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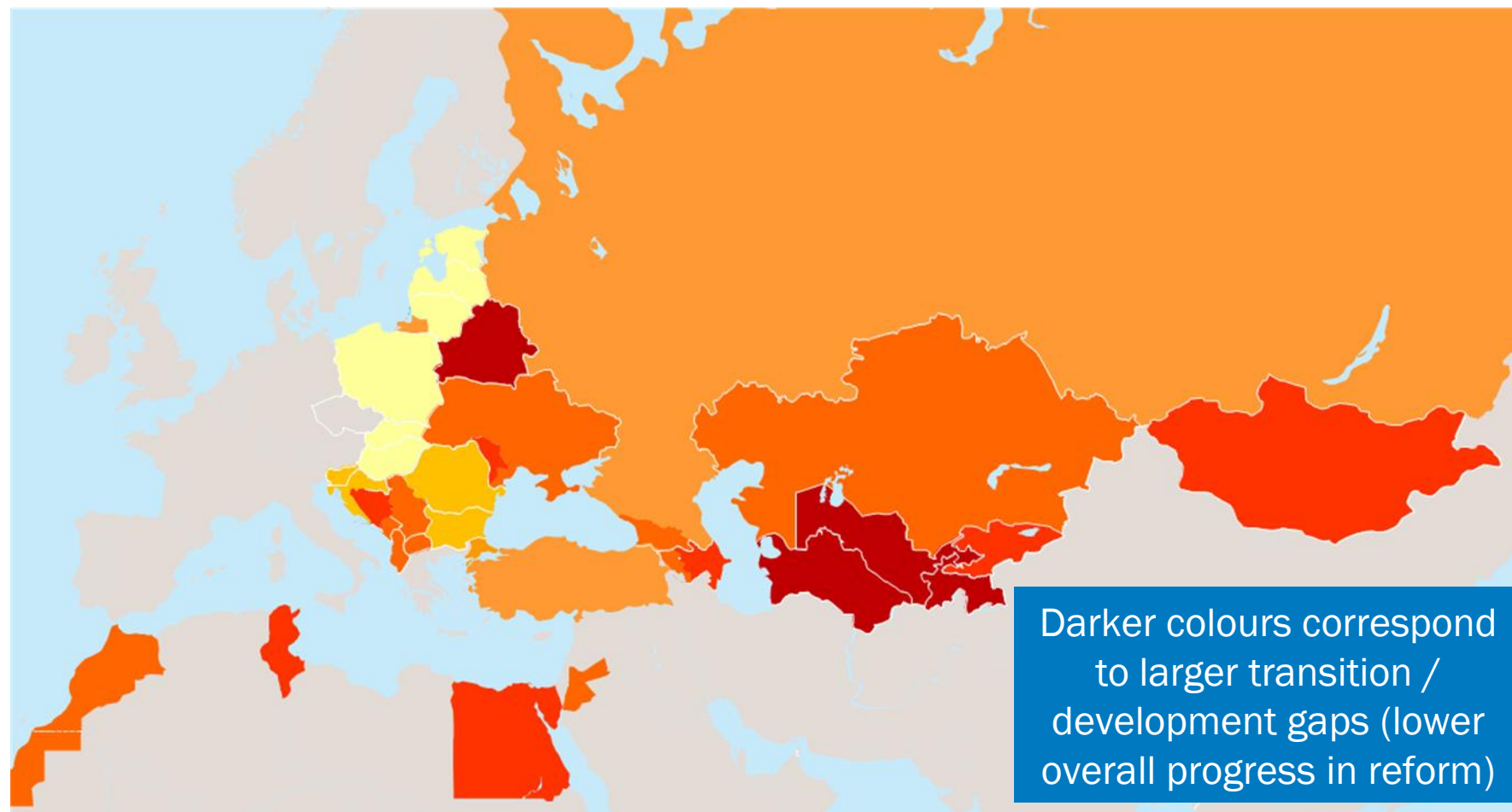
STUCK IN TRANSITION?



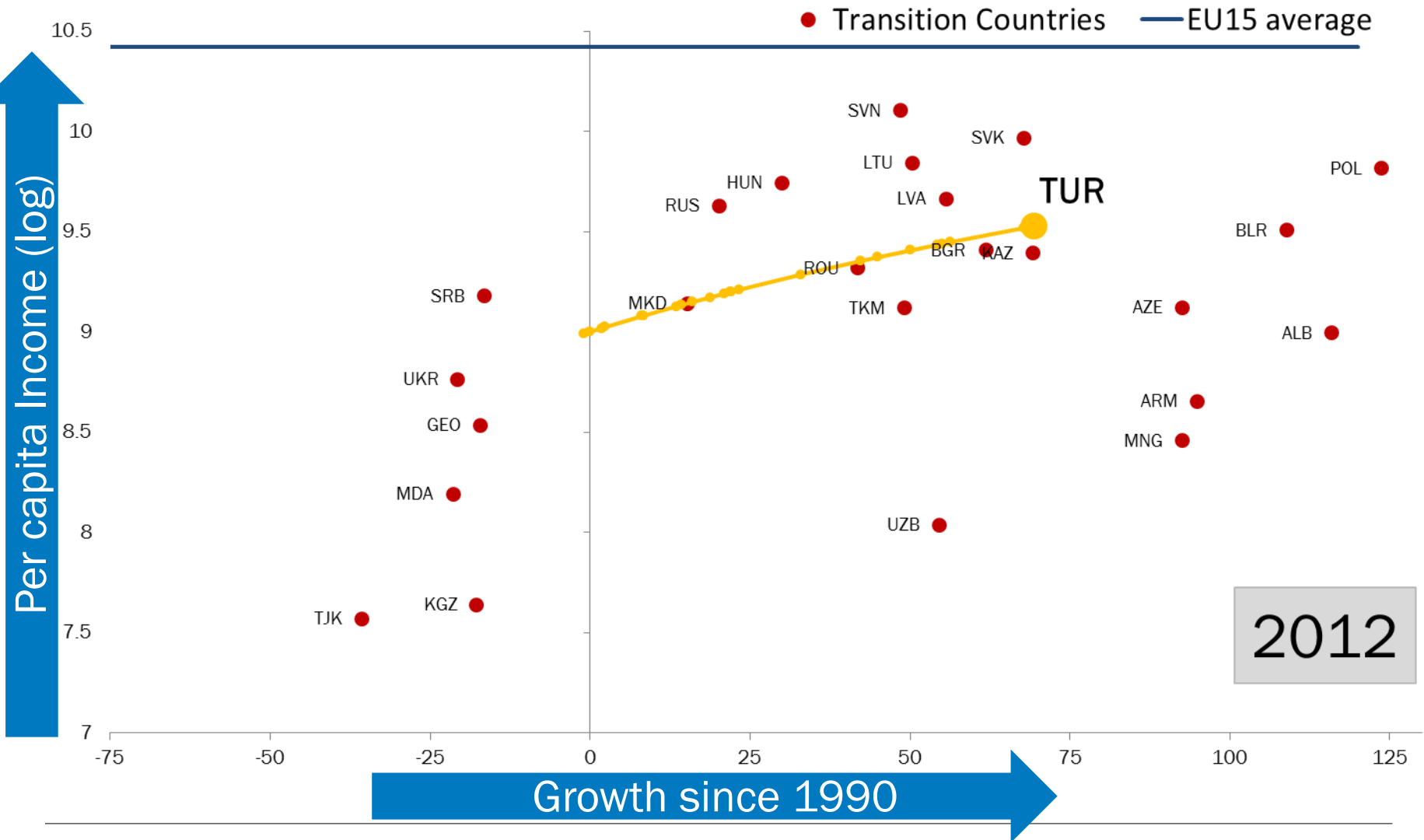
**Turkey – country visit
3-6 December 2013**

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Director for Country Strategy and Policy**

EBRD covers 34 diverse countries in three continents



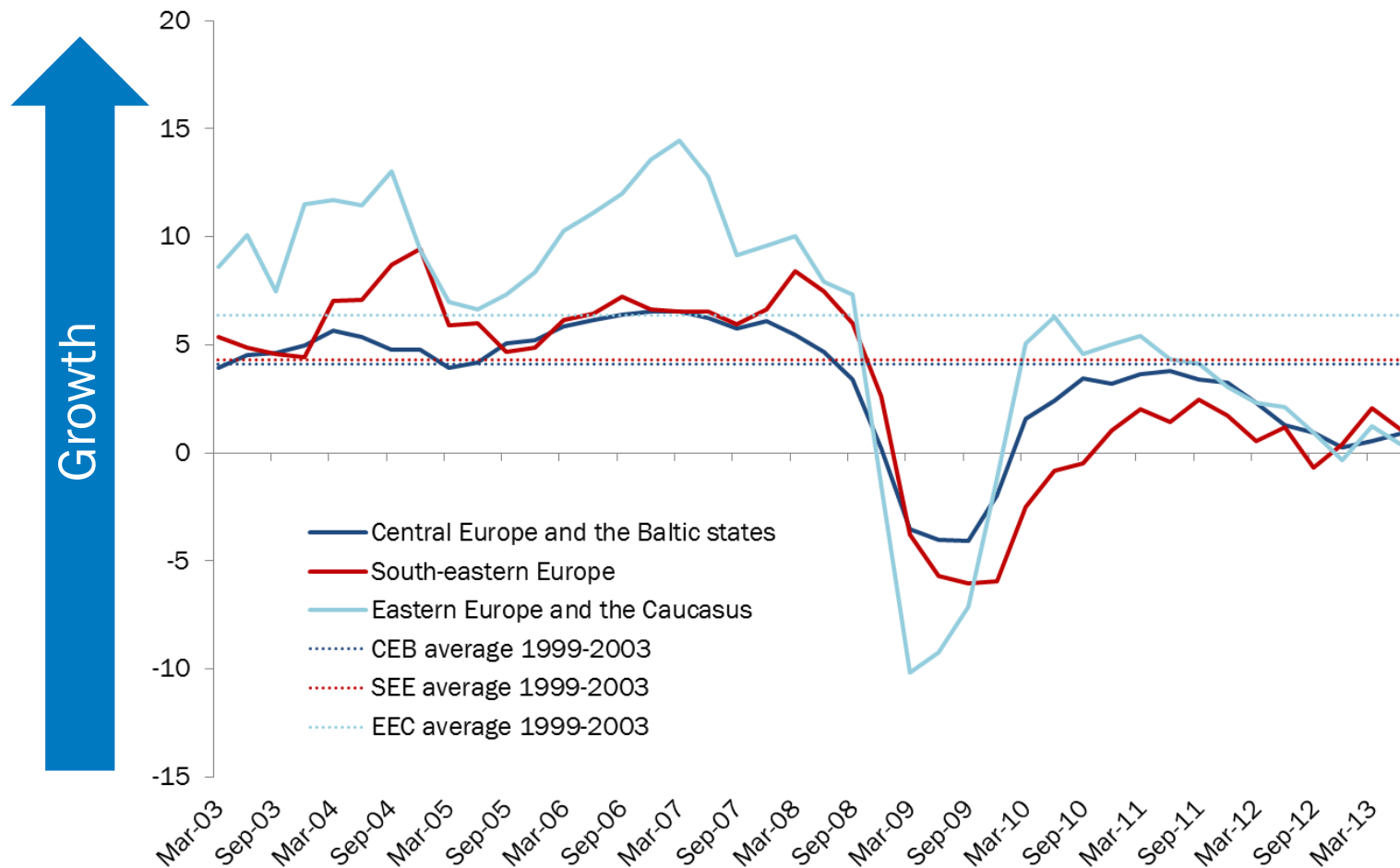
Income converged, but will it continue?



2012

Motivation: will convergence resume?

Real GDP growth y-o-y, per cent:



This Transition Report in a nutshell

I. Why has convergence slowed?

Answer:

- Low hanging fruit of transition (reform process) has been picked in most countries
- Reforms have slowed or stagnated since mid-2000s

II. How can we invigorate reforms and improve economic institutions?

Answer: complex; but best to think of it in terms of:

- Creating reform-friendly political systems
- Circumventing political constraints to reform

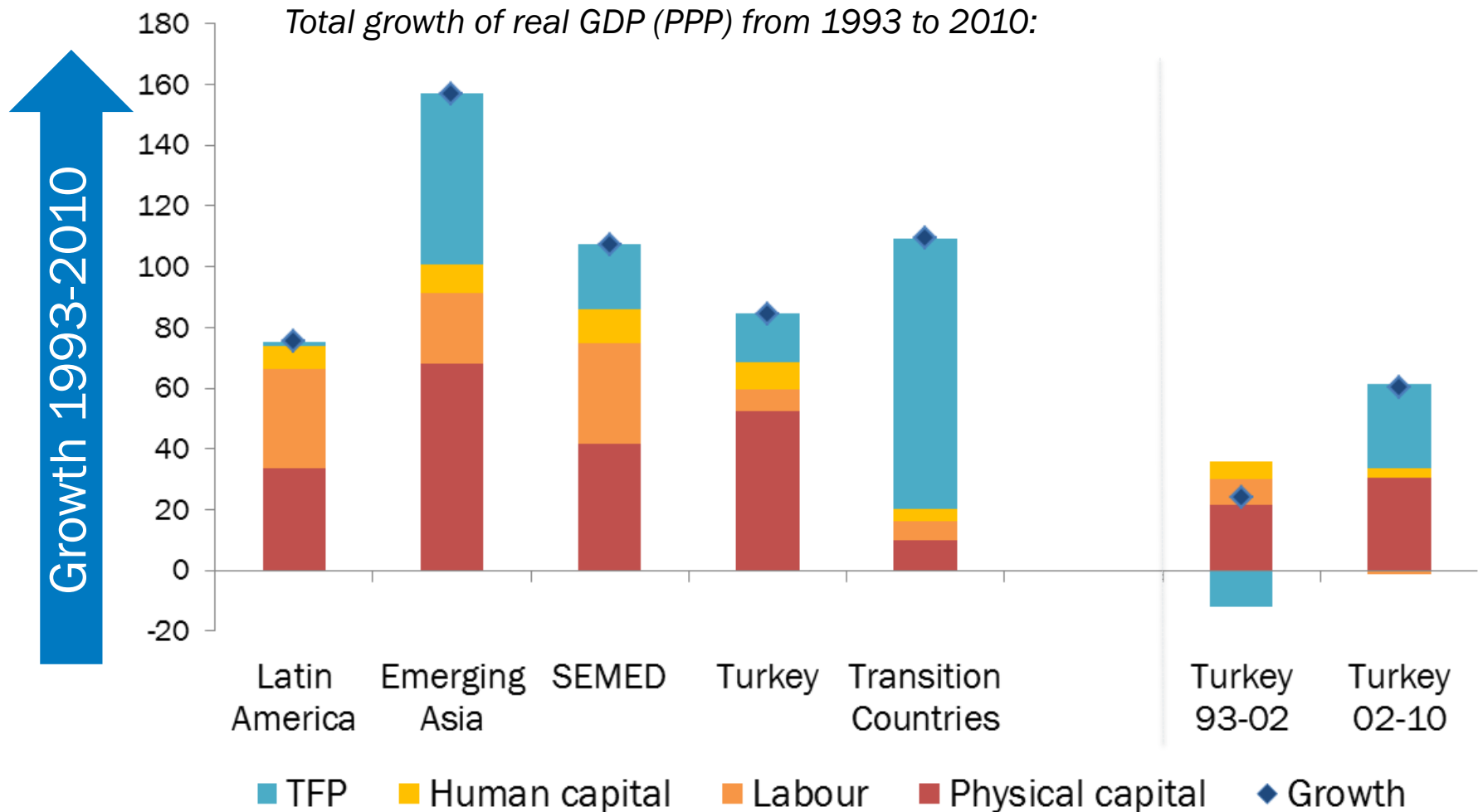
I. Why has convergence slowed?

Everyone focuses on slower capital flows. But this a cyclical phenomenon which will lose importance in the medium term.

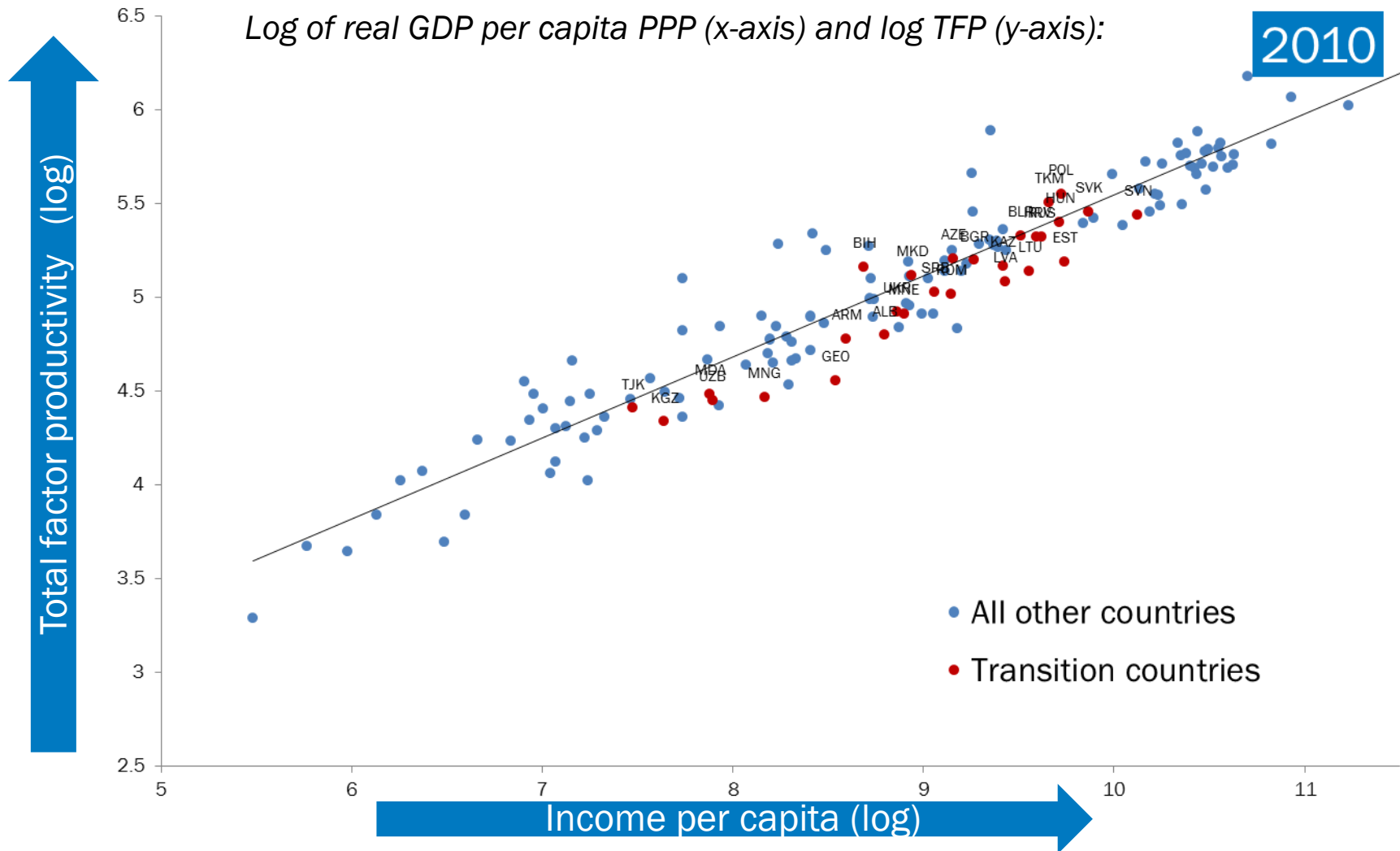
Three main reasons to be pessimistic about convergence are:

1. The end of productivity catch-up related to early transition (reform) period
2. Stalled reforms, even in transition countries outside the EU where scope for improvement remains largest.
3. Recent reform reversals, particularly in some more advanced countries

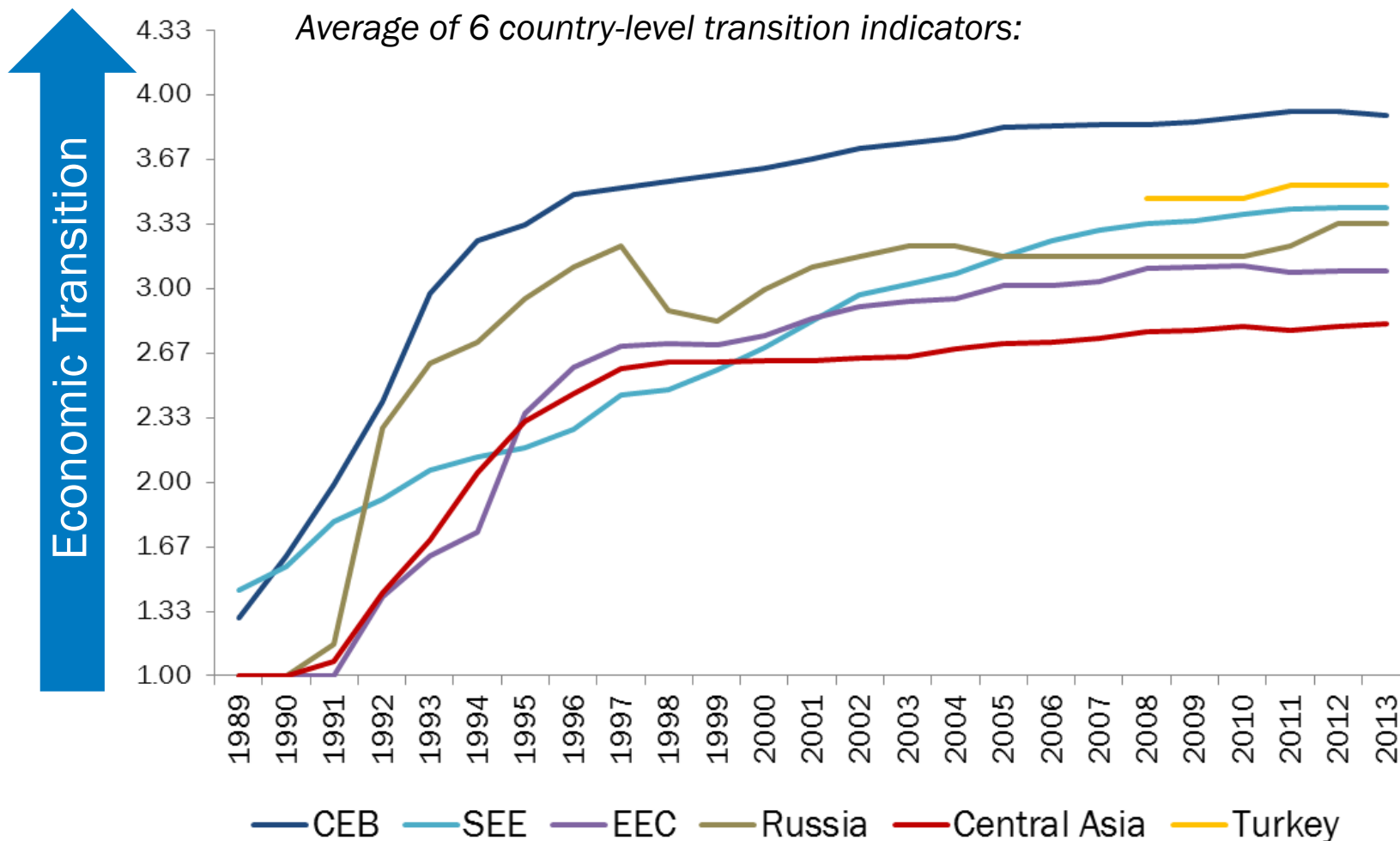
Convergence driven by total factor productivity growth...



...but this productivity catch-up may now be complete



Reforms in the transition region have stagnated since mid-2000s



What does this mean for future growth?

Analysis of long-term growth potential (panel of 88 countries, 30 years)

An augmented 4-equation neoclassical growth model:

- **TFP** = f(Initial TFP, human capital, FDI, distance, political institutions)
- **Savings** = f(demography, natural resources, financial openness)
- **Investment** = f(initial capital, savings rate, FDI, political institutions)
- **FDI** = f(initial GDP, trade and financial openness, law and order, share of services and manufacturing in GDP)

What does this mean for future growth?

Scenario 1: No reform to political and economic institutions

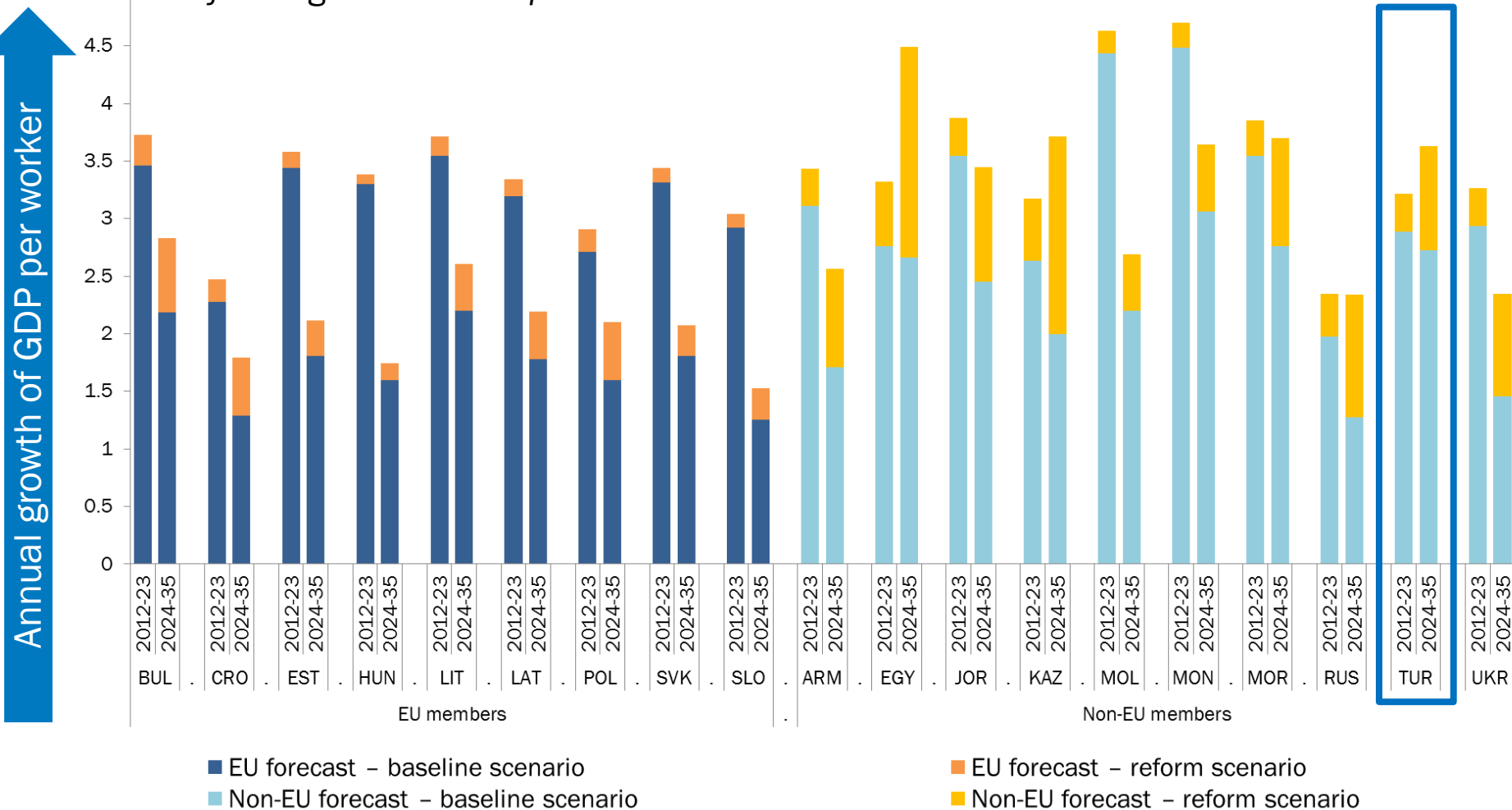
- Major slowdown in income convergence
- Convergence would stop in some countries (Croatia, Slovenia, Russia)

Scenario 2: Economic and political reforms gradually converge to highest level currently prevailing in EU

- Income convergence returns to all countries
- Some CEB countries would reach 80 per cent of EU-15 average by 2035
- Higher impact on growth in non-EU countries

Reform critical to accelerating convergence

Projected growth of GDP per worker in baseline and reform scenarios:



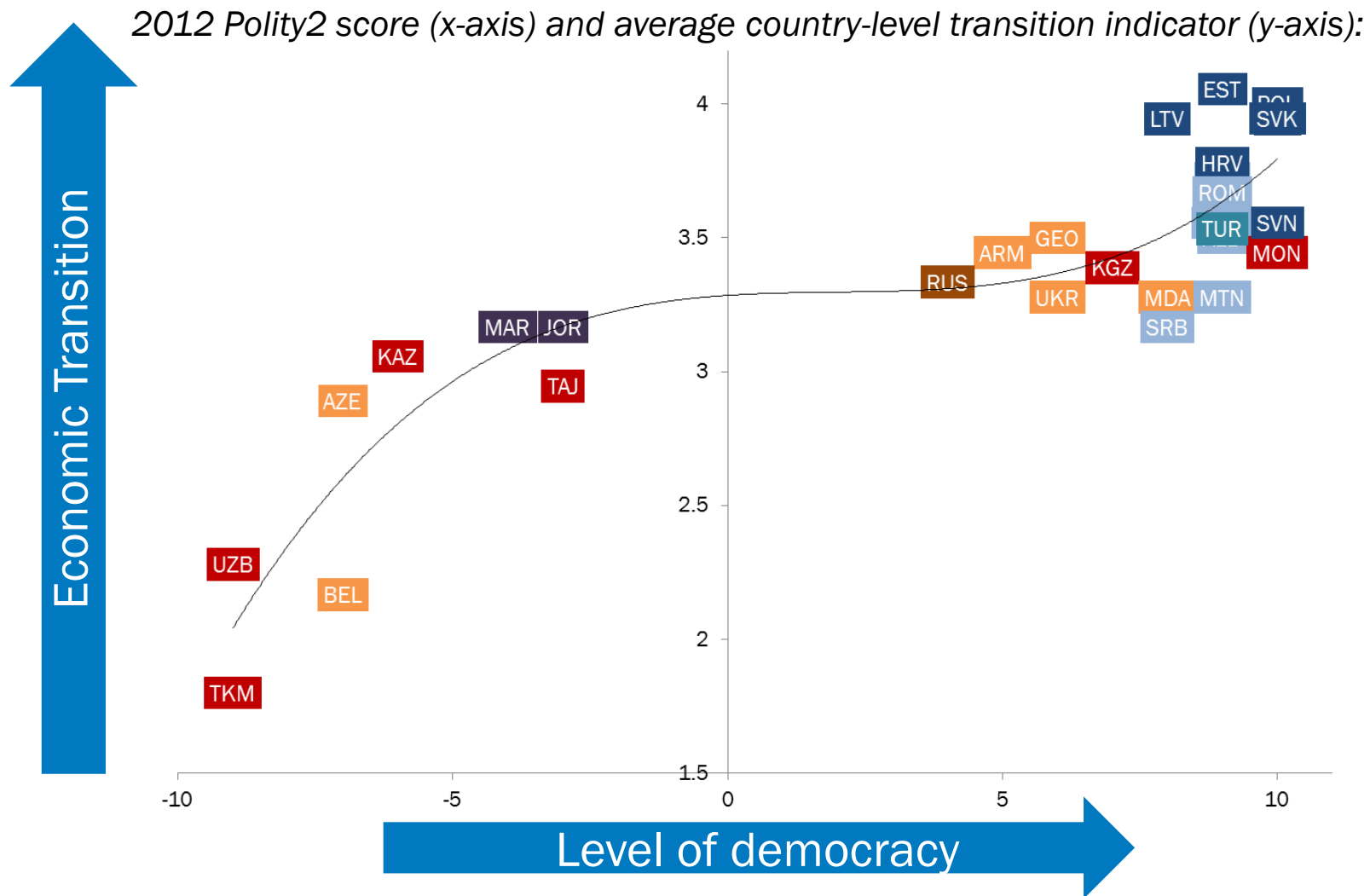
Examples of potential growth-enhancing reforms: Turkey

- Reinvigoration of privatisation programme (e.g in the energy sector)
- Simplification of labour market regulations and tax procedures that discourage employment and activity in the formal sector.
- Removal of trade barriers (e.g. high tariffs and subsidies in the agricultural sector)
- Mobilising local savings and further developing local capital markets
- Efficient delegated decision making to local governance

Invigorating reform: the big questions

1. Is democracy good for transition? Does lack of democracy impede reform?
2. Within a *given* political system, what can be done to invigorate reform and improve economic institutions?
3. What is the state of human capital (HK) in the region? What are the links if any, between HK and economic institutions?
4. How “inclusive” are economic systems in transition countries? Is this important for the success of future reform?

1. Democracy is a driver of reform (though not the only one)

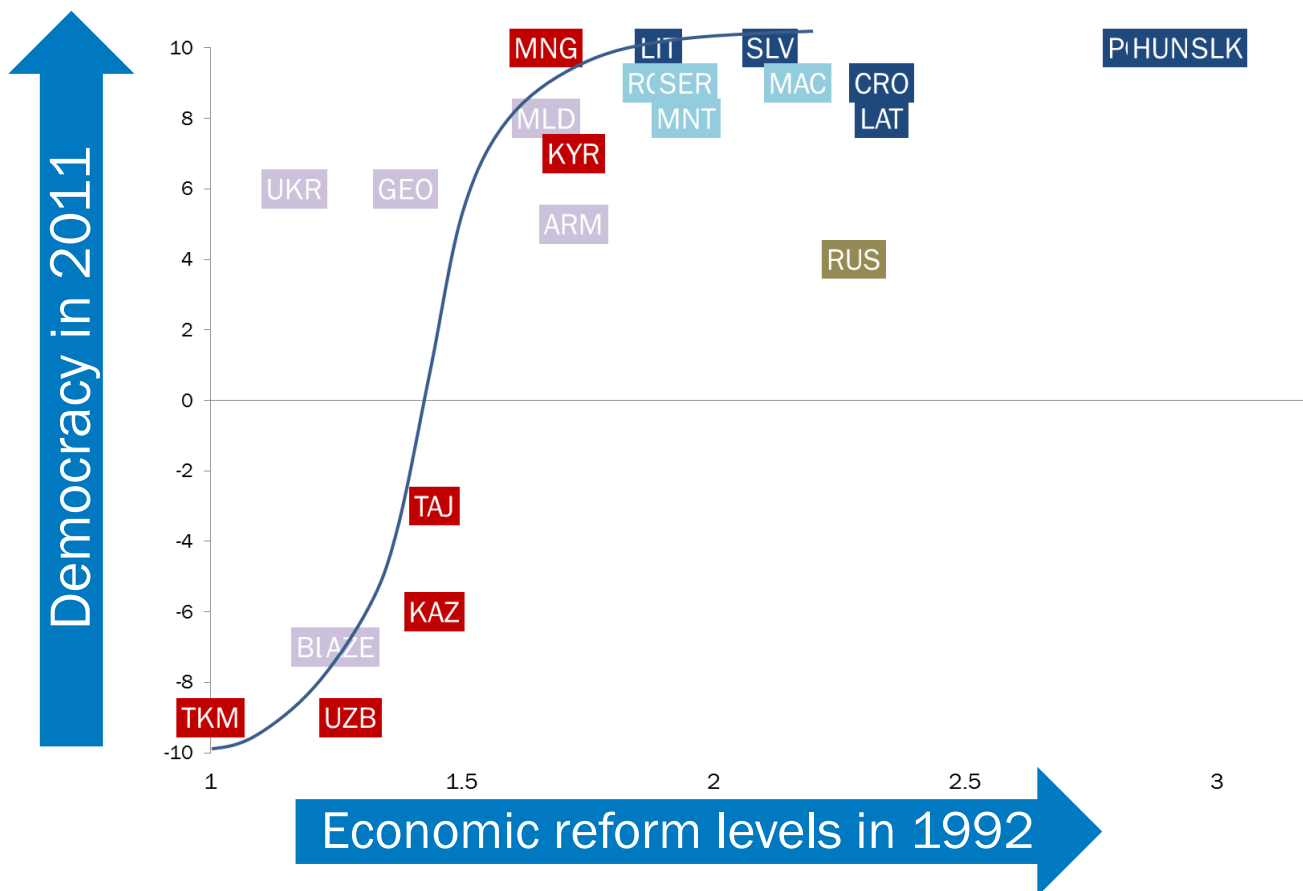


Reforms help democracy

- Reform can help democracy:
 1. By making societies richer and building constituencies for democratisation
 2. Creating competition and weakening special interests opposed to democracy
 3. Reducing inequality and polarisation

Early reforms help to predict democracy ...

Average country-level transition indicator 1992 (x-axis) and Polity2 score 2011 (y-axis) :

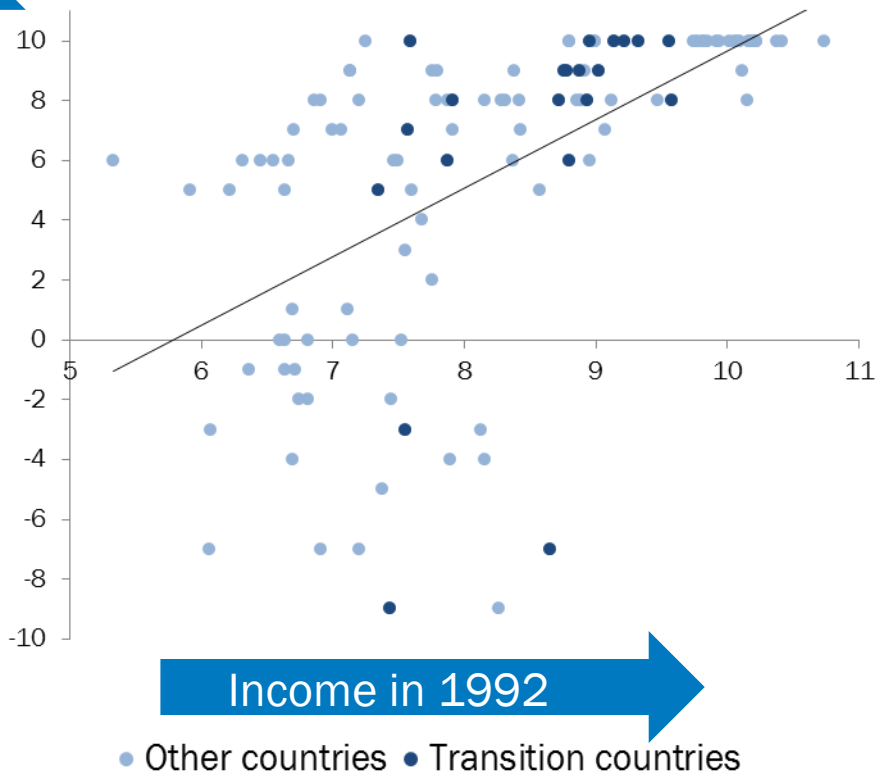


Note: relationship holds controlling for initial levels of democracy.

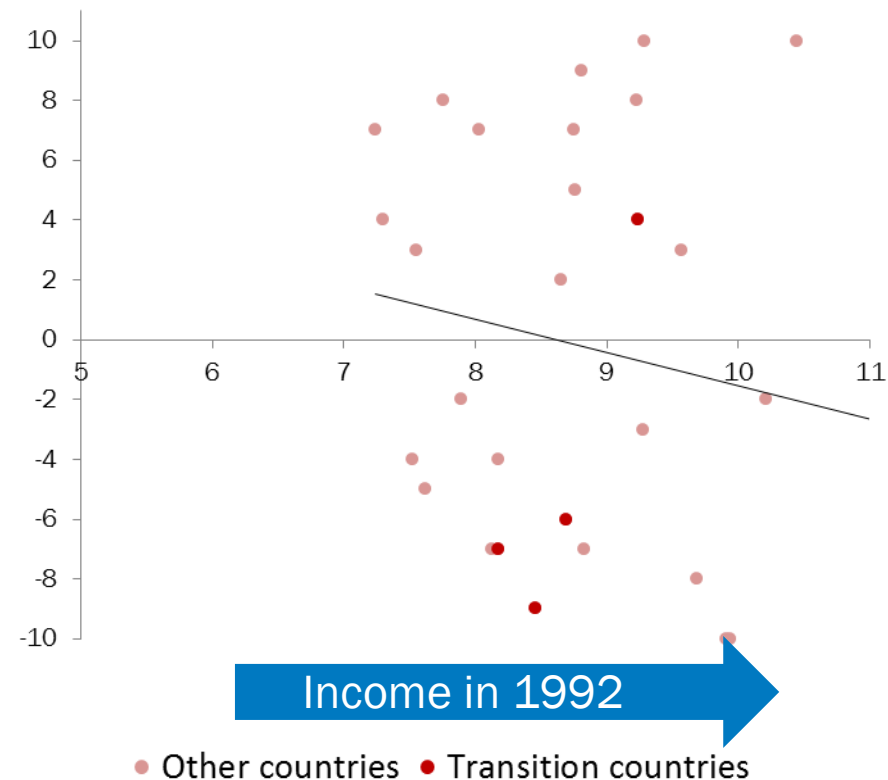
...but powerful interests – particularly in the presence of natural resources – may hold it back.

Log per capita income 1992 (x-axis) and Polity 2 score 2012 (y-axis):

Not oil producing



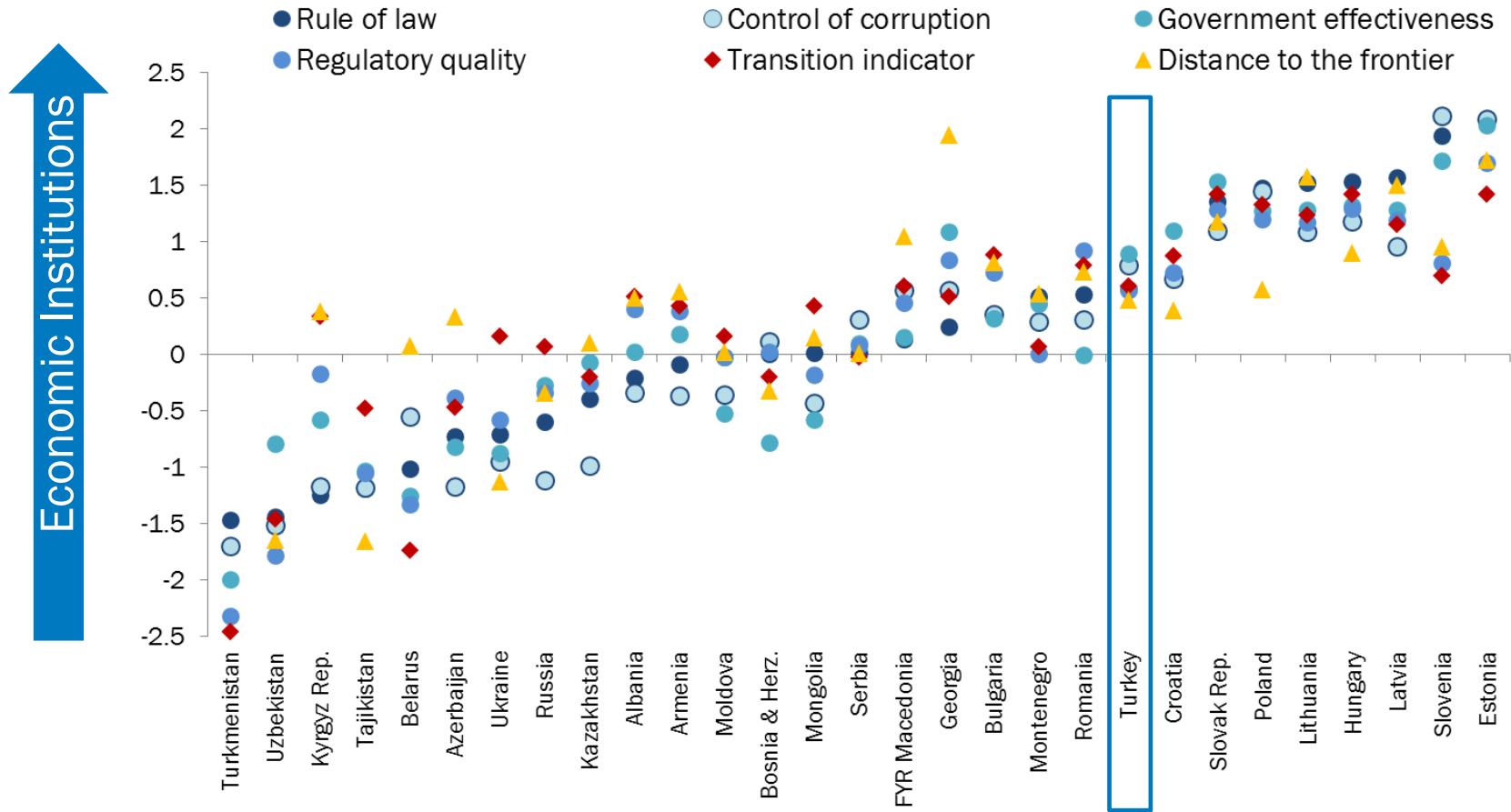
Oil-producing



2. Improving economic institutions for a *given* political regime

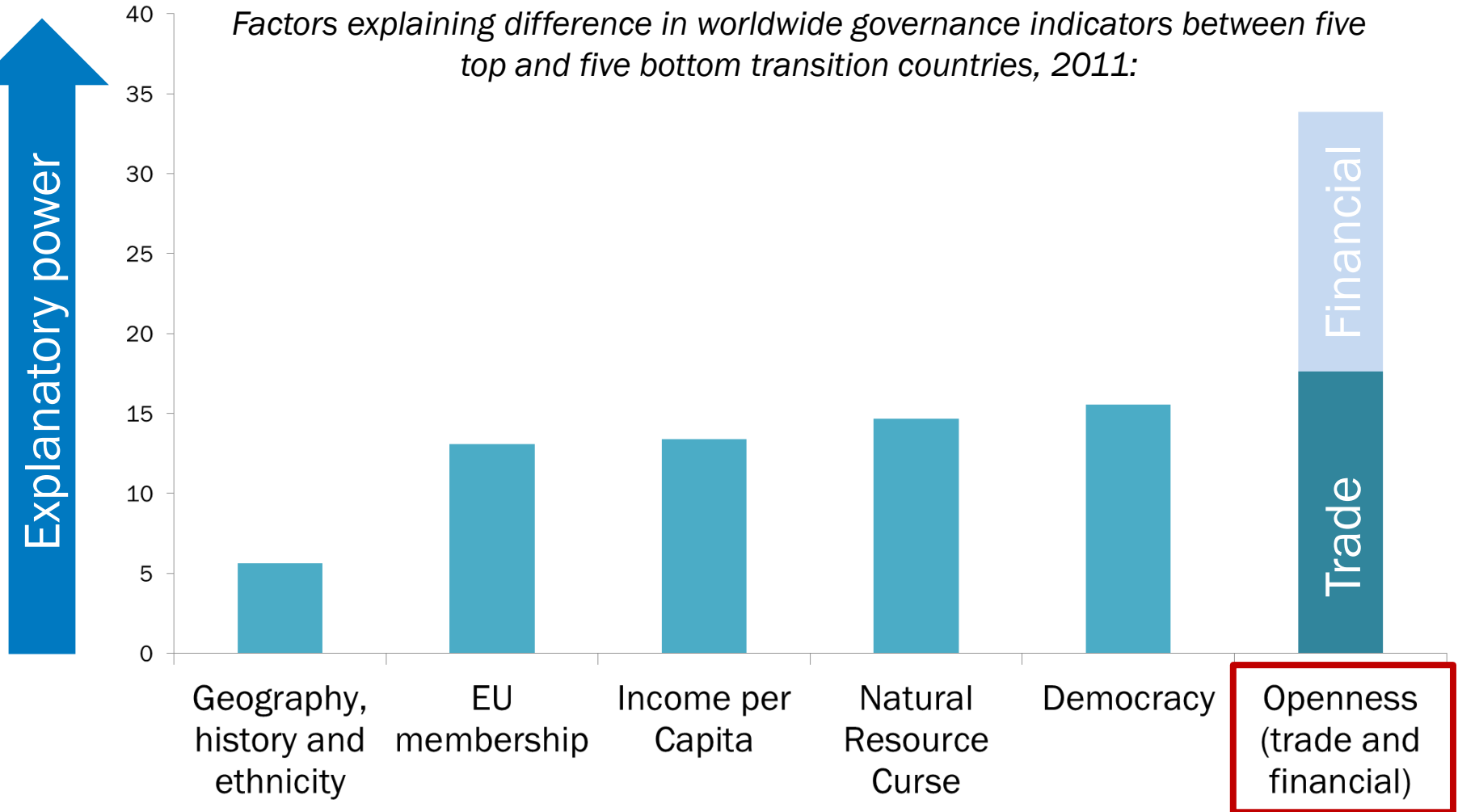
- i. International integration and external anchors
- ii. “Feasible political reform”:
 - National level (e.g. electoral system)
 - Local/regional level
- iii. Exploiting political windows of opportunity

What we mean by “economic institutions”



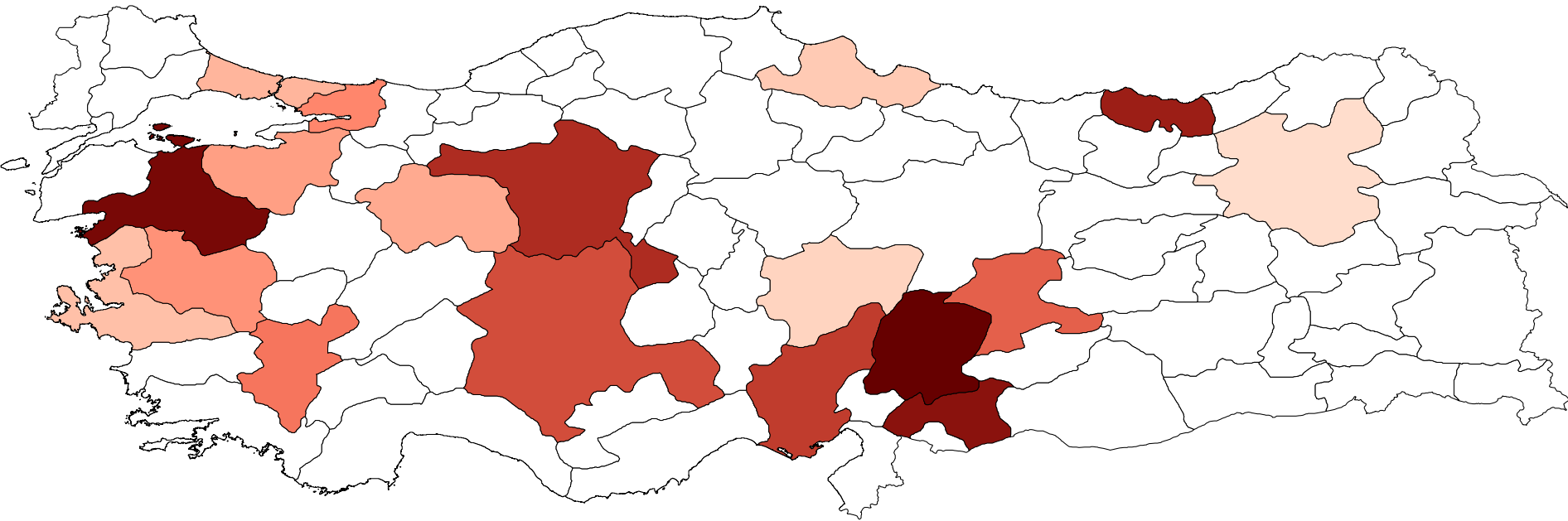
- World Bank Global Governance indicators (survey based)
- ▲ Doing business “distance to the frontier” (laws and regulations)
- ◆ EBRD transition indicators (cumulative market reform)

International integration stands out as a major correlate of good institutions



Large variation in business environment at regional/local level – opportunities for reform at the local level

- e.g. corruption as a business obstacle in Turkish provinces.



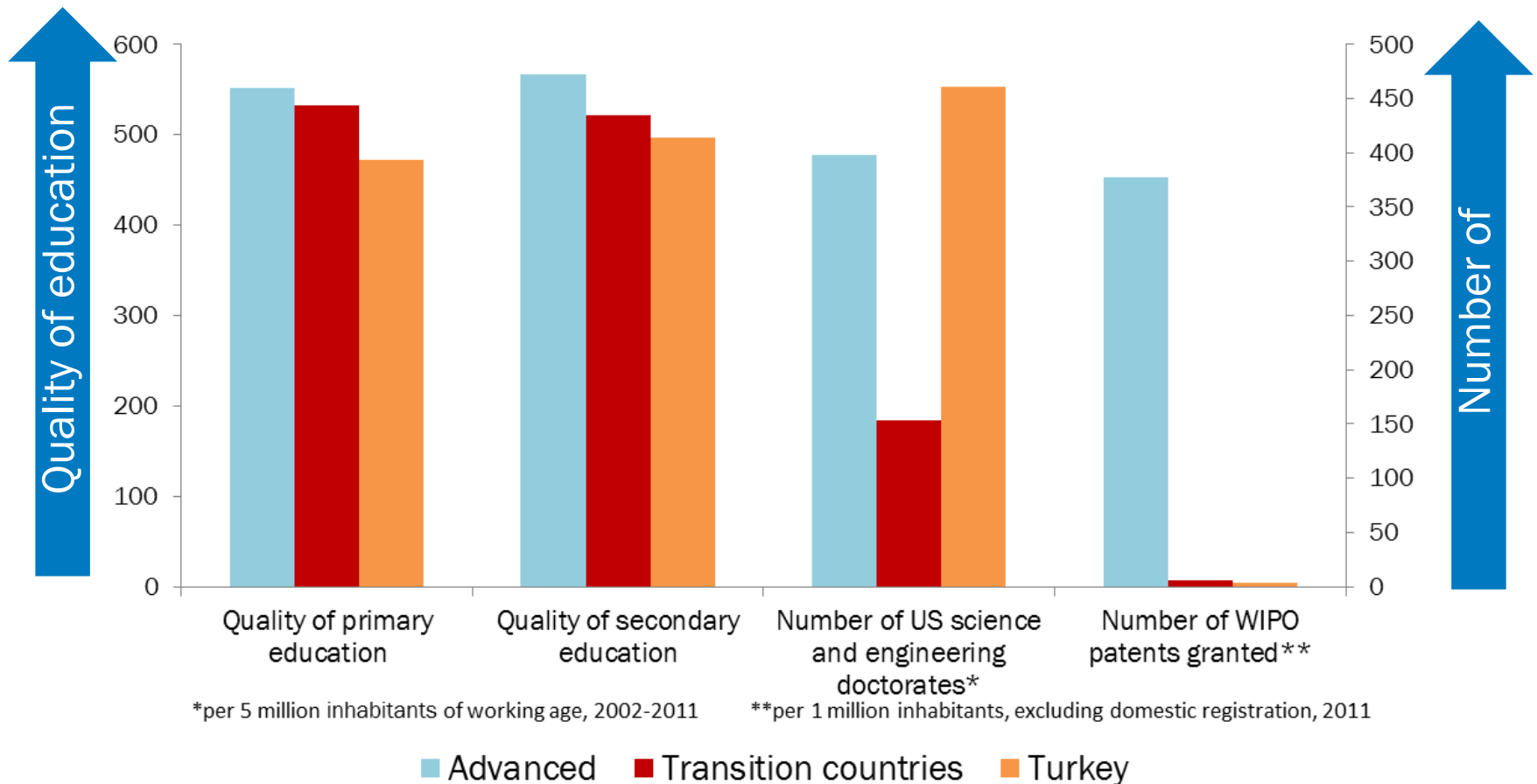
- *Based on 18 regions covered in BEEPs data*
- *Methodology Plekhanov and Isakova(2012)*
- *Dark colours indicate corruption is more of an obstacle*

3. Human capital, institutions and reform: the links

- *Links to institutions* in normal times: from human capital to institutional capacity; from institutional quality to returns to education
- *Importance in critical junctures* – recruitment of young, educated Georgians contributed to success of institutional reform after 2003.
- *Effect via economic inclusion* – *quality* of education and availability of opportunities for young people across countries.

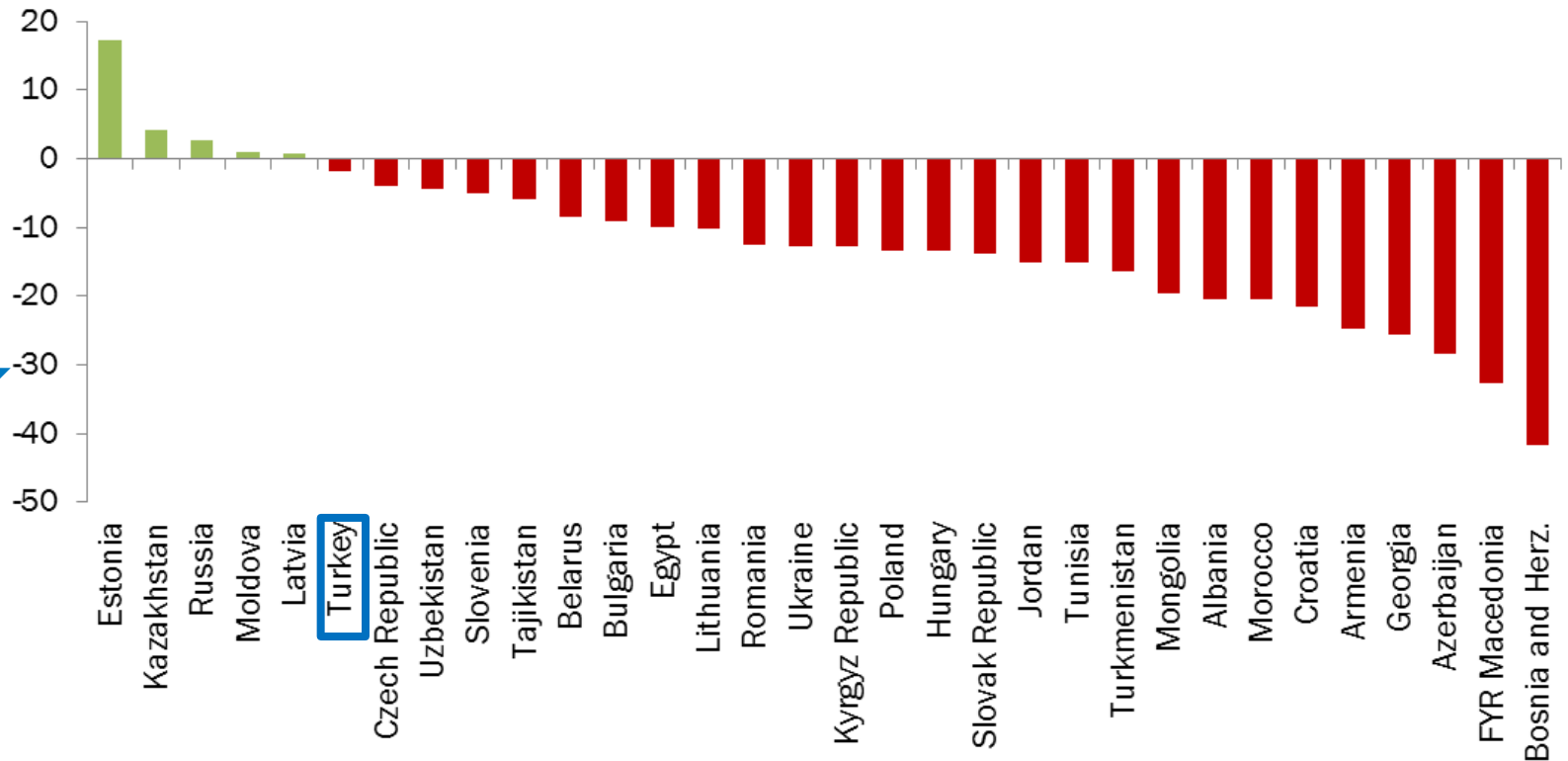
In transition region, increasing human capital requires better tertiary education...

Comparison of human capital in Advanced and Transition countries:



.... But *returns* on education are critical to persuade people to acquire education, and to retain them

Stock of high-skilled immigrants minus the stock of high-skilled emigrants abroad, as a percentage of high-skilled workers, 2000:



- Better institutions correlated with returns to tertiary education

5. The role of economic inclusion

- Reforms can be undermined by lack of inclusion: e.g. Egypt before revolution; privatisation in Russia
- Inclusion is correlated with, but not fully captured by, democracy and measures of institutional quality (e.g. rule of law).

This report

1. Initial attempt to measure economic inclusion “bottom up”: as inequality of opportunity (based on Life in Transition Survey)
2. Attempt to measure “inclusion gaps” across countries “top down”: by rating capacity of markets and institutions to create opportunities for women, young, and across sub-national regions .

Economic Inclusion

- Essential for well-functioning market economies
 - creating **incentives** for broad sections of societies to engage in activities that support economic growth;
 - increasing support for and **sustainability** of economic reforms.
- Defined as **broad access to economic opportunity**, regardless of circumstances at birth (gender, parental education, place of birth). Two approaches:
 - ‘**bottom up**’ approach focuses on **household level**, measuring the extent to which differences in wealth or education across households are attributable to circumstances at birth
 - ‘**top down**’ approach rates the **institutions, markets and education systems** in terms of their capacity to extend economic opportunity to individuals regardless of their circumstances.

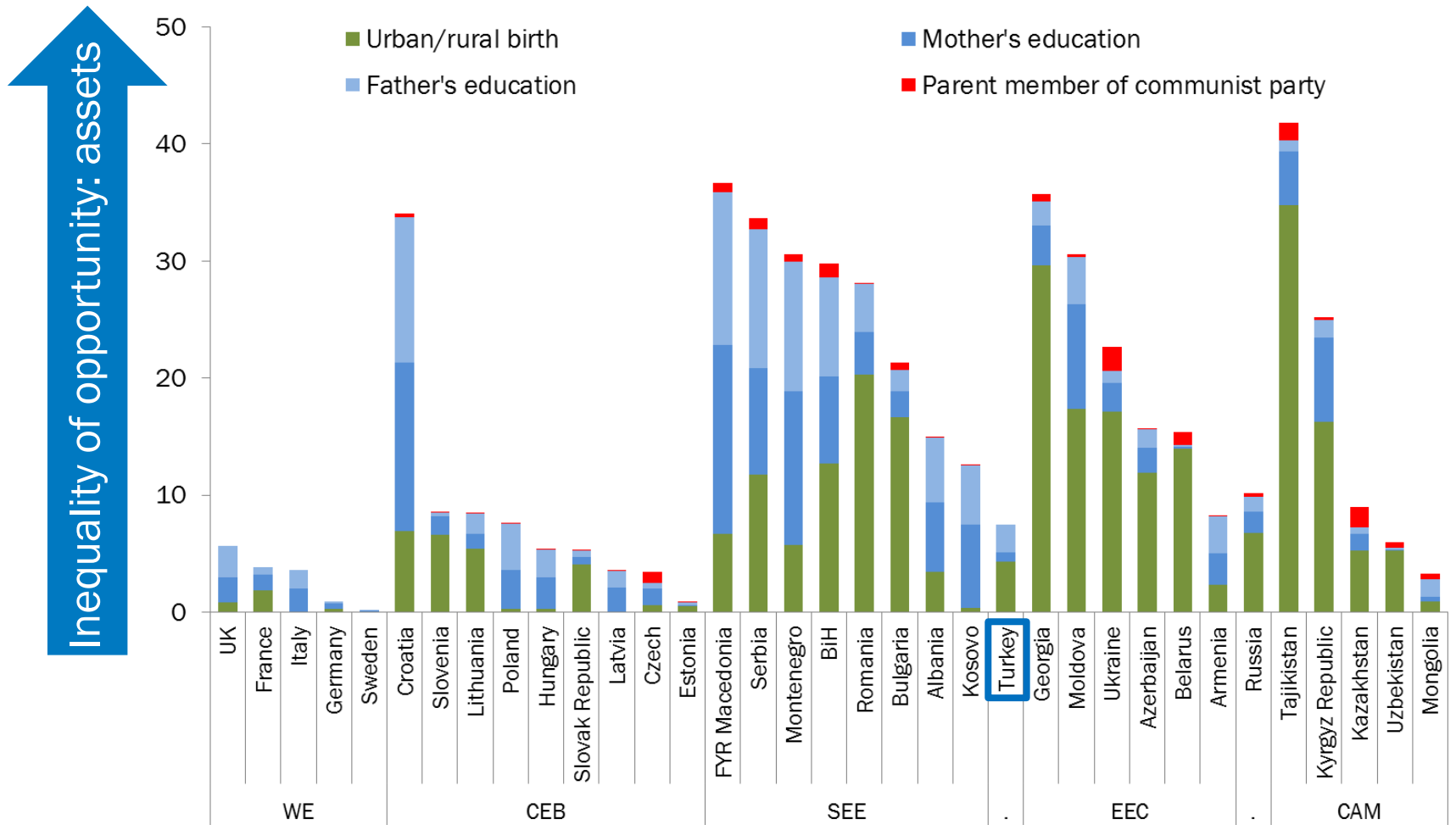
Gender Inclusion Gaps

Inclusion Gaps for Gender

Country	Legal Regulations	Health Services	Education	Labour Policy	Labour Practices	Employment and firm ownership	Access to Finance
Central Europe and Baltic States							
Croatia	Negligible	Small	Negligible	Medium	Large	Medium	Small
Estonia	Negligible	Small	Negligible	Small	Large	Medium	Medium
Hungary	Negligible	Small	Negligible	Negligible	Large	Medium	Large
Latvia	Small	Medium	Negligible	Small	Large	Medium	Small
Lithuania	Negligible	Small	Negligible	Small	Medium	Medium	Medium
Poland	Small	Small	Negligible	Small	Large	Medium	Medium
Slovak Republic	Negligible	Small	Negligible	Small	Large	Large	Medium
Slovenia	Negligible	Small	Negligible	Small	Large	Medium	Medium
South-eastern Europe							
Albania	Negligible	Medium	Small	Small	Large	Large	Large
Bosnia and Herzegovina	Negligible	Medium	Negligible	Medium	Large	Large	Large
Bulgaria	Negligible	Small	Negligible	Small	Large	Medium	Medium
Kosovo	<i>not available</i>	<i>not available</i>	<i>not available</i>	<i>not available</i>	<i>not available</i>	<i>not available</i>	Large
Macedonia, FYR	Small	Medium	Small	Small	Large	Medium	Medium
Montenegro	Small	Medium	Negligible	Medium	Large	Medium	Medium
Romania	Negligible	Medium	Negligible	Small	Large	Medium	Medium
Serbia	Small	Medium	Negligible	Medium	Large	Large	Small
Turkey	Small	Small	Medium	Small	Large	Large	Large
Eastern Europe and Caucasus							
Armenia	Medium	Medium	Negligible	Small	Large	Large	Small
Azerbaijan	Negligible	Medium	Small	Medium	Large	Medium	Large
Belarus	Small	Small	Small	Medium	Large	Small	Medium
Georgia	Small	Large	Negligible	Small	Large	Medium	Small
Moldova	Small	Medium	Negligible	Small	Large	Negligible	Medium
Ukraine	Negligible	Medium	Negligible	Small	Large	Medium	Large
Russian Federation	Small	Medium	Negligible	Medium	Large	Medium	Medium
Central Asia							
Kazakhstan	Small	Large	Negligible	Medium	Large	Large	Medium
Kyrgyz Republic	Medium	Large	Negligible	Medium	Large	Medium	Small
Mongolia	Small	Large	Negligible	Medium	Large	Negligible	Small
Tajikistan	Medium	Large	Medium	Small	Large	Medium	Large
Turkmenistan	Large	Large	Small	Medium	Large	Large	Large
Uzbekistan	Medium	Medium	Medium	Medium	Large	Large	Large
Southern and Eastern Mediterranean							
Egypt	Medium	Large	Medium	Medium	Large	Large	Large
Jordan	Medium	Large	Negligible	Medium	Large	Large	Large
Morocco	Medium	Large	Medium	Medium	Large	Large	Large
Tunisia	Small	Medium	Small	Small	Large	Large	Large
Comparator Countries							
France	Negligible	Small	Negligible	Small	Medium	Medium	Medium
Germany	Negligible	Small	Negligible	Negligible	Medium	Medium	Medium
Italy	Negligible	Small	Negligible	Small	Medium	Medium	Large
Sweden	Negligible	Negligible	Negligible	Negligible	Medium	Small	Medium
UK	Negligible	Small	Negligible	Small	Medium	Medium	Medium

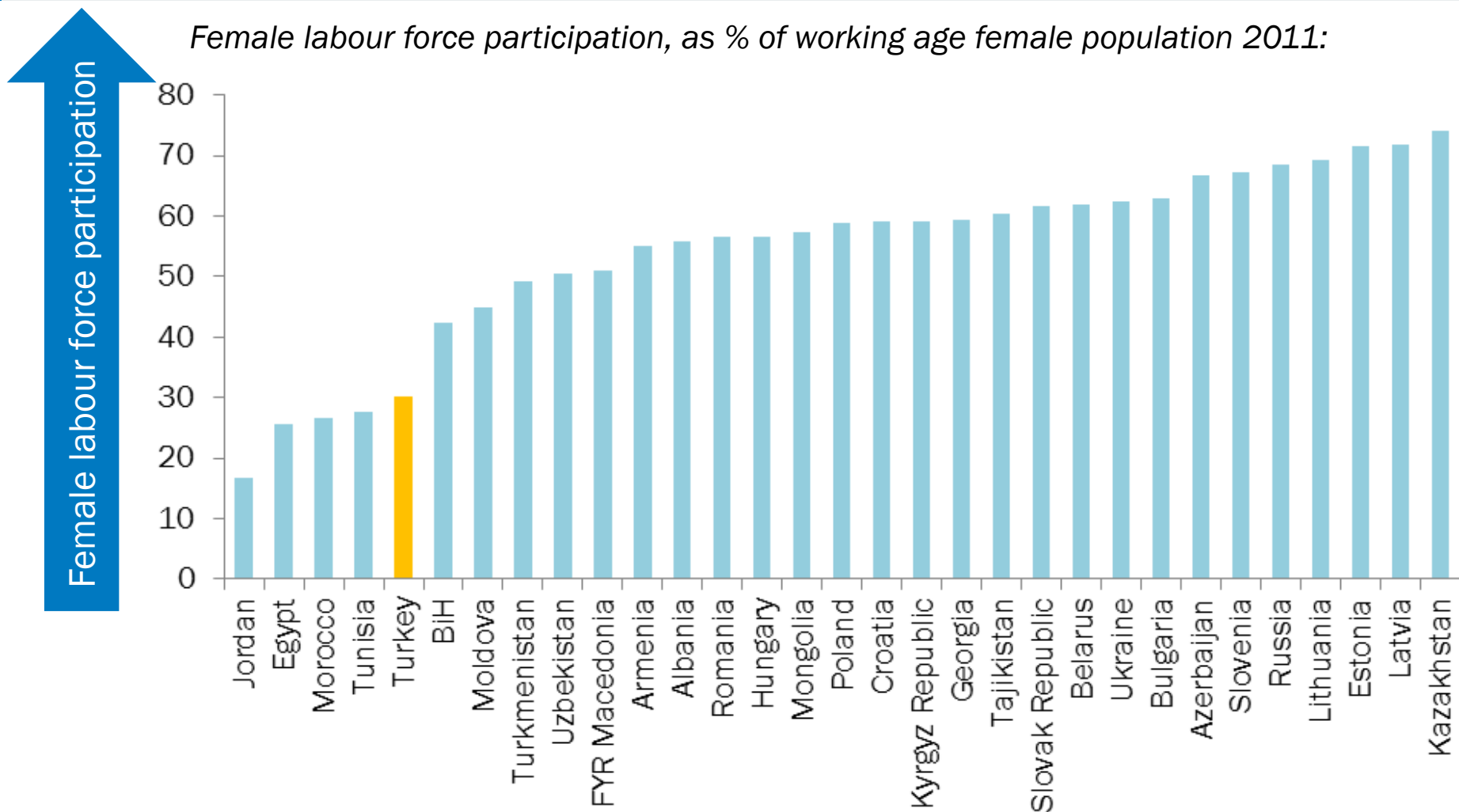
Wide variations in inequality of opportunity with respect to wealth

Percentage variation in household asset index explained by pre-determined factors:



Potential opportunity for significant growth from increased female labour force participation in some countries

Female labour force participation, as % of working age female population 2011:



Conclusion

1. Time is on the side of democracy and reform
2. But the process can be slow, and some factors – like natural resource abundance – can hold it back.
3. In the meantime, countries can:
 - Foster international integration
 - Improve transparency and accountability at local levels
 - Improve human capital and economic inclusion
4. This will *both* lead to gradually better economic institutions, *and* increase the chance of successful “critical junctures”
5. International integration and education are means through which the international community can help

Conclusion - Turkey

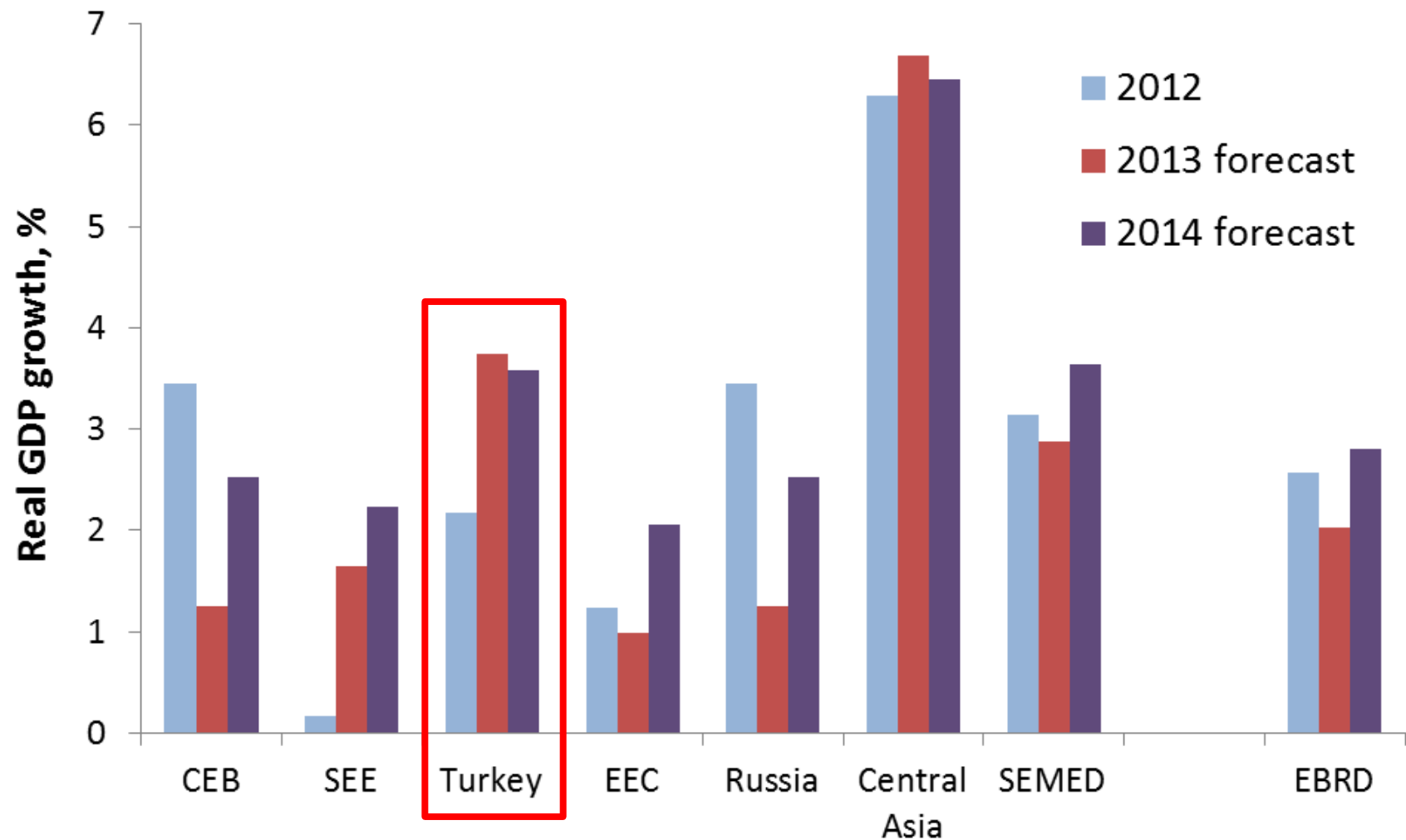
Long tradition of market economy and well-developed political institutions

BUT – more can be done to foster growth through promoting structural transformation and further developing economic institutions

- Education
- Inclusion
- Local governance
- Domestic capital markets

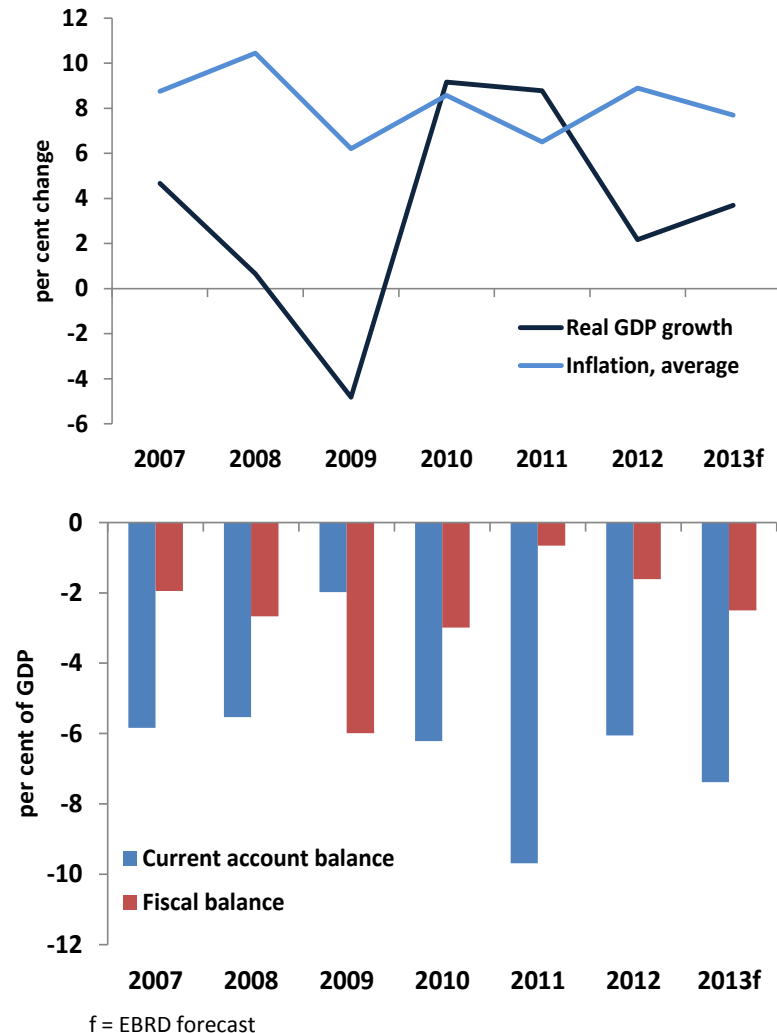
Thank you

Our current outlook: growth to remain modest



Turkey

- Growth picking up in H1 2013, following a sharp slowdown in 2012
- Some rebalancing with lower inflation and current account deficit, but both remain structurally high
- Recent capital outflows put pressure on the exchange rate, given large external financing requirements and reliance on volatile portfolio flows



Youth Inclusion Gaps

Inclusion Gaps for Youth

Country	Labour Market Structure	Opportunities for Youth	Quantity of Education	Quality of Education	Financial Inclusion
Central Europe and Baltic States					
Croatia	Medium	Large	Small	Medium	Medium
Estonia	Medium	Small	Negligible	Medium	Negligible
Hungary	Large	Medium	Negligible	Small	Large
Latvia	Small	Small	Small	Medium	Large
Lithuania	Medium	Small	Small	Medium	Small
Poland	Medium	Medium	Small	Medium	Large
Slovak Republic	Medium	Medium	Small	Large	Large
Slovenia	Medium	Small	Small	Small	Negligible
South-Eastern Europe					
Albania	Medium	Large	Small	Large	Negligible
Bosnia and Herzegovina	Small	Medium	Medium	not available	Small
Bulgaria	Small	Medium	Small	Medium	Small
Kosovo	not available	not available	not available	not available	not available
Macedonia, FYR	not available	Medium	not available	Large	Medium
Montenegro	Medium	Large	Small	Large	Large
Romania	Small	Medium	Small	Medium	not available
Serbia	Small	Large	Large	Medium	Large
Turkey	Medium	Medium	Large	Medium	Large
Eastern Europe and Caucasus					
Armenia	Medium	Large	Small	Medium	Negligible
Azerbaijan	Medium	Large	Negligible	Large	Medium
Belarus		not available	Negligible		Large
Georgia	Negligible	Large	Negligible	Medium	Negligible
Moldova	Medium	Medium	Small	Large	Negligible
Ukraine	Medium	Small	Small	Large	Negligible
Russian Federation	Medium	Medium	Negligible	Medium	Medium
Central Asia					
Kazakhstan	Small	Medium	Small	Large	not available
Kyrgyz Republic	Medium	Medium	Medium	Large	Small
Mongolia	Small	Medium	Medium	not available	Negligible
Tajikistan	Medium	Large	Small	not available	Negligible
Turkmenistan	not available	not available	Small	not available	Negligible
Uzbekistan	not available	not available	Small	not available	Small
Southern and East Mediterranean					
Egypt	Medium	Large	Large	not available	Negligible
Jordan	Negligible	Large	Large	Medium	Large
Morocco	Medium	Large	Large	Large	Medium
Tunisia	not available	Large	Large	Large	Small
Comparator Countries					
France	Medium	Large	Negligible	Small	Medium
Germany	Medium	Negligible	Small	Small	Negligible
Italy	Small	Large	Negligible	Medium	Large
Sweden	Large	Medium	Small	Small	Negligible
UK	Small	Medium	Small	Small	Negligible

Regional Inclusion Gaps

Inclusion Gaps for Regions

Country

Central Europe and Baltic States

	Institutions	Access to Services	Labour Markets	Education
Croatia	Medium	Medium	Small	Medium
Estonia	Small	Medium	Negligible	Small
Hungary	Medium	Small	Large	Small
Latvia	Small	Medium	Small	Medium
Lithuania	Medium	Large	Small	Small
Poland	Medium	Medium	Medium	Small
Slovak Republic	Medium	Small	Medium	Small
Slovenia	Small	Negligible	Small	Small

South-Eastern Europe

Albania	Medium	Medium	Large	Small
Bosnia and Herzegovina	Large	Large	Large	Small
Bulgaria	Medium	Medium	Medium	Medium
Kosovo	Medium	Large	Large	Small
Macedonia, FYR	Small	Medium	Large	Large
Montenegro	Medium	Medium	Large	Small
Romania	Medium	Large	Medium	Medium
Serbia	Large	Medium	Large	Large
Turkey	Medium	Large	Medium	Large

Eastern Europe and Caucasus

Armenia	Medium	Medium	Large	Medium
Azerbaijan	Medium	Small	Large	Small
Belarus	Medium	Negligible	Small	Negligible
Georgia	Negligible	Large	Large	Medium
Moldova	Medium	Large	Large	Large
Ukraine	Medium	Medium	Medium	Small
Russian Federation	Medium	Small	Small	Medium

Central Asia

Kazakhstan	Small	Small	Medium	Medium
Kyrgyz Republic	Medium	Large	Medium	Small
Mongolia	Negligible	Medium	Medium	Medium
Tajikistan	Medium	Large	Large	Small
Turkmenistan	not available	not available	not available	not available
Uzbekistan	Large	Medium	Large	Large

Southern and East Mediterranean

Egypt	not available	not available	not available	Large
Jordan	not available	not available	not available	Small
Morocco	not available	not available	not available	Large
Tunisia	not available	not available	not available	not available

Comparator Countries

France		Medium		Medium
Germany	Negligible	Large	Negligible	Medium
Italy	Large	Medium	Negligible	Small
Sweden	Medium	Small	Small	Small
UK	Medium	Small	Small	Large