

State of the Turkish Economy

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Agenda

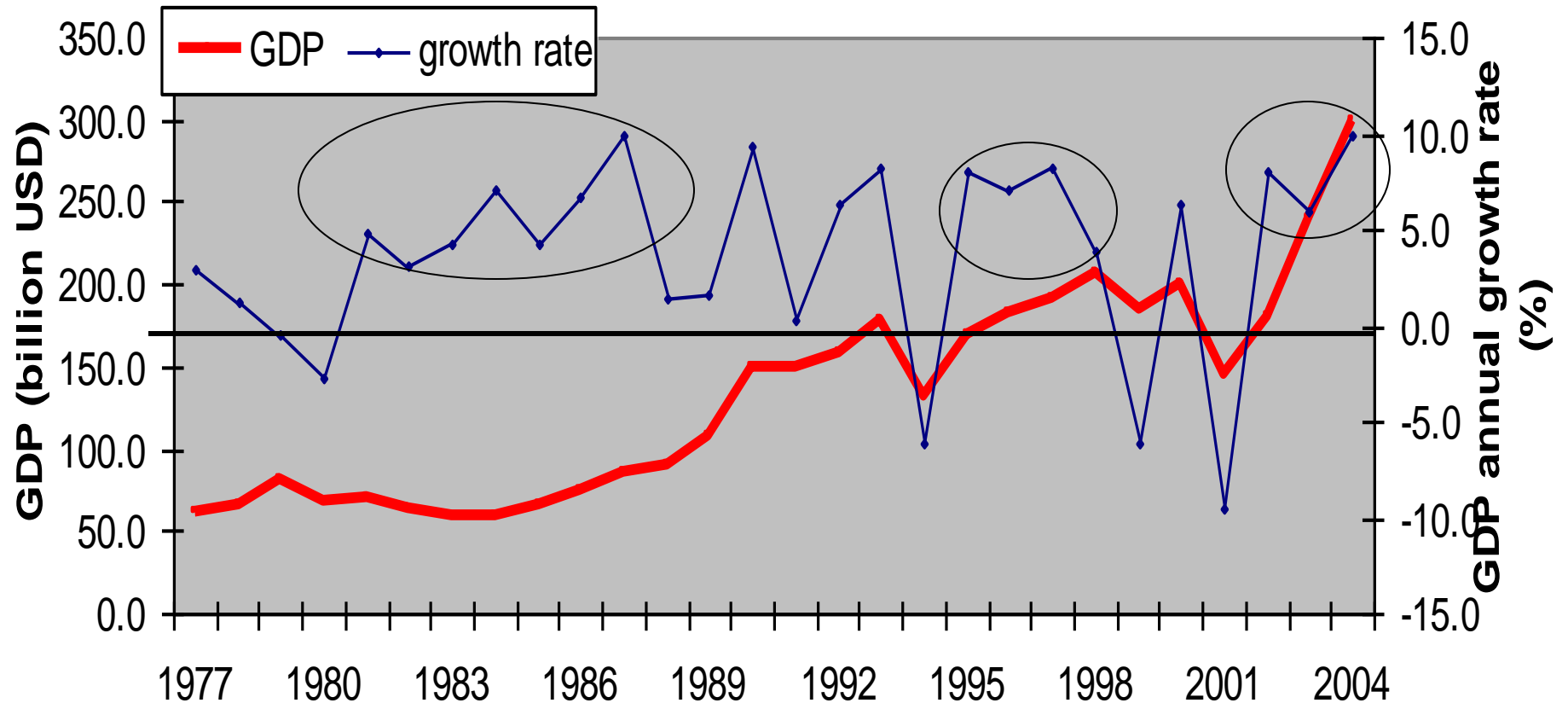
- Overview of the Turkish economy
- Risks and priorities
- New anchor: EU
- What are the policy implications?

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

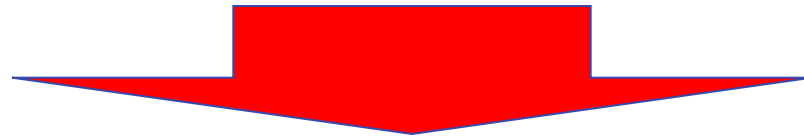
Economic growth

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



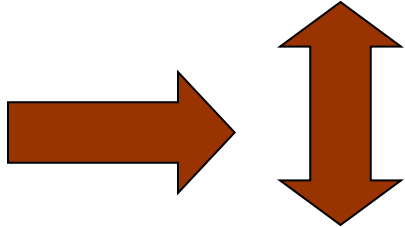
- three economic crises, internal conflict, 1999 earthquake...
- the 2001 economic crisis = GDP shrank by 10%

Putting risks into perspective: What has Turkey done so far?

Basic elements:

- Monetary Discipline
- Fiscal Discipline
- Public Administration Reform
- Banking Sector Reform-Corporate Restructuring

Basic Outcomes:

- Relative stability
- 
- Structural transformation process

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

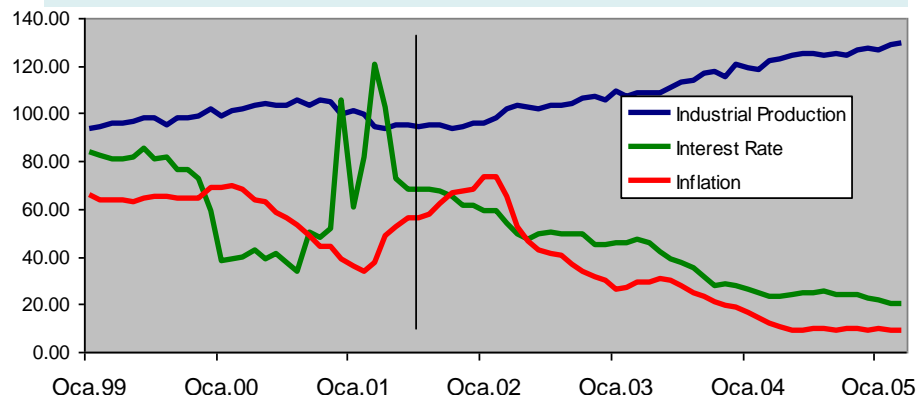
Financial Sector Reform

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

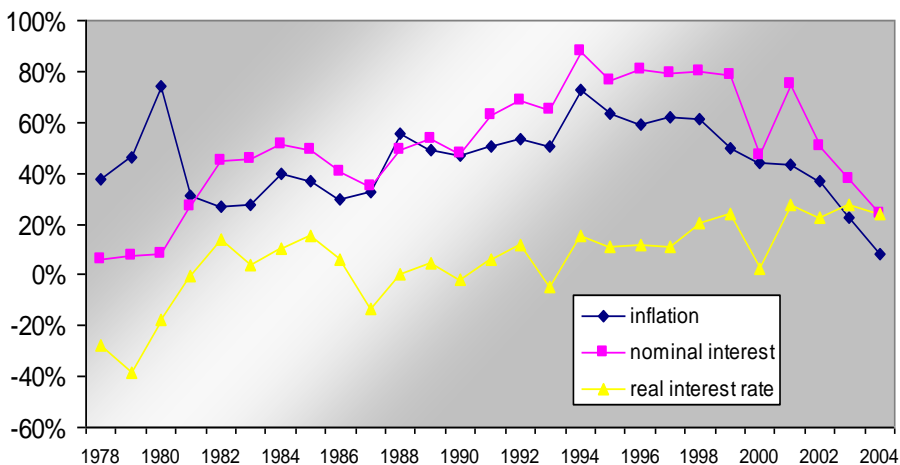
A new process following the 2001 crisis?

- Growth without inflation
- Interest rates are falling down
- Productivity is rising

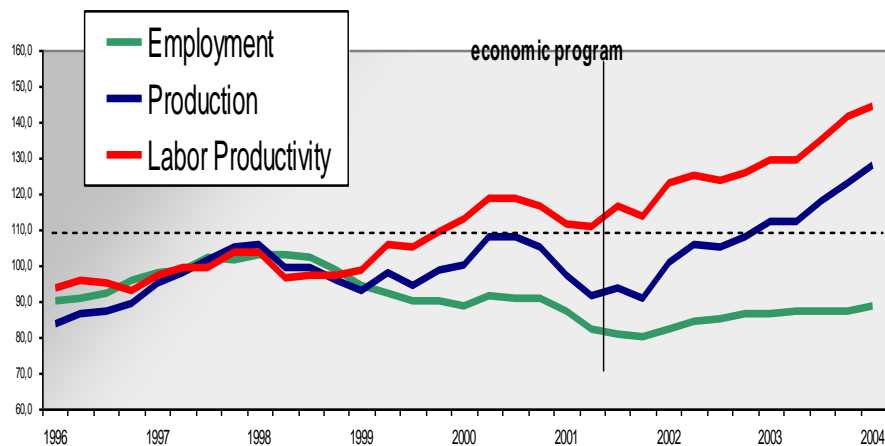
Non-inflationary growth (1999-2005)



Inflation and Interest Rates



Productivity and Employment Trends



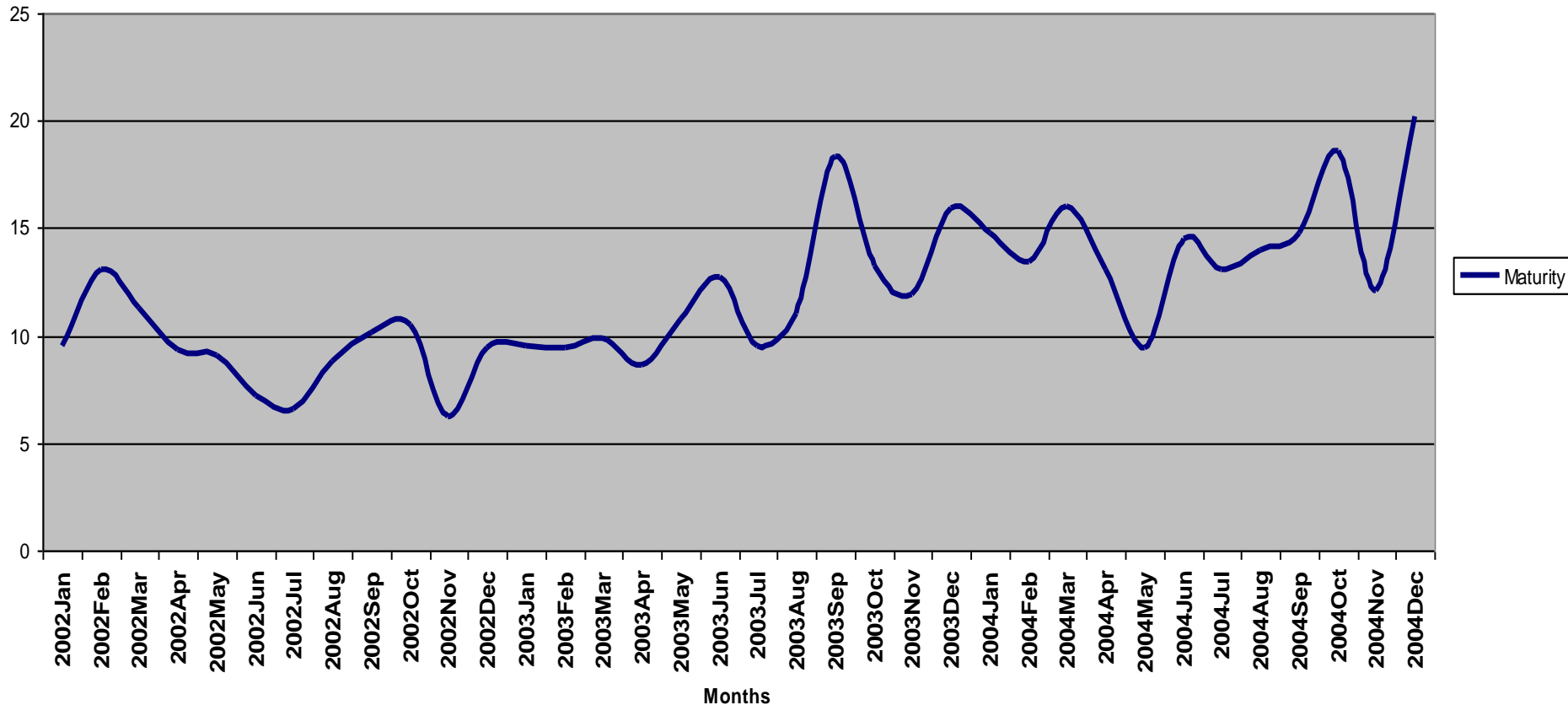
Turkey's Recovery since 2001

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

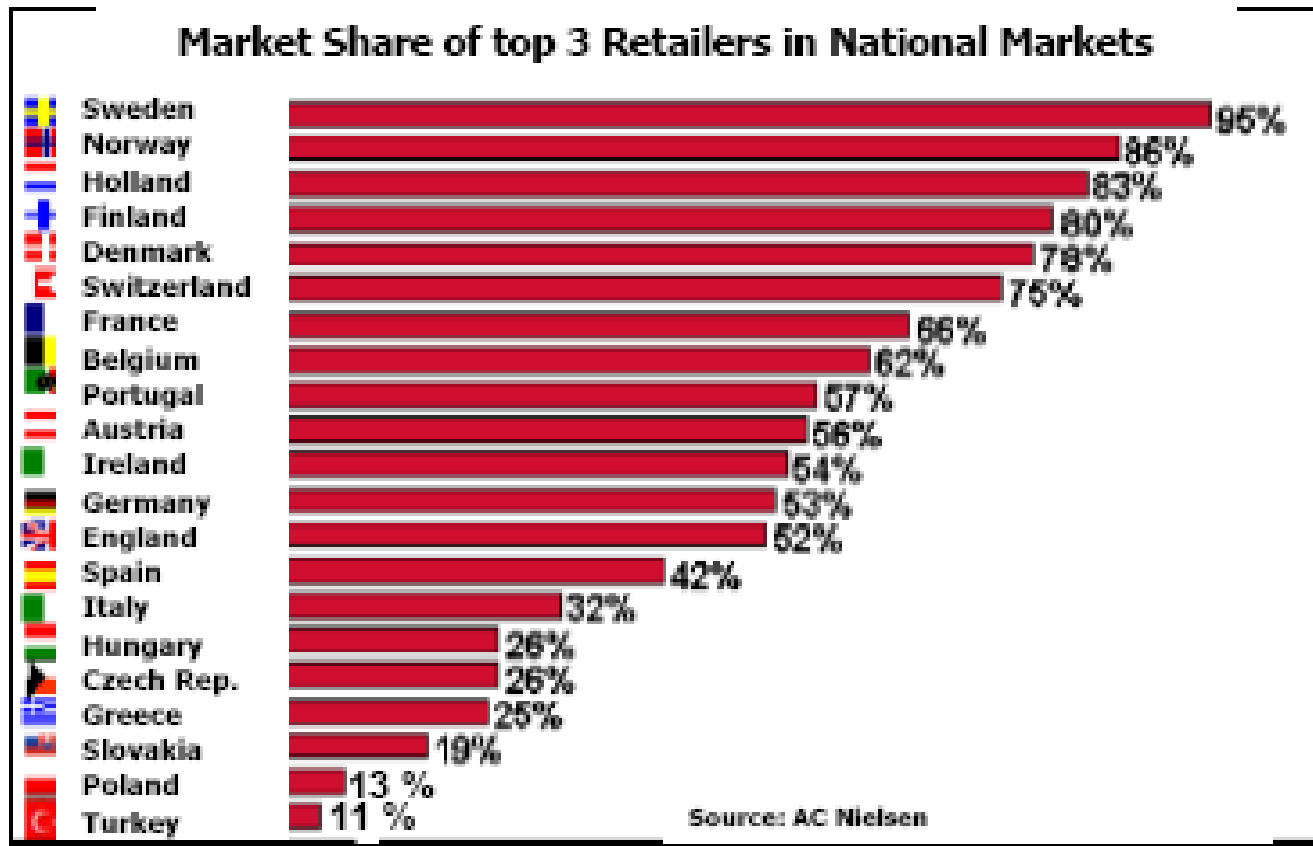
Risks:

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?

Inherent risks

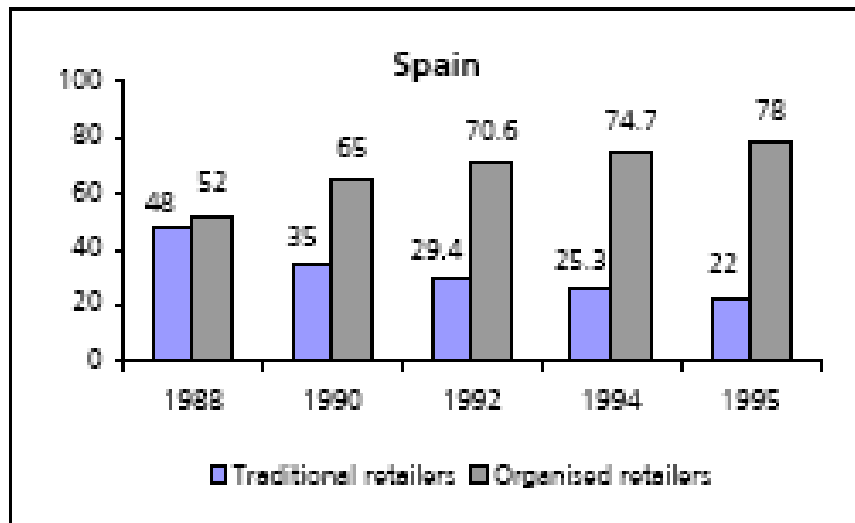
- Structural transformation risk
 - Growth sustainability risk
 - Risk of policy credibility
 - Governance risk
- } structural risks
-
- Macroeconomic vulnerabilities
- } triggering factor

Risk 1: Structural Transformation of the Turkish economy An example from retailing



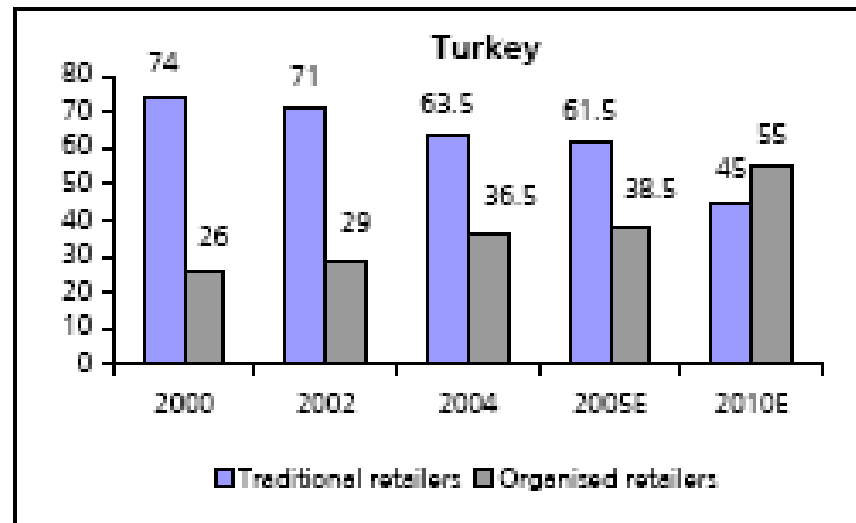
A projection for the future: Comparison of Spain and Turkey

Spain - retail market structure (1988-1995)



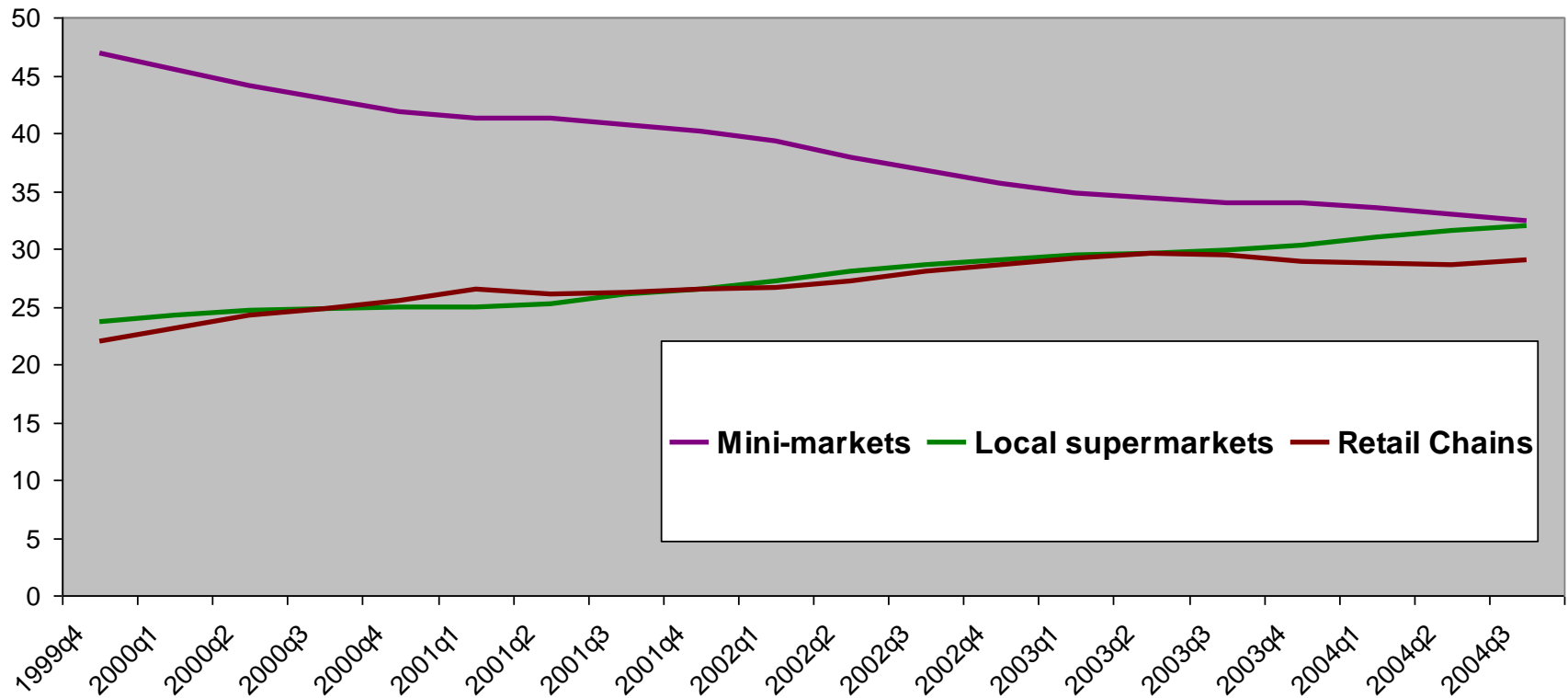
Source: Consumer's Co-operative Institute, Japan

Turkey - retail market structure (2000-2004)



Source: AC Nielsen

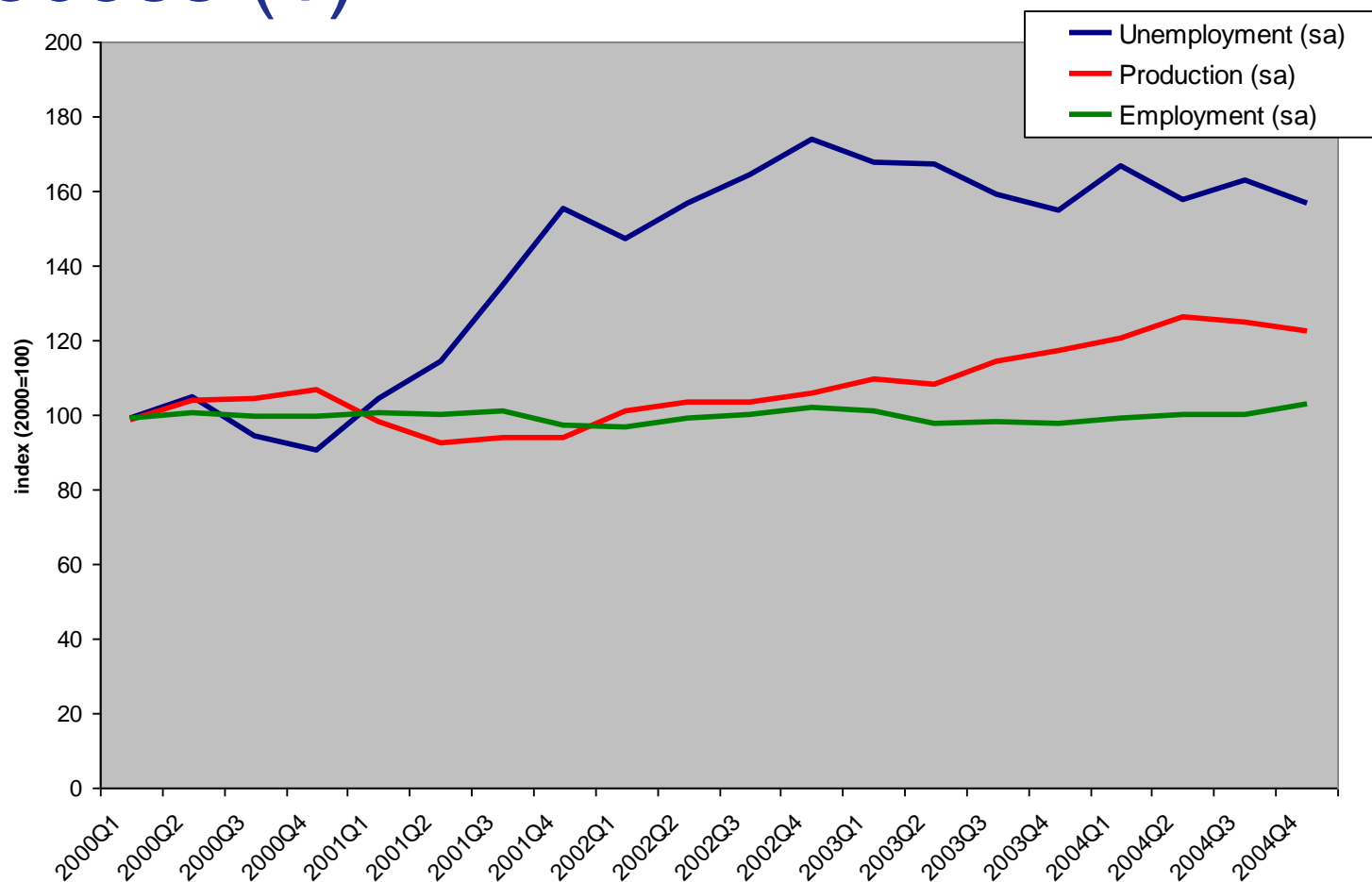
Market Shares in Retailing: Decline of Traditional Shops



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??)

Risk 2: Sustainability of the Growth Process (1)



Sustainability of the Growth Process (2)

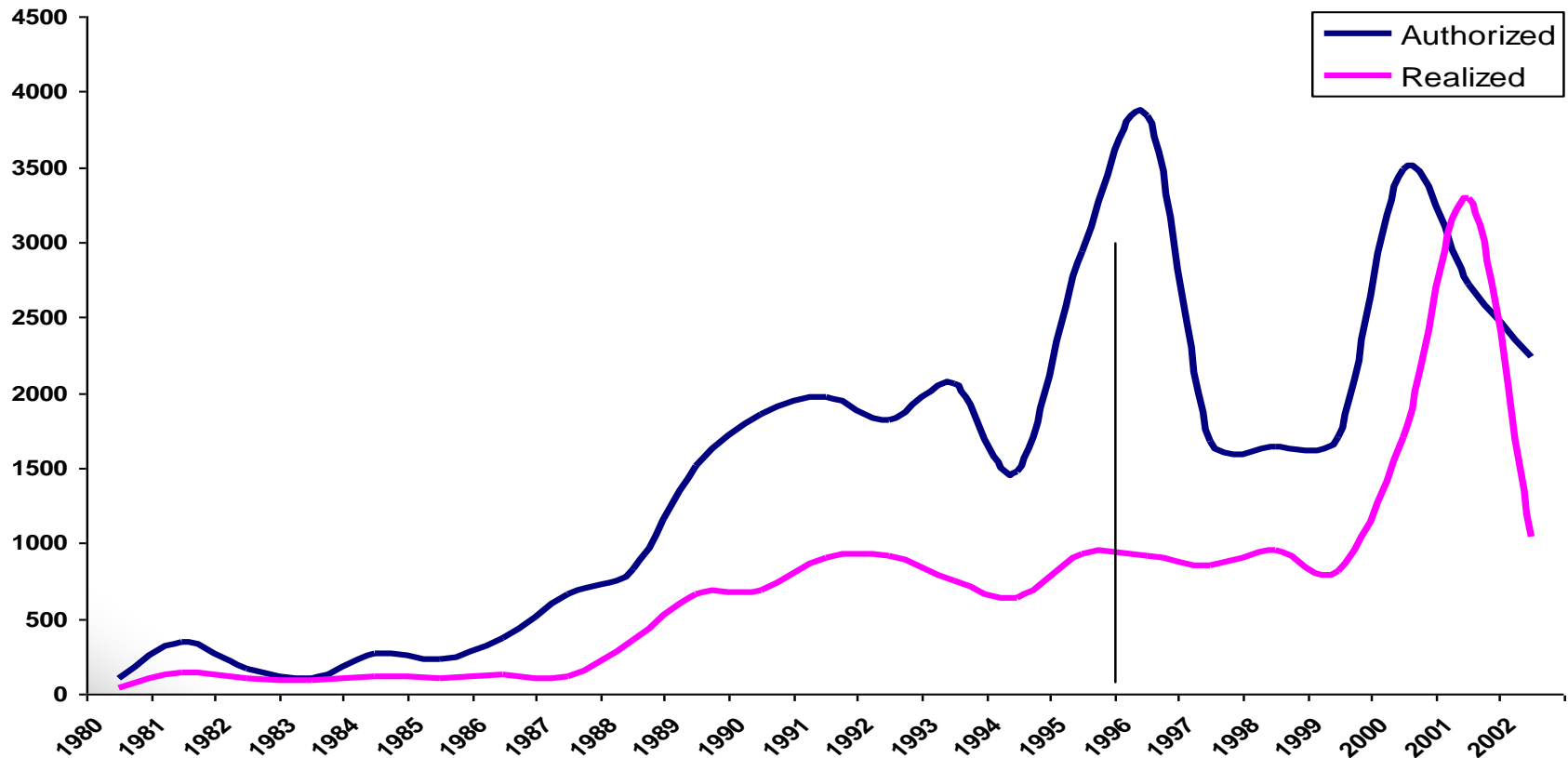
- Productivity increase not sustainable?
- Current Account
 - Imports of intermediate and capital goods are increasing... more than exports
 - Rising Trade Intergration has not led to an adequate Financial Structure
 - ...yet patterns & trends seem promising
- FDI inflows
- Unemployment

Risk 3: EU anchor is different from IMF 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.

Any anchor is not a guarantee for superior economic performance

FDI Inflows to Turkey (million US\$)



Source: Foreign Investment Directorate, Treasury

without accompanying reforms

■ Investment Climate Problems:

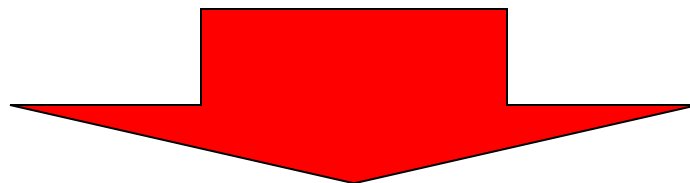
- Tax System and Administration
- Labor Regulations
- Informal Economy and Anti-competitive practices
- Access to and Cost of Finance
- Access to Land
- Local Administrative Barriers (i.e. Licenses and permits)
- Corporate Governance and Restructuring
- Low Technological Base
- Lack of Innovative Capabilities
- 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*

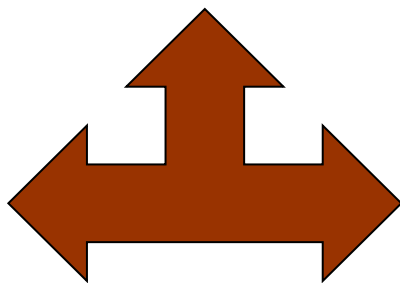
- Reducing costs: competition in infrastructure markets.
- Gaining legal flexibility: reform in bankruptcy and liquidation laws.
- Localization – Regional Development
- Monitoring and regulating state aids

Changing patterns of behaviour on *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
 - Health reform
 - Active labour market policies: bearing the costs of skills training
- } EU Framework ?

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.