, and reducing the duration of bankruptcy procedures while increasing recovery rates⁷. The following sections include the results of the diagnostic and policy recommendations on each issue.

III. A. REDUCING INFORMALITY AND IMPROVING FIRMS' FINANCIAL TRANSPARENCY

15. Reducing informality, which is mostly driven by the taxation regime, is most likely to produce first order gains in productivity and employment. More than one third of surveyed firms across all sizes and sectors indicated that they were competing with informal firms. Likewise, firms of all sizes and in all sectors perceived informality to have increased since 2001. The ICS shows that productivity and employment are strongly associated with lower informality and higher financial transparency “less informal” firms, which declare more income and labor costs for tax purposes, and firms using audited financial statements, are more productive and employ more staff. Turkish firms mention avoidance of taxes - together with avoidance of regulations - as the main reasons for remaining informal (Figure 8).

⁷ These priorities are based on several sources, including the econometric analysis of the Turkey ICS data, the analysis of firm dynamics using data from the Statistical Institute, complementary information compiled during preparation of the study, and discussions with the Government and the private sector.

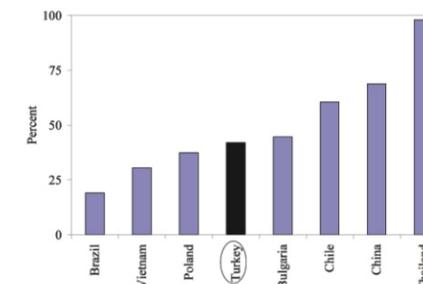
Figure 8: Drivers of competitive advantage for informal firms⁷



⁷Frequency of firms responding “fairly important” or “very important” when asked, “How important are the following in providing competitive advantage to [...] informal companies?”

Source: Turkey Investment Climate Survey (ICS).

Figure 9: Firms having financial accounts externally audited, by country



Source: Investment Climate Surveys

16. Recent reforms of the corporate taxation regime should be complemented by greater enforcement and reduction of tax compliance costs and labor tax rates. Turkey recently reduced corporate income tax from 30 to 20 percent and is implementing tax administration reforms to improve collection efficiency and reduce firms' compliance costs. These measures are expected to reduce informality. Further reforms aimed at spreading the tax burden to all firms, reducing compliance costs, and minimizing labor tax rates (which are very high compared to those in OECD countries⁸) would contribute both to reducing informality and to improving the competitiveness of formal firms.

17. Improving financial disclosure through better accounting and auditing will also help formalize firms. Audited financial statements are not common among Turkish firms (Figure 9). As is generally the case around the world, they are particularly inadequate among small and medium enterprises. The quality of financial reporting is also poor. Turkey has made some progress in recent years, including requiring listed companies to adopt international standards and establishing a National Steering Committee on Accounting and Auditing Reform. Further steps to improve financial transparency include: (a) developing a strategy and action plan to strengthen accounting and auditing; (b) providing incentives to increase firms' use of auditors; and (c) providing direct technical assistance to firms - particularly SMEs - to ensure that they have the capacity to prepare sound and reliable financial statements.

III. B. INCREASING THE FLEXIBILITY OF THE LABOR MARKET AND ALIGNING THE SKILLS OF THE LABOR FORCE WITH THE NEEDS OF THE PRIVATE SECTOR

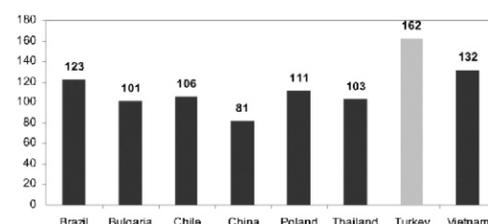
18. Well-functioning labor markets and a labor force with advanced skills improve firms' productivity and employment. Most reforms to the labor markets and education take time to yield

⁸ When comparing an average income earner who has a non-working spouse and two children, Turkey has the highest taxation of any OECD country.

benefits, but it is essential to start them now. Well-functioning labor markets and advanced skills increase labor force participation and the quality of labor, as well as firms' productivity. They also facilitate diversification of the economy toward higher technology sectors and improve firms' competitiveness in all sectors.

19. Turkish firms would increase employment if labor restrictions were loosened. Employers interviewed through the ICS perceive regulatory restrictions on employment as obstacles to growth. Over 60 percent of ICS respondents indicated that, if regulations and mandatory benefits were less restrictive, they would substantially increase regular, full-time employment even at current production levels (Figure 10). Turkish labor regulations are inflexible compared to other countries - Turkey's employment protection legislation is more restrictive than that in nearly all European countries, and payroll taxes, tax wedges, and compulsory non-wage benefits are high.⁹

Figure 10: Estimated change in the number of regular full-time workers if no labor restrictions existed, Turkey and selected comparator countries (100=no change)



Source: Investment Climate Surveys

20. Turkey has implemented some labor market reforms, but “shifting protection from jobs to workers” requires further changes. Reforms already introduced include an unemployment insurance system and a new Labor Code. Recommended reforms include increasing the flexibility of labor market regulation, extending unemployment insurance coverage, boosting the capacity to deliver cost-effective active labor market programs, and easing restrictive employment protection rules, as well as reducing high payroll taxes, social security contributions, mandatory benefits and severance payments.

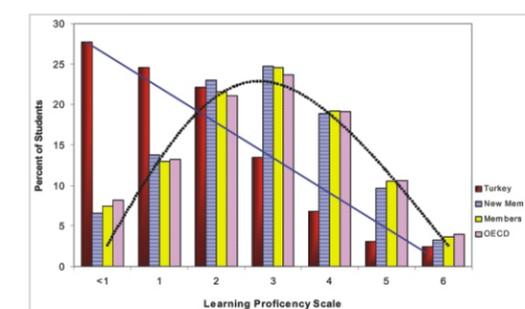
21. Increasing the effectiveness and efficiency of regulating the labor market also calls for institutional changes. ICS data indicate that labor and social security inspections are not burdensome to employers. In fact, mostly because of lack of resources, MOLSS and SSK inspectors have largely been able to respond only to complaints, covering only a very small share of firms. Targeted, risk-based labor and social security inspections would improve workforce and payroll reporting, but enforcement institutions would need adequate resources to carry out their functions.

⁹ See footnote 5.

22. Despite recent reforms, the Turkish education system still lags behind those in comparator countries. Over the past 10 years, Turkey has significantly reformed many areas of education - achieving nearly universal enrollment in basic education, improving equity, increasing financing, bringing top students to world-class levels, and modernizing curricula. Nevertheless, the quality of education and the skills learned by Turkish students remain below those in comparator countries (Figure 11).

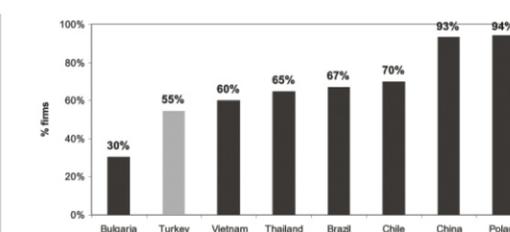
23. Despite skill deficiencies, few firms in Turkey provide formal training to their workers. Turkish firms provide less training than firms in comparator countries (Figure 12). Some 54 percent of firms allocate less than one percent of their budget to training and 80 percent allocate less than five percent.¹⁰

Figure 11: Distribution of 15-year-old students by proficiency level, Turkey, EU and OECD



Source: World Bank Education Sector Study 2005

Figure 12: Percentage of firms providing formal training, Turkey and selected comparators



Source: Investment Climate Surveys

24. Recommended reforms to improve the skills of the labor force include raising educational achievement, aligning education with the needs of the labor market, and increasing firm-provided worker training. Specific recommended reforms include: (a) continuing to increase enrollment in secondary and higher education, particularly among girls; (b) improving the quality of secondary education; (c) expanding, diversifying and improving the quality of higher education; (d) aligning higher education with the needs of the private sector, including exploring the potential for private sector contribution to vocational education; (e) increasing training provided by firms to employees by providing incentives for firms - particularly SMEs - through technical assistance and matching grants programs.

III. C. SUPPORTING FIRMS' TECHNOLOGICAL PROGRESS

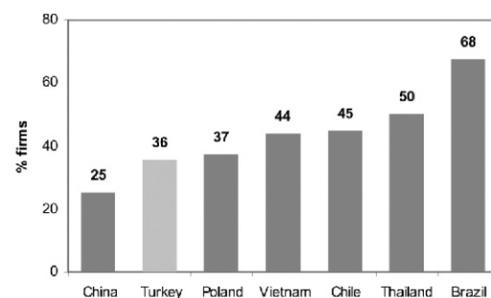
25. Technological progress - via innovation, technology absorption, quality standards, and ICT use - contributes to growth of incumbents and the creation of new firms. Reforms to facilitate technological progress in Turkey will yield the greatest impact if pursued in conjunction with reforms to improve the skills of the labor force. International evidence indicates that technology

¹⁰ TEPAV, 2006.

adoption, innovation, standards and ICT¹¹ are associated with productivity and growth. The ICS analysis confirms these results and indicates that technology adoption, quality standards and ICT use are particularly important for exports and FDI, which are in turn beneficial for productivity and employment. As discussed in the previous section, sophisticated skills are complementary to technological progress. Thus, pursuing reforms in all of these areas jointly will maximize the benefits of technological progress.

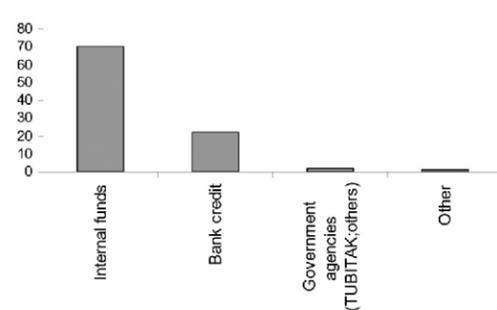
26. Several measures - including assessing current innovation programs, reviewing fiscal incentives for innovation, and aligning IPR legislation with EU standards - would help ensure that Government efforts increase productive innovation and technology adoption in Turkey. R&D financed by private firms is still limited. Turkey's rankings in terms of patents, industrial designs, and scientific publications are below those of comparator countries. Fewer firms than in most comparator countries have introduced a new product in the past two years (Figure 12) and the overall level of technology absorption in Turkey is moderate. At the same time, innovation is mostly firm-financed, with Government and venture capital contributing little (Figure 13). Several measures would help improve innovation in Turkey. First, conducting a thorough assessment of the Government's innovation strategy and current programs of innovation intermediation. Second, reviewing fiscal incentives for innovation which seems excessive. Third, fully aligning IPR legislation with the EU, improve IPR enforcement, and grant more independence to the Turkish Patent Institute (TPE). Fourth, revising the overall policy framework for innovation. Among the significant disincentives to innovation is the law preventing academics from establishing start-up firms, which could be revised. The obligation for academics to transfer income from private consulting back to host universities could be replaced with an incentive scheme similar to the U.S. Bayh-Dole Act which incentivates technology commercialization. Finally,

Figure 12: Percentage of firms developing a new product, international comparison



Source: Investment Climate Surveys

Figure 13: Sources of finance for introduction of new technology, percentage values, Turkey

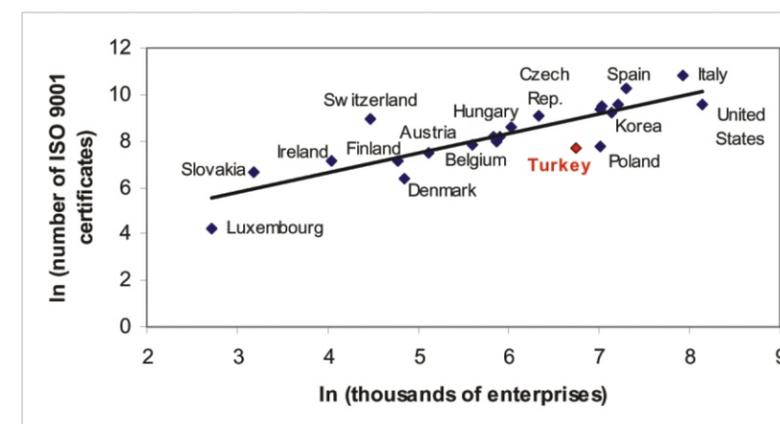


¹¹ Innovation is the creation and commercial application of new ideas. Technology adoption is the application of existing technological advances in a new environment, often transferred via FDI, imports, licensing, new capital equipment and technical expertise. Quality standards codify the technical requirements expected by customers. ICT (telephony, the Internet) is the general-purpose technology that is transforming the way in which we exchange information and conduct business.

increasing sustainable access to finance for innovation is also critical. Two helpful measures are introducing reforms to increase the liquidity of the capital market and supporting programs similar to the U.S. SBIC or the Yozma Program, which triggered development of the venture capital industry in Israel.

27. Several reforms are recommended to improve firms' adoption of quality standards, including matching grants to firms and labs, improving accreditation and metrology services, and further progress on standardization. First, it is recommended that Turkey endeavor to increase the number of certified firms - particularly SMEs and firms operating in the service sector - which is low by international standards (Figure 14). Recommendations to improve adoption of quality certification include: (a) continued support for training and matching grants programs to firms, (b) support for provision of technical assistance to Notified Bodies, and (c) procurement rules that forbid the recognition of certifications from certification bodies that use anticompetitive practices. Second, support for improving accreditation services, which help ensure good functioning of the certification system, is also recommended. This requires improving accreditation services and the number of accredited organizations, as well as revising the Law of the Turkish Accreditation Agency (TÜRKAK) to be less prescriptive. Third, improve metrology by revising the law and adjusting operations of the National Metrology Institute (UME) to provide more flexibility in its governance, operations, staff hiring and remuneration. Finally, improve standardization, by clearly separating the standardization and commercial activities of the National Standardization Agency (TSE), ensuring that it continues to adopt international standards and intensifies its efforts to obtain full membership in European standards bodies, and reducing Turkey's stock of idiosyncratic standards, which may create technical barriers to trade.

Figure 14: Number of ISO 9001 certificated firms vs. total number of firms



Note: Certificate data is for Dec. 2004, enterprise data is for 2002, except United States, 2001.

Source: ISO (2005) The ISO Survey of Certifications 2004; OECD (2005) OECD.

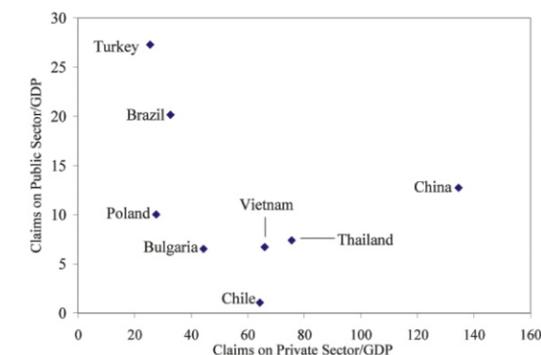
28. Access to - and use of - the Internet for productive purposes has increased in Turkey, but measures are recommended to reduce the gap with other countries as well as differences in access to and quality of services among different regions within Turkey. Fixed, mobile and Internet penetration percentages and the rollout of broadband services in Turkey lag behind those of OECD and EU countries. The overall share of ICT expenditure in Turkey is modest (2.5 percent of GDP), well below levels in the EU (8 to 10 percent). Turkey has taken important steps toward telecom liberalization, particularly the privatization of Turk Telekom in 2005. Despite this, Turk Telekom retains considerable market power, limiting competition. In 2006, the “Information Society Strategy 2006-2010” has been adopted. This strategy places strong emphasis on both expanding ICT reach and increasing its productive uptake by the private sector. Continued liberalization of the telecom sector is recommended, together with enhancing the institutional capacity of the Telecom Regulation Agency and the Competition Authority. Encouraging equal access across regions entails implementing schemes such as universal funds to improve services in underserved areas and segments of the population. Finally, the Government can help increase productive uses of ICT among firms (particularly SMEs) by increasing its own use of ICT and developing ICT skills in the workforce, locally relevant online content and productive applications.

III. D. INCREASING FIRMS' ACCESS TO FINANCE AND IMPROVING CORPORATE GOVERNANCE

29. Access to finance and good corporate governance help firms grow and increase employment. Improving access to finance can yield short-term benefits, while reaping the benefits of corporate governance reforms takes more time. Both the empirical literature and the Turkey ICS show important links among financial sector development, productivity, growth and employment. Good corporate governance increases access to finance and facilitates capital market development, in turn improving firms' performance. Turkey has already made progress toward ensuring financial development and stability, and it could undertake most pending measures to improve access to finance in the short term at relatively low cost. Conversely, measures to improve corporate governance - which are important to create a level playing field, reduce concentration and increase effective competition - will take longer to implement and produce results, in part because Turkey has made less progress to date in this area.

30. Progress is needed to increase access to finance for Turkish firms. Access to finance for firms in Turkey remains relatively poor in terms of both credit volume and credit maturity. At 25 percent of GDP, bank credit to the private sector is among the lowest in comparable markets (Figure 15). Only half of Turkish firms surveyed had a loan (Figure 16), a level well below comparator countries, and most loans are short term.

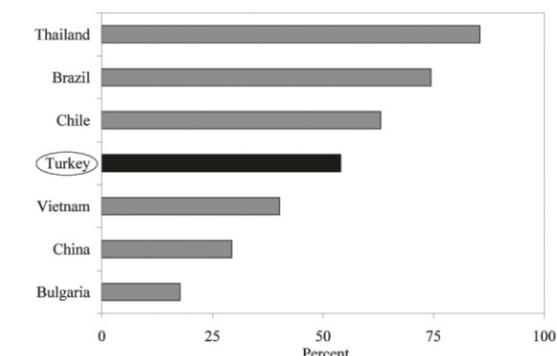
Figure 15: Bank credit to the public and private sectors, 2005



Source: IFS and Staff Calculations.

Note: Data reflect Deposit Taking Banks.

Figure 16: Share of firms with loans, by country



Source: Investment Climate Surveys

31. Recommended measures to increase access to finance include continuing efforts to manage risks in the financial sector as well as specific measures to enhance the credit market by improving financial disclosure and credit information on firms and by strengthening the collateral regime. Specific recommended reforms include:

- Managing risks in the financial sector by continuing broad reforms aimed at ensuring prudential supervision and regulations.
- Improving credit information. The private credit bureau, KKB, has built the technical infrastructure for an effective system for credit information on firms. The launch of KKB's system warrants encouragement.
- Improving the collateral regime. It is expected that the recently approved mortgage law will strengthen the collateral regime for land and buildings. Turkey also would benefit from measures to improve the movable assets regime, given that movable assets account for most of firms' total assets value. Specific recommendations include: legal reform (ideally a comprehensive new law, but minimally amending current laws) development of a new registry (preferably a national Internet filing archive), and legislation and judicial reform to ensure faster repossession and sale of collateral.

32. A range of reforms are recommended for strengthening corporate governance. The business sector in Turkey includes large, family-owned, mixed conglomerates with prevalent cross ownership and intra-group transactions. Thirteen holding companies and their affiliated banks account for about 40 percent of the market capitalization on the Istanbul Stock Exchange. The lack of transparency and protection of minority shareholder rights, the generally inadequate independence and accountability of directors, and regulations that do not provide timely or effective remedies all compound the potential for

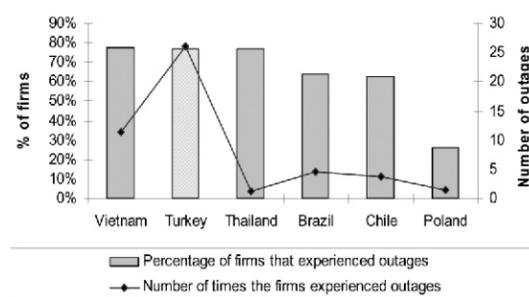
abuse. The Capital Market Board (CMB) has developed a voluntary corporate governance code that could be improved by revision and enforcement. Several additional measures are pending. One is approving a revised commercial code aligning company law with EU directives and its Corporate Governance Action Plan. Another is approving a Capital Markets law closer to EU requirements. A third is implementing EU directives on conglomerates and disclosure of the ultimate shareholders of companies, and strengthening public disclosure of share trades by company insiders.

III. E. IMPROVING FIRMS' ACCESS TO INFRASTRUCTURE

33. Access to infrastructure significantly affects business performance. The lack of reliable infrastructure services reduces the competitiveness of the private sector by limiting access to markets, increasing transaction and operation costs, and discouraging investment in incumbent firms and the creation of new enterprises. The ICS analysis indicates that the aspects of infrastructure that most affect Turkish firms are the unreliable electricity supply and delays in clearing customs on both import and export.

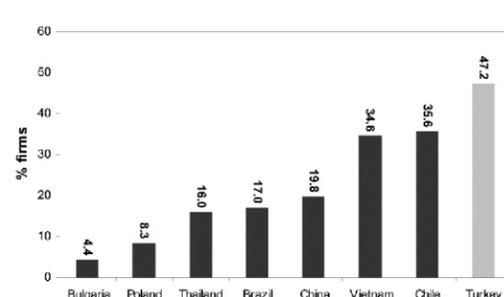
34. It is recommended that the Government follow through with its restructuring plans for the energy sector and ensure that adequate and consistent financing is available for elements of the system that continue to require public funding. ICS firms reported losses averaging 3.6 percent of sales that were directly linked to deficiencies in the electricity supply. As many as 80 percent of surveyed firms experienced at least one outage per year - a higher percentage than in any comparator country (Figure 17). Because of these inefficiencies, many Turkish firms own private generators, which add to operating costs (Figure 18). Electricity generation capacity exceeds demand, but growth in consumption is quickly eroding the margin. Without generating capacity beyond that already scheduled, Turkey may face electricity shortages as early as 2009. Electricity prices, although significantly higher than the average in OECD countries, do not ensure adequate net revenues, due to a distribution system plagued by both inefficiency and financial problems, compounded by a low collection rate with overdue receivables from public sector users.

Figure 17: Proportion of firms suffering outages and number of power outages per year



Source: Investment Climate Surveys

Figure 18: Firms that own an electricity generator, international comparison



Source: Investment Climate Surveys

35. The Government is restructuring the electricity sector, but further reforms are recommended. Energy authorities are undertaking pilot studies to establish a competitive electricity market, assessing ways to expedite the restructuring process, and considering incentives that might motivate investors to address regional disparities in service provision. However, there are several pending issues. The first is ensuring that sufficient financing to operate and maintain existing energy infrastructure can be provided during restructuring. The second is the lack of a long-term plan to ensure adequate supply of electricity beyond 2009. Finally, payment discipline could be dramatically improved, particularly through collecting overdue bills from municipalities.

36. Although Turkey has improved customs administration substantially, complementary institutions have not improved, limiting the overall gains. Surveyed firms experience waiting periods of 6 days for exports and 9 days for imports - shorter than for firms in Brazil and China, but longer than for firms in other countries (such as, for example, Poland, where the wait is 1.7 days for exports and 3 days for imports). Regional differences are also large - firms in Ege report export waiting periods almost twice as long as those in other regions. The Turkish Customs Authority improved procedures in the 1990s, reducing clearance time for both imports and exports, but operational improvements in other agencies (including the Turkish Standards Institution, the Ministry of Agriculture, and the Ministry of Health) could further speed customs processing.

37. Transport recommendations focus on enhancing road quality and improving the transport mix. Roads, the main transport mode in Turkey, are inadequately maintained. More than a third of companies surveyed reported losing goods in transport within Turkey, a proportion almost three times higher than in European comparators. The value of goods lost in transport is also high, at 1.9 percent of total consignment value. Despite rapid growth in demand for road transport, public spending on transport is only 1.7 percent of GDP, compared to 5 - 7 percent in other middle-income countries. Use of railways is low-covering less than 5 percent of all transport needs in Turkey, versus 11 percent in Europe and 40 percent in the U.S. The Government has aligned transport charges with relevant EU principles. The State Planning Organization's Ninth National Development Plan aims to improve multimodal transportation, but maintenance and expansion of the road network continues to consume significant resources. Private participation could help finance roads but requires a clear long-term policy and regulatory framework.

III. F. REDUCING ADMINISTRATIVE BARRIERS TO FIRMS' START UP AND OPERATION

38. Although firms' entry and exit is substantial in Turkey, further reducing administrative barriers to firms' entry, exit and operation is feasible and could be pursued in the short term at low cost.

39. Reducing start up fees and revising bankruptcy procedures would further facilitate firms' entry and exit. It takes only 9 days to open a firm in Istanbul, close to world best practice. However,

registration fees are high at 27.7 percent of GNI, compared to 6.8 percent in OECD countries¹² - Table 1. Start up costs could be reduced by setting an acceptable overall fee, publicizing the principles for calculating registration fees and abolishing the double fee for registration. An average business bankruptcy takes 5.9 years, versus 1.5 years in the OECD, and recovery rates are among the lowest in the world, at 7 percent of GDP. A detailed analysis of the long procedures and low recovery rates would be the first step toward improving exit. Reform of the bankruptcy law and procedures could then follow the analysis for maximum effect.¹³

Table 1: Comparison of registration costs in selected countries.

Country	Startup cost (% of income per capita)	
	2005	2006
Turkey (Istanbul)	27.7	27
International Best Practice	0.0 ^a	0.0 ^b
Region (Europe & Central Asia)	13.5	14.0
OECD	6.8	7.6
Brazil	10.1	10
Bulgaria	9.6	8
Chile	10.3	10
China	13.6	9
Czech Republic	9.5	9
Hungary	22.4	21
Malaysia	20.9	20
Romania	5.3	4
Russia	5.0	3

Notes: ^aDenmark; ^bDenmark, Ireland & New Zealand

Source: *Doing Business 2006/2007*, World Bank

40. Modifying the licensing and inspection regimes, as well as the land acquisition process, would facilitate firms' operation.

- Licensing.* The ICS indicates that it takes 66 days on average to obtain a license in Turkey, much longer than in comparator countries (Figure 18) (2005 ICS data). Interviews conducted in 2006 revealed that the fees were also high - US\$319 to obtain a general business license from a municipality in Turkey, compared to US\$36 in the Czech Republic, for example (Table 2). Important ongoing reforms to reduce license requirements include the 2005 Regulation on Opening a Business Place and Work Licenses and the establishment of regional facilitation units. Recommended reforms include further reducing the number of licenses, reducing fees, replacing entry screening and physical inspections before starting a business with targeted post-inspections,

¹² *Doing Business 2006/2007*, World Bank.

¹³ The World Bank has recently started to analyze this.

abolishing documentation requirements that are not essential for urban planning, health, safety or environmental protection, eliminating inspections of sanitary businesses, and reviewing the licensing regime for specific sectors. The Government has recently undertaken several measures to reduce the number and cost of licenses. The results of these reforms are not captured by the ICS and this study. An ad hoc analysis should be conducted to evaluate them.

- Inspection.* Inspection schedules in Turkey depend on availability of inspectors and other criteria unrelated to risk - a “catch all” approach that is not very burdensome but is ineffective. The best way to improve inspection services would be to implement an approach based on assessed risk and the likelihood of violations, as well as ensuring exchange of information and increased transparency and accountability.
- Land.* On average, it takes a Turkish firm 15.4 months to develop a site, four times longer than in Finland, the best practice EU comparator. Fees are more than 20 times higher than in the Czech Republic. The Government has already taken measures to improve land availability for entrepreneurs, including a cadastral reform program in progress and new legislation that allocates land to industrial zones free of charge for business development. Additional measures are recommended, such as further encourage private sector participation in developing industrial zones, strengthening strategic planning for land development, and streamlining the construction permitting process.

IV. CONCLUSIONS

41. To reduce the income gap with EU countries and ensure continued support for reforms, Turkey needs to increase productivity and employment. Turkey's per capita income has remained at 25 percent of that of the EU-15 since 1975 and has grown slower than those of other emerging markets. Increasing labor productivity - which is responsible for 80 percent of the income per capita gap between Turkey and the EU-15 - and improving employment - which remains low at 46 percent - are essential to reduce Turkey's income gap with the EU and other emerging economies, as well as to sustain political support for future reforms.

42. Turkey's progress in recent years provides a good basis for the future, but leaves no room for complacency. Turkey has made significant progress in recent years, including maintaining macroeconomic stability, implementing structural reforms and moving forward with EU negotiations. The Ninth Development Plan, centered on improving competitiveness and employment, sets the right strategic framework for future improvements. Continuing and accelerating reforms is essential to ensure convergence with EU income levels and fulfill social expectations.

43. The Turkey Investment Climate Study informs the Government's reform agenda by providing firm-level evidence on bottlenecks limiting labor productivity and employment and recommendations to reduce them. Using several sources of firm-level data and complementary information, the Turkey Investment Climate Study identifies factors that constrain Turkish firms' productivity and employment. First, the study finds that, compared to non-European countries, firms in Turkey have traditionally boosted productivity more by downsizing and reallocating resources across existing enterprises than by expanding, suggesting that strategic growth of existing firms should be at the center of Turkey's private sector development agenda. Second, the study provides recommendations to improve Turkish firms' productivity and employment. The four central recommendations are: reducing informality, increasing the flexibility of the labor market, improving the skills of the labor force, and facilitating firms' technological progress. Increasing access to finance and improving the quality of infrastructure are also needed, while reducing red tape is a low cost complementary measure that could be pursued in the short term. Table 1 in Annex 1 provides a summary of key issues and recommendations to improve performance in each area.

44. Broad, coordinated structural reforms carried out by the Government in collaboration with the private sector will maximize productivity and employment gains. This study has attempted to prioritize reforms, based on several complementary sources of evidence compiled during the analysis. It is important to emphasize that simultaneous actions in all areas analyzed in the study (and included in the Annex) would be much more powerful than actions in one - or a few - areas only. The successful accomplishment of this goal - and in turn Turkey's capacity to reduce its income gap with EU countries and improve the living standards of its entire population - depends upon the Government and the private sector collaborating closely to undertake actions in all of these areas.

ANNEX A: SUMMARIES OF KEY ISSUES AND POLICY RECOMMENDATIONS

	Deficiency by aspect of the investment climate	Recent/ongoing government activities & short-term initiatives (6 months)	Recommended actions for the medium term (6 months to 3 years)
Informality and financial transparency			
Taxes	High tax rates and extensive tax evasion	Reduction of the corporate tax rate	Reduce labor taxes, spread tax burden to all firms and ensure enforcement
Financial reporting	Poor quality of financial reporting, especially among SMEs	Capital Market Board required listed companies to use international standards (IFRS and ISA).	Develop strategic plan on accounting & auditing, provide technical assistance for auditing among SMEs
Labor market and skills			
Labor market regulation	Protective labor laws, high severance payments & inflexible contracting Low labor force participation, low employment & high informal employment	Commitment to modify severance and create a severance fund (2003 Labor Law) Institute new severance rules	Extend flexible contracting options in Labor Code Strengthen unemployment insurance and active labor market programs
Labor taxes	High labor tax wedge, especially for low-wage labor and for workers with families	Analysis of employment impacts of a reduction in labor taxes	Reduce taxes on labor after fiscal situation consolidated
Labor market institutions	Low enforcement capabilities Costly labor dispute resolution	Fully implement private arbitration for individual and collective labor disputes	Raise capacity of MOLSS & social insurance inspectors; eliminate 10% rule for union bargaining authorization
Education, skills and training	Low levels of education in workforce constraints job growth Low levels of proficiency and mismatch of skills between higher education graduates and needs of firms Low rates of enrollment in higher education Firms provide limited training to workers	Adopt program to modernize curriculum for basic and secondary education Complete construction and renovation of schools and preschool classrooms Draft Higher Education Strategy by YOK Finalize Higher Education Strategy on improved access, quality and labor market relevance	Modernize curricula and integrate teacher training Adopt Education Strategy Develop options to increase firm-provided training and increase collaboration between education institutions and the private sector to provide vocational training Increase the output of science and engineering graduates, especially at the MS and PhD levels

	Deficiency by aspect of the investment climate	Recent/ongoing government activities & short-term initiatives (6 months)	Recommended actions for the medium term (6 months to 3 years)
Technological progress			
Innovation and technology adoption	<p>Low private investment in R&D and limited public-private collaboration on innovation</p> <p>Few patents, industrial designs and scientific publications</p> <p>Low incidence of firms innovating via the introduction of new products or upgrading existing product lines</p> <p>Insufficient access to finance for innovation, particularly for start-ups</p>	<p>Increase Scientific and Technological Research Council's budget to support innovation</p> <p>Created of Turkish Research Area & completed "Information Society Strategy 2006-2010"</p> <p>IPR Committee reviewing legislation</p> <p>Revisions to venture capital regulations</p> <p>Creating Growing Enterprise Market to improve access to finance for SMEs</p>	<p>Evaluate effectiveness of innovation intermediaries</p> <p>Center innovation strategy on productive innovation</p> <p>Ensure full alignment of IPR legislation with EC directives and improve IPR enforcement</p> <p>Review R&D incentives to assess effectiveness, fiscal prudence and consistency with the <i>Acquis</i></p> <p>Extend technopark benefits to all researchers</p> <p>Reduce constraints on VC industry</p>
Quality standards and certification	<p>Low ISO 9000 certification rates</p> <p>Low international recognition of accreditation</p> <p>Limited role in developing regional standards</p>	<p>KOSGEB providing technical assistance</p> <p>TÜRKAK accepted to EA-MLA</p> <p>TSE reviewing & removing obsolete standards</p>	<p>Matching grants to increase certification rates</p> <p>TÜRKAK membership in IAF & accession to IAF-MLA</p> <p>Translate EN standards into Turkish.</p>
ICT	<p>Barriers to entry for new operators & broadband providers</p> <p>Regional inequality in ICT coverage & uptake</p> <p>Low use of ICT by small firms</p> <p>Limited e-Commerce</p>	<p>Recent privatization of Turk Telekom</p> <p>Information Society Strategy Action Plan for 2006-2010 completed</p>	<p>Complete liberalization by unbundling local loop</p> <p>Strengthen telecom regulator & competition authority</p> <p>Universal fund schemes for underserved regions</p> <p>Develop complementary ICT skills & online content; increase use of ICT by Government and banks</p>
Access to finance and corporate governance			
Financial sector	Firms have inadequate access to credit	Strengthen supervisory and regulatory regime	Continue reforms (CEM, 2006 & FSAP, 2007)
Strengthening credit information on firms	Credit to firms, particularly SMEs, is constrained by inadequate information available to lenders at a low cost.	Private credit bureau (KKB) has technical infrastructure for credit information sharing	Encourage & expand commercial credit bureau at KKB
		Ministry of Justice records available on Internet	Integrate public & private credit bureaus
			Implement consumer credit information rights

	Deficiency by aspect of the investment climate	Recent/ongoing government activities & short-term initiatives (6 months)	Recommended actions for the medium term (6 months to 3 years)
Strengthening the use of collateral	Credit to firms is constrained by ineffective use of collateral and in particular movable collateral	Mortgage law passed	Change law to facilitate pledging movable collateral
Corporate Governance	Lack of transparency in corporate transactions and ownership structures	The Government is preparing reforms of the mortgage market	Establish national archive for movable collateral
	Directors insufficiently liable for their actions	CMB revising corporate governance principles	Pass Commercial Code & Capital Markets Law after enhancements to corporate governance legislation
		New Commercial Code & Capital Markets laws drafted	Strengthen public disclosure of insider trading & implement EU Directive on Conglomerates
		Draft financial services & bank acts include provisions on governance of lending institutions	Review courts' capacity on shareholder rights cases
Access to infrastructure			
Electricity service	<p>Low quality of electricity provision with frequent power outages</p> <p>Electricity prices are high</p> <p>Losses and additional costs posed by electricity disproportionately affect firms in specific sectors or regions.</p>	<p>Considerable drive for liberalization of the market is expected with the first privatizations of the distribution companies.</p> <p>Energy authorities are planning to implement a competitive market for electricity, with pilot trials already underway</p>	<p>Ensure sufficient public financing & formulate plan to ensure electricity past 2009</p> <p>Expedite restructuring to attract private investors</p> <p>Align pricing of services with cost of generation & provide incentives to address regional disparities</p> <p>Implement enforceable service level standards</p> <p>Curtail stolen electricity & collect overdue bills</p>
Trade services	<p>Long lead times for imports and exports</p> <p>Longer lead times in specific regions</p>	Increased efficiency of the Turkish Customs Authority which resulted in reductions in the clearance time for both imports and exports	Ensure public institutions involved in foreign trade streamline export and import (Turkish Standards Institution, Ministry of Agriculture & Ministry of Health)
Transport	<p>Rapid deterioration of road network</p> <p>Poor transport mix, over-reliant on trucking</p>	Road charges aligned with EU; refinements to ensure they reflect the actual cost per user	Raise trucking charges to invest in road maintenance
		Efforts to diversify transport by investing in rail	Improving transport mix by restructuring railway to be commercially oriented & cost efficient



	Deficiency by aspect of the investment climate	Recent/ongoing government activities & short-term initiatives (6 months)	Recommended actions for the medium term (6 months to 3 years)
Red tape			
Market entry	Relatively high costs of registering; Fees not transparent	Steps and time to register have been reduced significantly	Set acceptable overall registration fee; Abolish double fee for company registration
Licensing /a <small>/a/ This assessment does not include the results of recent reforms undertaken by the Government to improve the licensing regime.</small>	Obtaining operating licenses is time-consuming and expensive Time to obtain business license varies by region and firm size Licensing cumbersome in some sectors	Law on regional facilitation units was adopted; implementation is underway Regulation on "Opening a Business Place and Work License"; reduced documents required for general business licenses	Streamline licenses & reduce fees; replace licensing with targeted post-inspections Eliminate inspections of sanitary businesses; review other sector-specific and municipal licenses Streamline procedures in food processing industry
Land	High land development costs and long approval procedures	Cadastral reform program and allocation of new land to Industrial Zones free of charge for business development	Further develop industrial zones via increased private sector participation Strengthen strategic planning for land development Streamline construction permitting process
Inspections	Catch-all approach to inspections	Time to obtain environmental clearance reduced significantly	Implement coordinated, risk-based inspections; Increase transparency & accountability of inspectors
Closing a business	Bankruptcy procedures extremely long (5.9 years) and low recovery rates (7% of GNI)	Amendments to the Bankruptcy Law allow for stronger protection of debtors	Study reasons for long procedures & low recovery rates

