

State of the Turkish Economy

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Agenda

Overview of the Turkish economy

Risks and priorities

New anchor: EU

What are the policy implications?

Turkish Economy: Basic Facts

GDP US\$ 300.6 billion (end- 2004)

GDP per capita US\$ 4,187

Highest growing country in world with 9.9 percent growth in 2004

Population 71.3 million, population growth rate 1.5 percent

Population living in urban cities 60 percent, urbanization rate 32 percent

Labor force 24.3 million

Labor force participation rate 48.7 percent

Unemployment rate 10.5 percent

Life expectancy 68.7 years

Infant mortality 3.8 percent

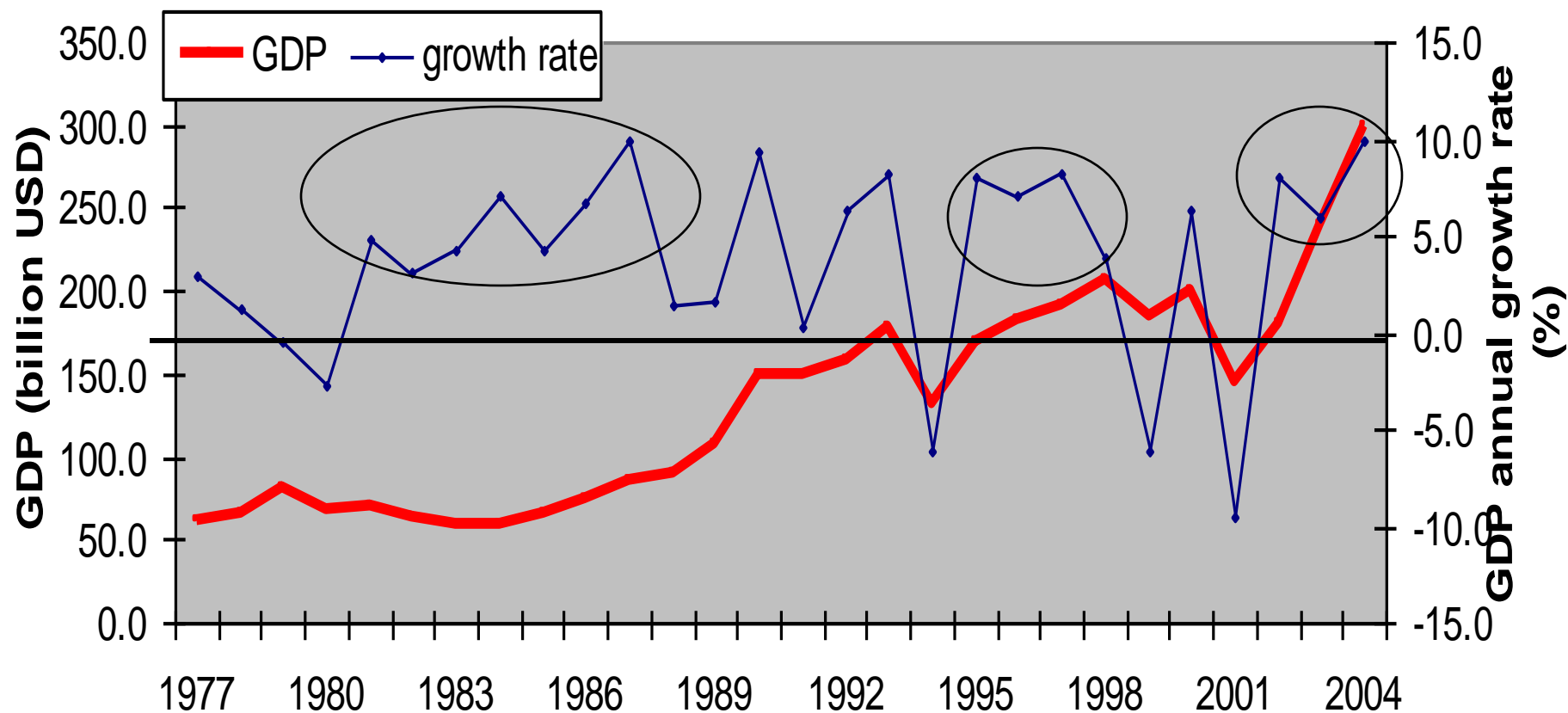
Literacy rate 88.3 percent

Gini coefficient 0.42

Percent of population living under 1\$ per day 0.2

Economic growth

1977-2004 Gross Domestic Product (billion USD) and GDP growth rate



Turkish economy in the 1990s

Despite huge potential, Turkish economy significantly underperformed in the 1990s:

boom and bust cycles in growth

high and chronic inflation

high public sector deficit

fiscal indiscipline

high levels of uncertainty (political and macroeconomic)

very high interest rates



three economic crises, internal conflict, 1999 earthquake...

the 2001 economic crisis = GDP shrank by 10%

Turkey done so far?

Basic elements:

Monetary Discipline

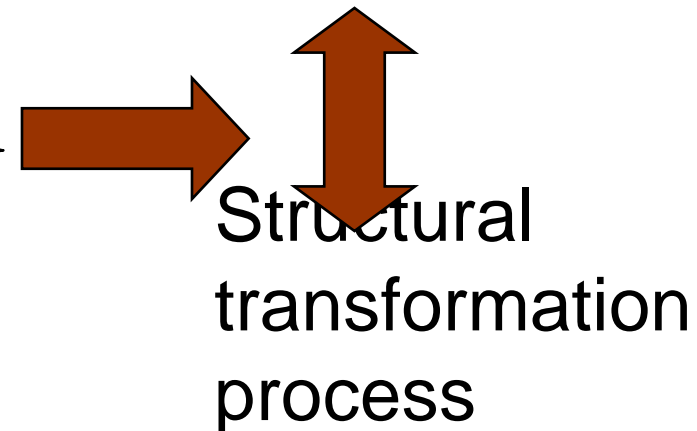
Fiscal Discipline

Public Administration
Reform

Banking Sector Reform-
Corporate Restructuring

Basic Outcomes:

Relative stability



Key: is it sustainable??

New policy framework after 2001

Public Sector Reforms

- Granting Central Bank Full Independence
- Ensuring Universality of the Budget
- Public Finance and Debt Management Law
- Indirect Tax Reform (Special Consumption Tax Law)
- Public Procurement Law
- Private Pension Law
- Civil Service Reform
- Pension Reform
- Reform on SEEs' Governance
- Direct Tax Reform (Second Phase of Tax Reform)
- Tax Administration Reform
- Public Financial Management and Financial Control Law

Creation of Regulatory Authorities

- Electricity Market
- Natural Gas Market
- Sugar Market
- Tobacco Market
- Telecommunication
- International Arbitration

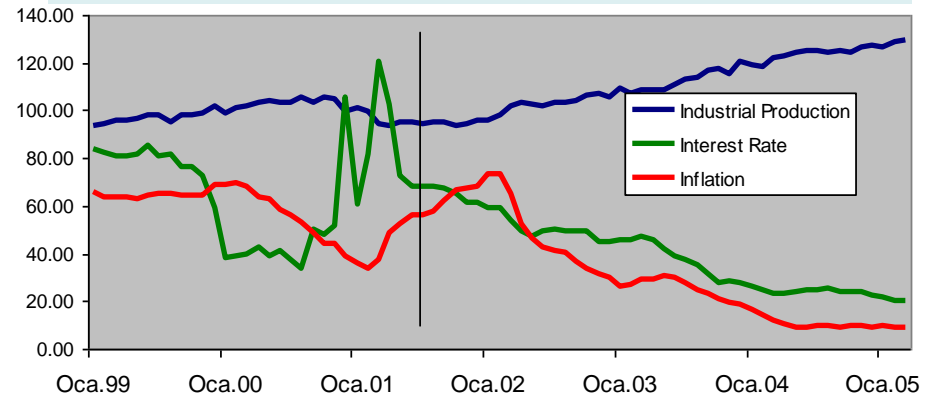
Financial Sector Reform

- Creation of Banking Regulation and Supervision Agency (2000)
- Non-performing banks transferred to Savings Deposit Insurance Fund.
- Transition to more bank activities.

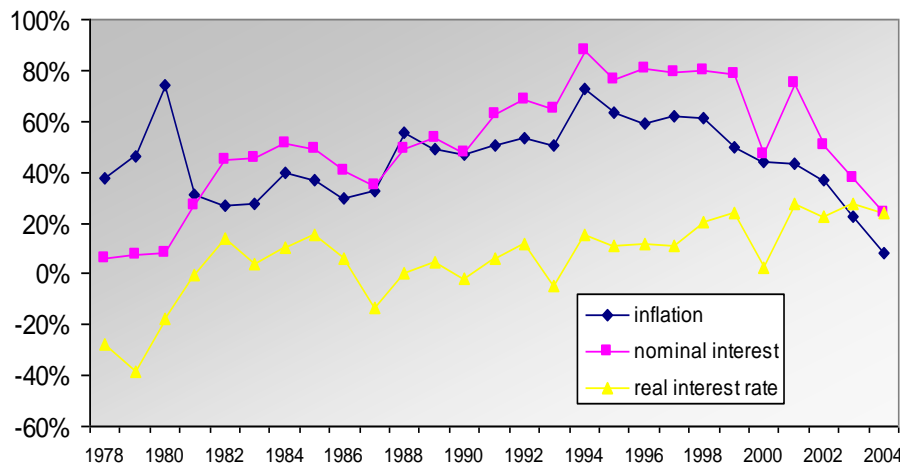
A new process following the 2001 crisis?

Growth without inflation
 Interests rates are falling down
 Productivity is rising

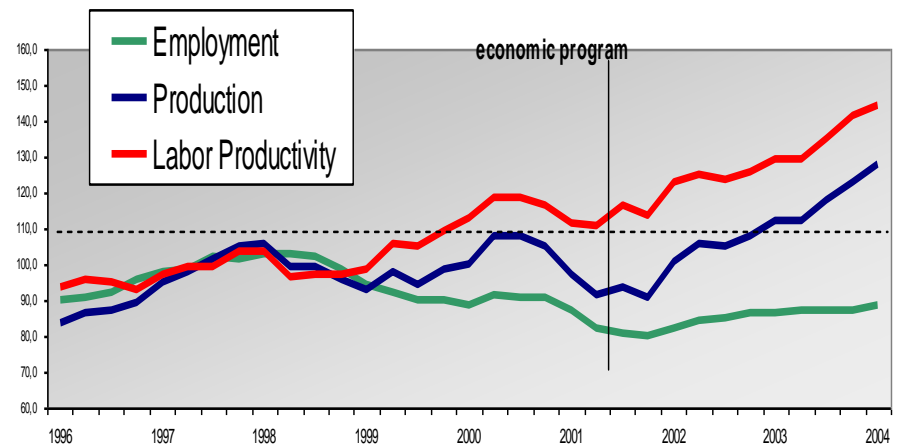
Non-inflationary growth (1999-2005)



Inflation and Interest Rates



Productivity and Employment Trends



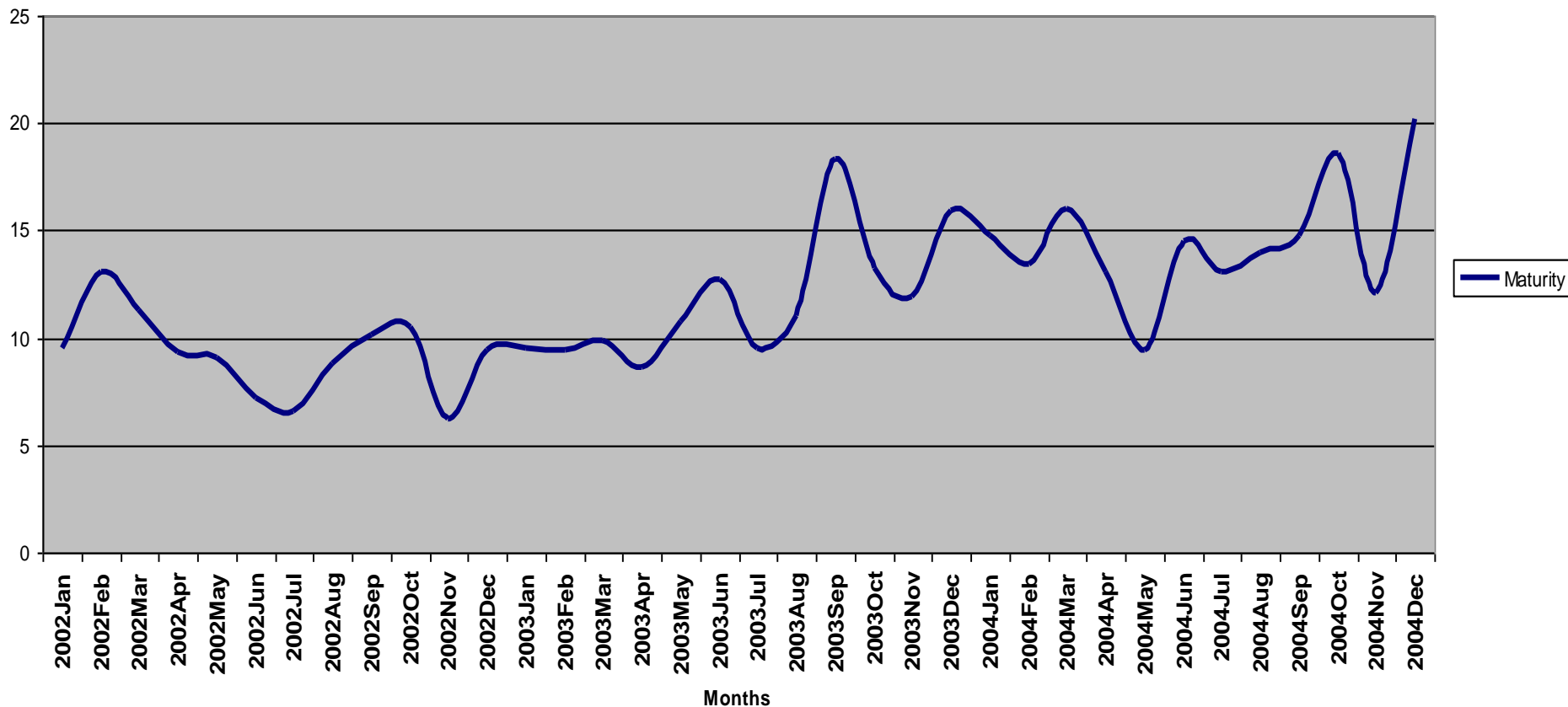
Turkey's Recovery since 2001

Transformation → Relative Stability → Superior Economic Growth

	2001	2004
GNP (billion \$)	150	300
Growth (%)	-9,4	9,9
Inflation (CPI%)	70	10
Public debt (% of GNP)	95%	65%
Budget Deficit (% of GNP)	17	10
Exports (billion \$)	31	60
Foreign Reserves (billion \$)	19	35

Stability Implies Higher Maturity

Weighted Average Maturity of Domestic Borrowing Raised Through the Market



, but depends on risk management

Relative stability

Structural transformation

political stability

Risks:

1. Need for above average growth rates for net job-creation.
2. Risks due to structural transformation.
3. Need for a credible and longlasting anchor: EU?

Innerent risks

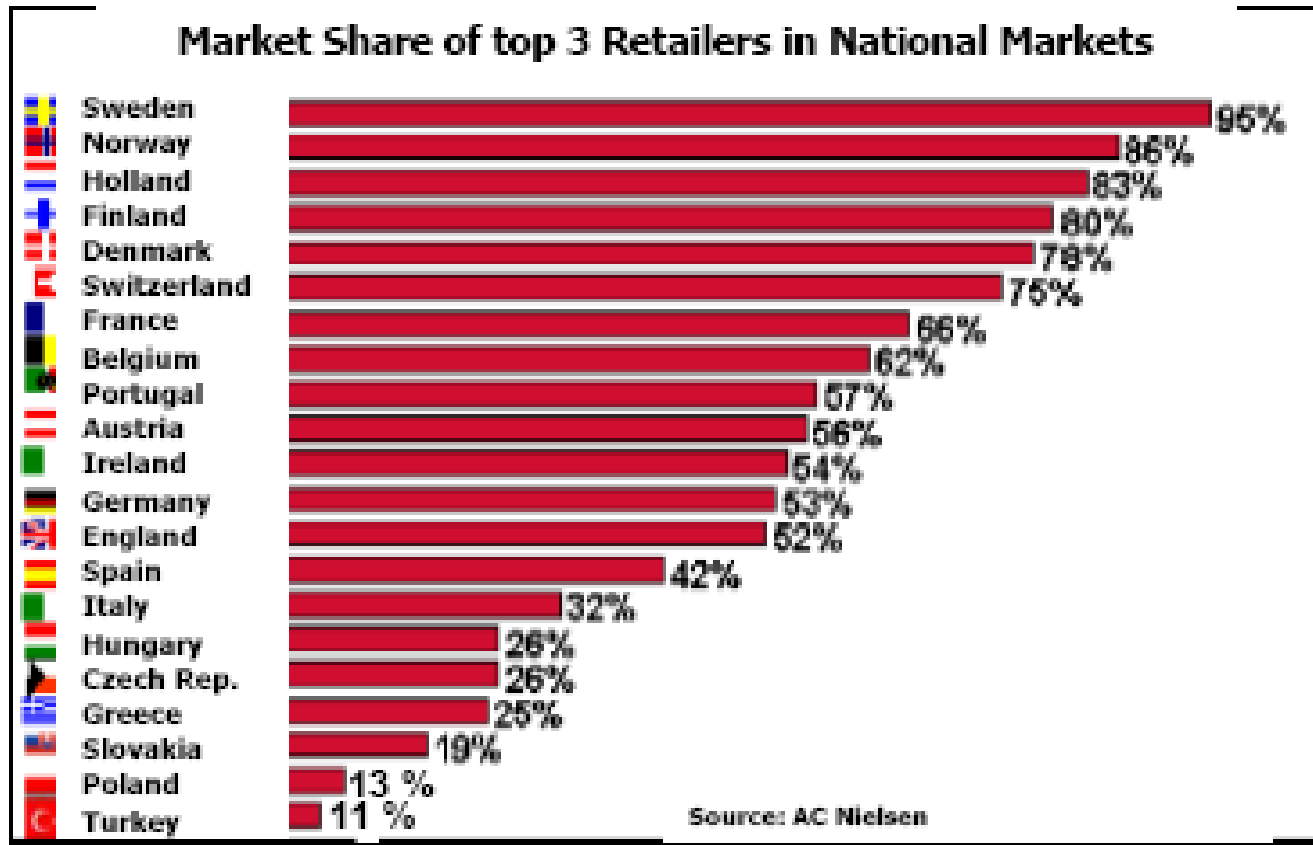
Structural transformation risk
Growth sustainability risk
Risk of policy credibility
Governance risk

structural
risks

Macroeconomic vulnerabilities

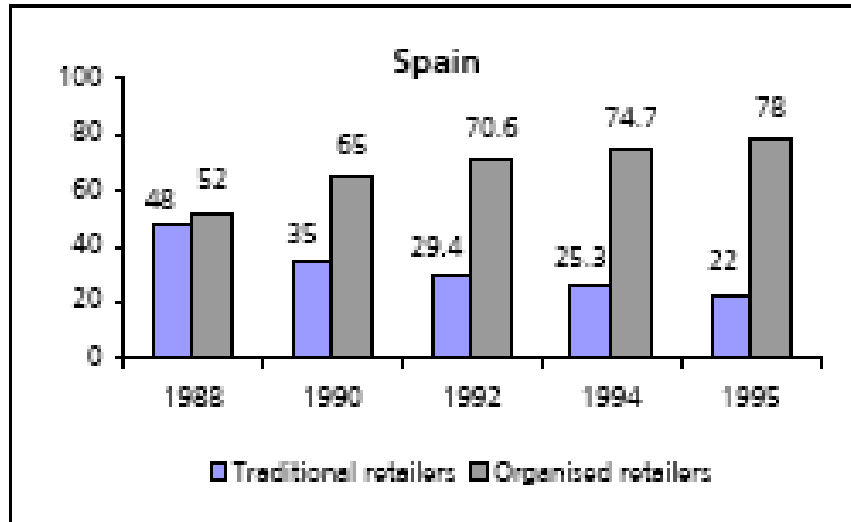
triggering
factor

Structural Transformation of the Turkish Economy An example from retailing



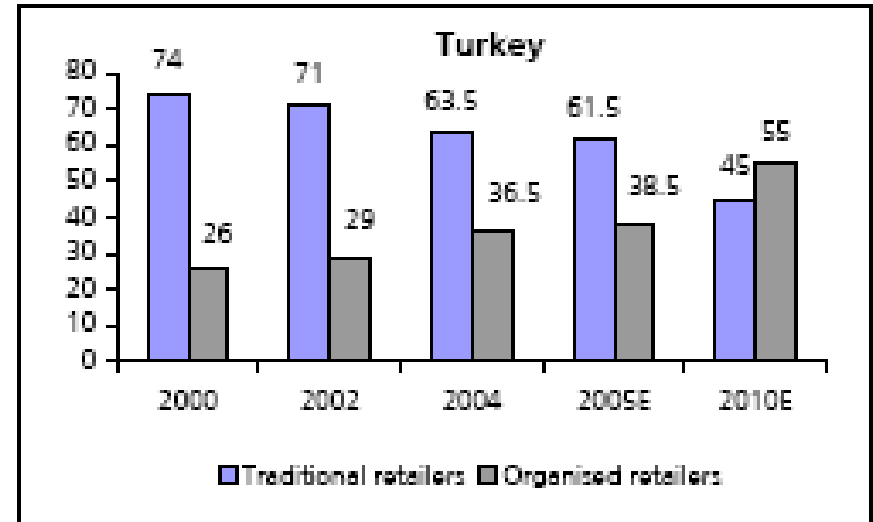
A projection for the future. Comparison of Spain and Turkey

Spain - retail market structure (1988-1995)



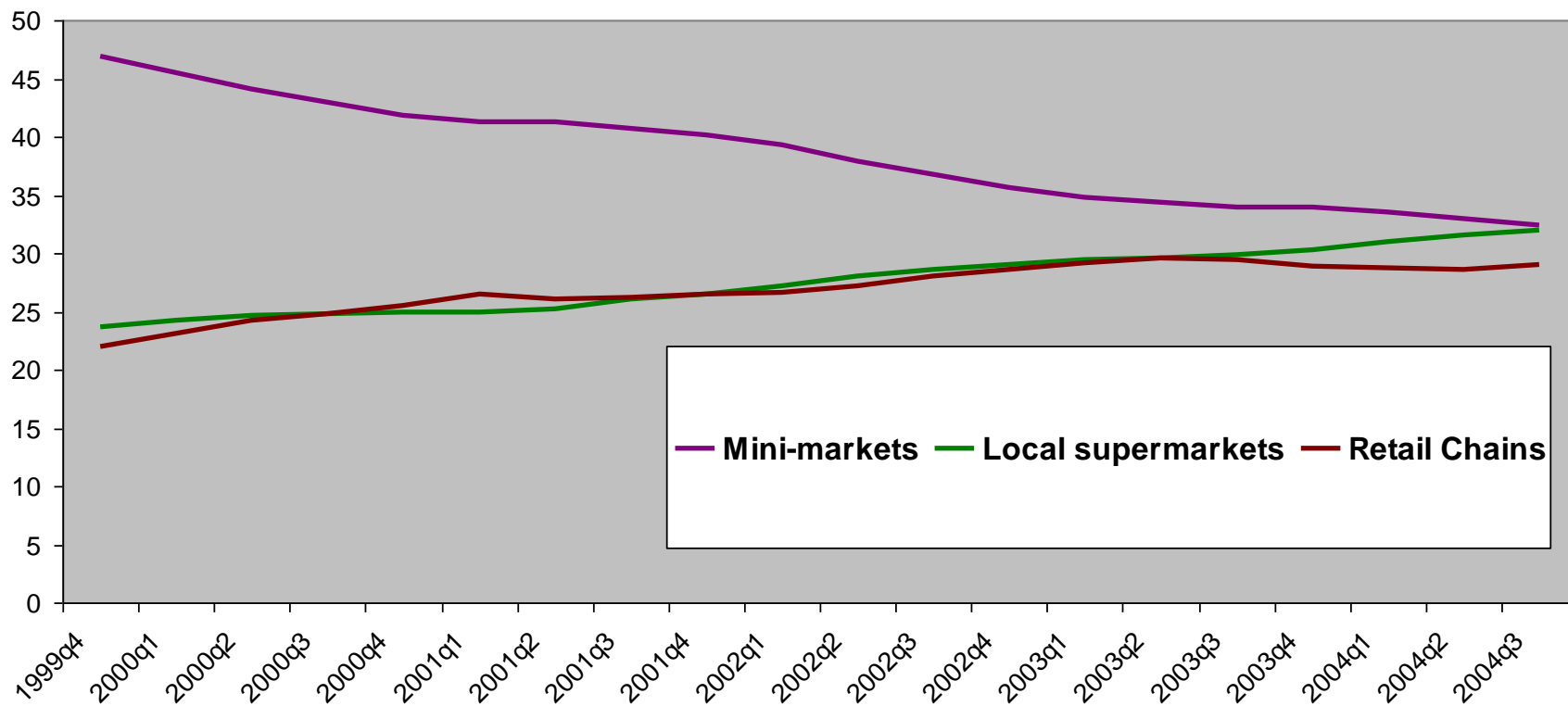
Source: Consumer's Co-operative Institute, Japan

Turkey - retail market structure (2000-2004)



Source: AC Nielsen

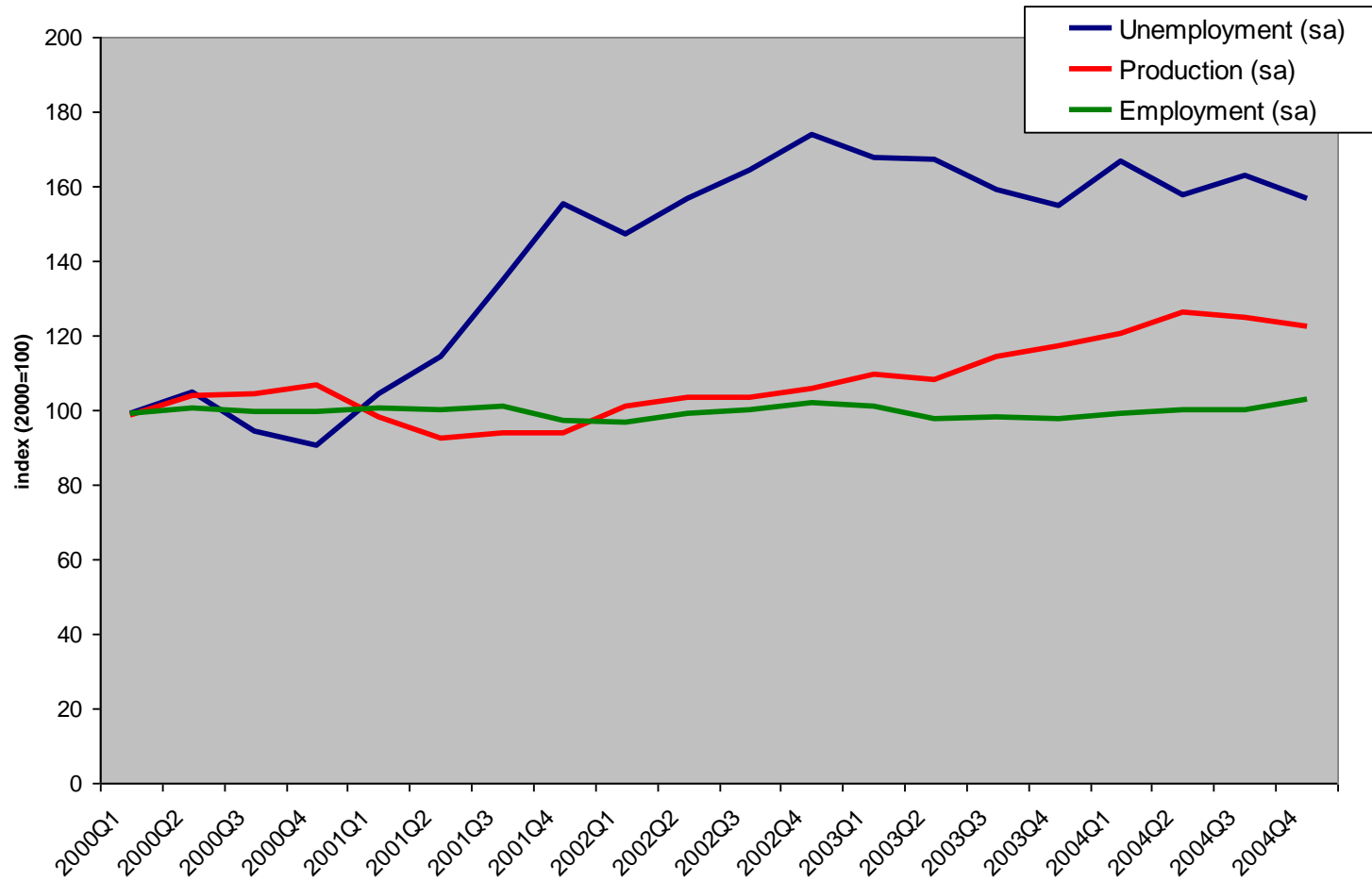
Decline of Traditional Shops



Winners and losers in retailing

	Winners	Losers
End-points	Organized chains	Groceries, traditional shops
Distribution	Suppliers	Wholesalers
Transportation	Logistic firms	Individual truck-owners
Production	Brand-names	Informal producers (quality??)

Process (1)



Sustainability of the Growth Process (2)

Productivity increase not sustainable?

Current Account

Imports of intermediate and capital goods are increasing... more than exports

Rising Trade Intergration has not led to an adequate Financial Structure

...yet patterns & trends seem promising

FDI inflows

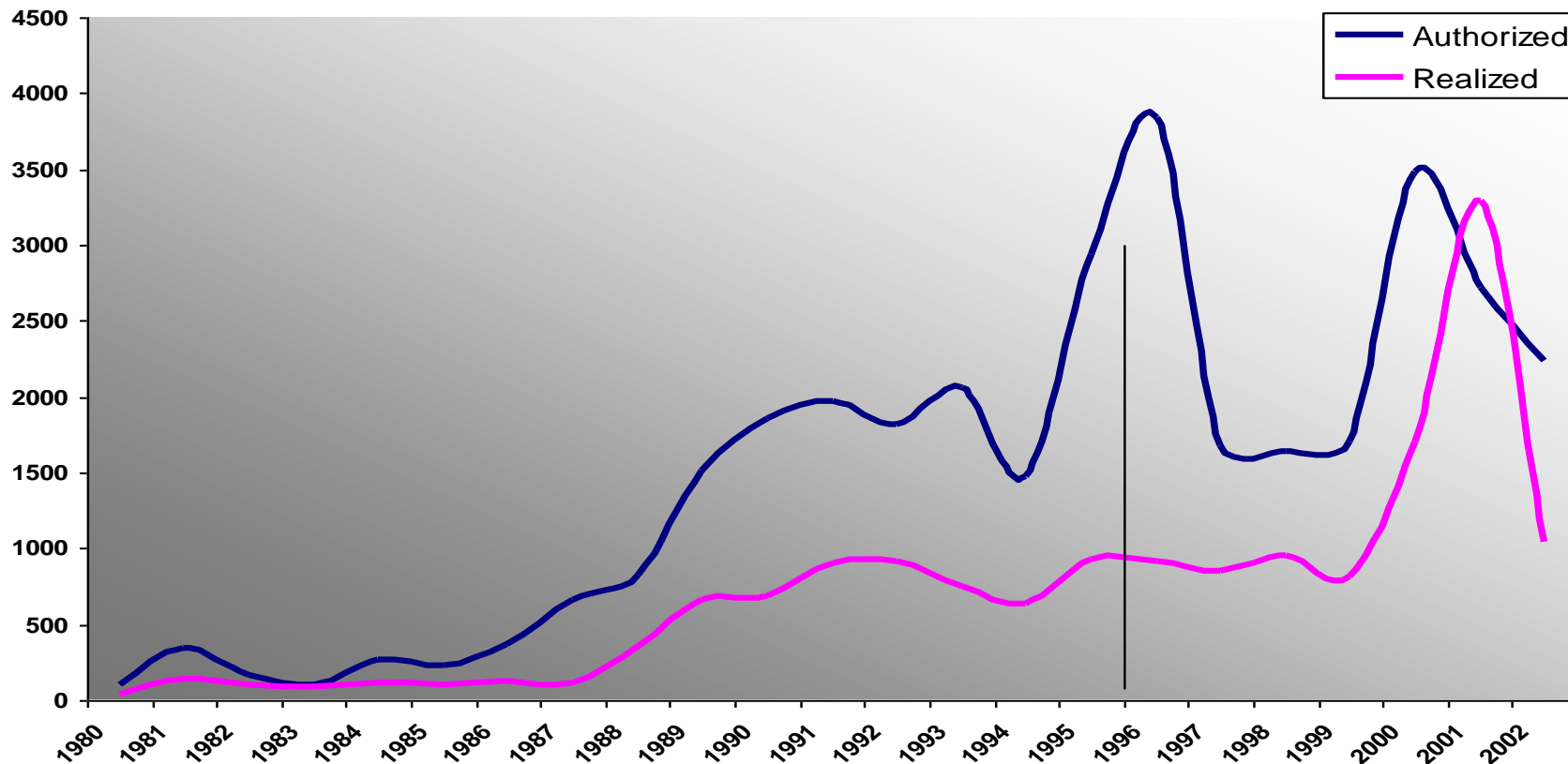
Unemployment

anchor

IMF	EU
When you agree with the IMF, IMF is <i>actively</i> overseeing the performance.	When you start the negotiation process, EU Commission is <i>passively</i> overseeing the performance.
IMF <i>stands by</i> and actively <i>participates</i> as a guarantor of policy credibility.	EU <i>stands apart</i> and actively criticizes long afterwards.

economic performance

FDI Inflows to Turkey (million US\$)



Source: Foreign Investment Directorate, Treasury

without accompanying reforms

Investment Climate Problems:

Tax System and Administration

Labor Regulations

Informal Economy and Anti-competitive practices

Access to and Cost of Finance

Access to Land

Local Administrative Barriers (i.e. Licenses and permits)

Corporate Governance and Restructuring

Low Technological Base

Lack of Innovative Capabilities

Lack of Skills

A doomsday scenario

Economic program lacks in new job-creation.

Losers from structural transformation attack the economic program.

Expansionary monetary policy and giving up fiscal discipline to increase domestic demand.

National unrest against EU.

Lose of anchor, political turmoil.

Triggering factors become active

Framework for sustainability of reforms

IMF program only provides minimum requirements.

More is necessary for sustaining a ***politically viable*** reform program.



How to support the new ***modus operandi*** and enhance the ***competitiveness*** of the Turkish corporate sector?

Reforms on the *public side*

Reducing costs: competition in infrastructure markets.

Gaining legal flexibility: reform in bankruptcy and liquidation laws.

Localization – Regional Development

Monitoring and regulating state aids

corporate side

Technological transformation

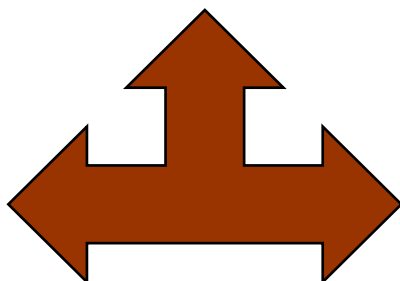
Skills-training for the new technologies

New governance structures

Outcomes:

Sustaining
productivity gains

Keeping high
dynamism of firms



We need:

Foreign direct
investment

Better financial
intermediation for
domestic firms

Sustaining the reform: Social Policies to ease structural transformation

Social security reform: implementation of social assistance programs – poverty alleviation

Education reform } EU Framework ?
Health reform }

Active labour market policies: bearing the costs of skills training

Where's the catch?

Governance structure

Flexible and fast policy making

Rule of law and credible enforcement

Conclusion: A policy agenda

We should have policies targeted to higher growth rates, rather than being afraid of it.

We should have more than IMF program to attain above-normal growth rates:

- More reforms targeted to corporate sector.

- A stronger internal commitment to EU anchor.

- Introduction of social policies.