This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.
Summary

- Main findings
- Key recommendations
Main findings

Turkey’s business sector dynamism has underpinned strong and inclusive growth in the 2000s, even though well-being indicators suggest there remains ample room for improvement. Economic performance has been supported by robust public finances and a resilient banking sector. However, with low domestic saving and volatile external competitiveness, growth is highly dependent on domestic demand and foreign finance.

Rebalancing growth by achieving financial stability and curbing inflation

External demand is strengthening, in particular in a context of recovery in the European Union, but high inflation, exchange rate volatility and low productivity growth endure. Competitiveness remains fragile and dependence on foreign savings is very high. Monetary and financial policies aim at disinflation while keeping the exchange rate and credit growth on a sustainable path, but inflation is well above target and private debt levels have risen substantially, albeit from a low level. Credit to SMEs and foreign currency borrowing by large firms have both expanded rapidly, which may increase financial risks. However, the authorities have increased their efforts to keep household debt in check and so far, household and commercial loan default rates have remained low. To help rebalance demand, further improvements in external competitiveness are indispensable. In this regard curbing inflation is essential, calling for a restrictive monetary policy stance.

Preserving the credibility of public finances

Public finances strengthened considerably over the past decade, which has boosted Turkey’s international credibility. While the overall fiscal position appears robust, public spending has increased considerably, in particular for education, health and pensions. Demographic trends, active social policies and large infrastructure projects will put additional pressure on public spending. Accrual-based general government accounts need to be aligned further with international standards, and fiscal and quasi-fiscal transactions associated with public-private partnerships need to be reported more systematically.

Fostering structural change, productivity growth and trust in a rule-based business environment

Businesses range from myriad micro, low-productivity firms to a small core of modern, high-productivity corporations. The regulatory framework burdens expanding firms with costly employment, tax and other obligations. Uneven compliance with laws deepens business sector segmentation and tends to weaken trust. As a result, institutionalised enterprises face obstacles to growth. Despite ever-greater government incentives to promote formal businesses and investment in selected regions and sectors, resources do not flow enough from lower to higher-productivity activities. All these factors inhibit productivity growth and entrench a social divide between the earnings, work conditions and human capital development prospects of workers in different segments of the business sector. Stronger trust in a rule-based business environment would encourage faster growth of foreign direct investment firms, which would contribute to productivity gains, inclusive growth and non-debt creating absorption of foreign savings.
Key recommendations

Rebalancing growth by achieving financial stability and curbing inflation

• Ensure the monetary policy stance is sufficiently restrictive to better align inflation and inflation expectations with the inflation target.
• Consider introducing dynamic provisioning and debt-to-income caps across more loan types.
• Further encourage the development of savings and long-term investment.

Preserving the credibility of public finances

• Continue the ongoing fiscal consolidation. Stand ready to provide discretionary stimulus should downside risks materialise.
• Further improve fiscal monitoring by publishing general government accounts according to international standards as well as a comprehensive report on fiscal policy covering all fiscal and quasi-fiscal activities.
• Adopt a multi-year general government spending ceiling and report outcomes transparently to improve compliance.

Fostering structural change, productivity growth and trust in a rule-based business environment

• Improve the overall regulatory framework for doing business, make it more predictable and use OECD product and labour market indicators as benchmarks.
• Continue to reduce de facto differences in the tax and social obligations of firms related to their size.
• Eliminate restrictions on the full range of modern employment forms in the formal sector (including temporary work, employment through work agencies, home-based work and remote work).
• Strengthen the social safety net and the up-skilling avenues for the unemployed, expanding the most successful schemes.
• Consider reducing labour tax wedges for low-skilled workers across the country and expanding earned income tax credit type support.
• Continue to strengthen incentives for female labour force participation through reforms facilitating the hiring of women in the formal sector.
• Implement the legislated but not yet operational state aid monitoring system. Evaluate the outcomes of support programmes for the SMEs and workers affected by structural changes. Focus on the most successful schemes.
• Consider harmonising the implicit carbon tax rate across fuels in different uses in the medium term.
Assessment and recommendations

- Growth is projected to pick up
- Macroeconomic policy to tackle imbalances
- Fostering strong and inclusive growth by promoting structural change in the business sector
- Managing the social implications of structural change
- Growth, well-being and environmental sustainability
Broad-based and inclusive growth, driven by a vibrant business sector, resumed after the global financial crisis. However, growth is overly centered on domestic consumption, which is funded too much by foreign saving. The resulting wide current account deficit has recurrently forced the authorities to curb domestic demand. Consumer price inflation is persistently above target, which calls for a restrictive monetary policy stance. Even though below-potential growth helps reduce these imbalances, they remain a source of macroeconomic vulnerability. In mid-2013, the associated risks were illustrated by the financial turmoil triggered by the announcement of a reduction in monetary stimulus in the United States. Aggravated by domestic political tensions, the ensuing financial stress was greater for Turkey than for a number of other emerging countries (Figure 1).

Figure 1. Turkey has come under global financial market pressure

1. An increase in the nominal effective exchange rate (NEER) implies its appreciation.
2. JPM EMBI global diversified stripped spreads, showing the yield gap in basis points between a JPMorgan emerging market bond index (EMBI), stripping out any credit enhancements such as principal and/or interest collateral, and US Treasuries.

Source: OECD calculations based on OECD Economic Outlook Database and Datastream.
Achieving vigorous growth without widening external imbalances calls for rebalancing the composition of demand from domestic to external sources. Absent such rebalancing, Turkey’s economy will remain volatile (Figure 2) and overly dependent on capital inflows, as discussed in Chapter 1 of this Survey: Reducing dependence on short-term foreign debt is key and requires raising domestic saving and attracting more FDI (Figure 3). As documented in Chapter 2, structural reform in the business sector is essential, as it would deliver substantial productivity gains and allow Turkish firms to better compete in export markets and at home. It would also attract more FDI, especially of the greenfield type.

Figure 2. Growth furthers social inclusion but remains volatile

1. The reference year differs across countries. For mid-1980s, it refers to 1985 or nearest available year. As for late 2000s, it refers to 2010 or 2009.


Growth is projected to pick up

Growth recently slowed but is projected to pick up. Activity has been held back by tighter financial conditions (see below) but high-frequency indicators, such as business and consumer confidence and industrial production, point to a recovery in domestic demand. A weaker currency – despite some more recent appreciation- combined with a pick-up in export market growth should support exports, help rebalance the economy and narrow the current account deficit. Nevertheless foreign rollover/funding needs (defined as the current account deficit plus maturing gross external debt) are expected to remain large in 2014. However, so far debt has been readily rolled over, even during phases of financial market tensions. Overall, GDP growth is projected to slightly decline to around 3.5% in 2014 before picking up to around 4% in 2015 (Table 1). Inflation is projected to fall in the second half of 2014 but should remain well above the 5% target, partly due to pass-through effects from exchange rate depreciation and from the January 2014 tax hikes.
Figure 3. External vulnerabilities are high and have increased since the global financial crisis
In per cent of GDP

The main downside risks relate to possible renewed global financial market turmoil during the
normalisation of monetary policy in the United States, and to domestic political tensions. If these risks
were to materialise, investor and consumer confidence would suffer, risk premia might increase further
and tensions could arise in foreign funding with deleterious effects on domestic demand. While the
financial sector still looks robust, pressures have built up owing to rapid leveraging in the private sector,
including through foreign exchange liabilities (see below). As a result, financial stability could be
imperilled if capital inflows slowed, funding costs rose markedly or the currency depreciated sharply. To
avoid such a scenario, maintaining confidence and credibility is crucial. Growth would also be negatively
affected, mainly through weaker exports, if geopolitical risks were to intensify in some MENA countries,
Russia and Ukraine. Finally, renewed tensions in the euro area could unsettle financial markets and
confidence again, hurting Turkey both through trade and financial linkages.

Source: IMF, International Financial Statistics; IMF, Balance of Payments; OECD Economic Outlook
Database; World Bank, IMF, BIS, OECD Joint External Debt Hub.
Table 1. Macroeconomic indicators and projections

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>prices</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TRY billion</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>1 098.8</td>
<td>8.8</td>
<td>2.1</td>
<td>4.0</td>
<td>3.3</td>
<td>4.0</td>
</tr>
<tr>
<td>Private consumption</td>
<td>787.8</td>
<td>7.7</td>
<td>-0.5</td>
<td>4.6</td>
<td>2.8</td>
<td>4.2</td>
</tr>
<tr>
<td>Government consumption</td>
<td>157.5</td>
<td>4.7</td>
<td>6.1</td>
<td>5.9</td>
<td>6.6</td>
<td>3.6</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>207.8</td>
<td>18.0</td>
<td>-2.7</td>
<td>4.3</td>
<td>-1.2</td>
<td>5.7</td>
</tr>
<tr>
<td>Final domestic demand</td>
<td>1 153.1</td>
<td>9.1</td>
<td>-0.1</td>
<td>4.8</td>
<td>2.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Stockbuilding¹</td>
<td>6.7</td>
<td>-0.1</td>
<td>-1.4</td>
<td>1.4</td>
<td>-1.3</td>
<td>-0.1</td>
</tr>
<tr>
<td>Total domestic demand</td>
<td>1 159.8</td>
<td>8.9</td>
<td>-1.4</td>
<td>6.1</td>
<td>1.2</td>
<td>4.5</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>233.0</td>
<td>7.9</td>
<td>16.3</td>
<td>0.1</td>
<td>9.6</td>
<td>6.4</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>294.0</td>
<td>10.7</td>
<td>-0.4</td>
<td>8.5</td>
<td>0.7</td>
<td>7.7</td>
</tr>
<tr>
<td>Net exports¹</td>
<td>-61.0</td>
<td>-1.2</td>
<td>4.0</td>
<td>-2.6</td>
<td>2.2</td>
<td>-0.8</td>
</tr>
</tbody>
</table>

Other indicators

|                      |          |      |      |      |      |      |
|                      |          |      |      |      |      |      |
| GDP deflator         | 8.6      | 6.9  | 5.9  | 8.5  | 6.6  |
| Consumer price index (CPI) | 6.5      | 8.9  | 7.5  | 8.0  | 6.5  |
| Core CPI             | 6.8      | 8.1  | 6.6  | 8.1  | 5.9  |
| Employment           | 6.6      | 2.9  | 2.8  | 1.8  | 2.4  |
| Unemployment rate²   | 9.6      | 9.0  | 9.5  | 9.8  | 9.6  |
| Current account balance³ | -9.6    | -6.1 | -7.9 | -6.4 | -6.6 |

1. Contributions to changes in real GDP (percentage of real GDP in previous year).
2. As a percentage of labour force.
3. As a percentage of GDP. Includes volatile gold sales and purchases.

Source: OECD, OECD Economic Outlook 95 database.

On the upside, if the recovery in the European Union or the United States were swifter than projected, export growth would be stronger and the rebalancing of the economy more pronounced. Maintaining recent competitiveness gains is crucial to take advantage of such a scenario. Political uncertainty diminished following the March 2014 local elections, which could boost both domestic demand and international confidence more than assumed.

Macroeconomic policy to tackle imbalances

Turkey’s impressive growth performance in the 2000s was mainly driven by domestic demand, but this also led to a widening current account deficit (Figure 4). As analysed in detail in the previous Economic Survey (OECD, 2012a) and revisited in Chapter 1 of this Survey, pressures on competitiveness, a sharp fall in private saving and increasing energy imports lie at the heart of the current account deterioration. While Turkey has successfully improved non-price competitiveness and diversified its exports towards medium-to-high technology sectors, the share of low-technology sectors is still high. These sectors are more vulnerable to the erosion of price and cost competitiveness, owing to higher average inflation and unit labour cost growth compared to trading partners and competitors, notwithstanding bouts of nominal depreciation in times of financial turmoil (Figure 5). The drop in private saving stemmed mainly from a broad-based fall in household saving, encompassing all income groups (Figure 6).
Rebalancing requires both short and long-term actions. The government’s 2014-16 Medium-Term Programme and 2014-18 Development Plan rightly focus on domestic saving and external competitiveness. To boost saving, the voluntary private pension system was reformed. While participation in the scheme has increased substantially, it has yet to be seen to what extent this will be offset by declines in other forms of household saving. The authorities have also introduced many schemes to improve competitiveness by mitigating some of the excess costs and barriers to resource reallocation created by weak regulatory product and labour market settings. As discussed below and in Chapter 2 of this Survey, longer-term reforms in the overall institutional framework and governance structures of the economy are indispensable to unleash long-term investment and productivity growth in the business sector and strengthen competitiveness. If successful, such reforms would reduce uncertainty and improve confidence. They would also promote social inclusion as well as enterprise profits and saving. However, they face political economy obstacles and may take time to implement. In the meantime, the burden will fall on macroeconomic policies to preserve competitiveness by keeping inflation, nominal wage growth and the exchange rate on a sustainable path.
Figure 6. Private saving has declined

1. Data for 2013 are Ministry of Development estimates.

Source: Ministry of Development; Turkstat, Household Budget Surveys.

Monetary policy

Given Turkey’s open capital account, the CBRT faces the difficult task of taming inflationary pressures while avoiding potentially destabilising capital inflow surges. Other things equal, raising policy interest rates to contain inflation encourages capital inflows, which push up the exchange rate, harming competitiveness, and fuel domestic credit booms, inducing a build-up of foreign currency liabilities that weakens balance sheets. The same challenge arises when global liquidity expands and global rates decline, but high domestic inflation calls for tight monetary policy.

Figure 7. The monetary policy stance

Source: Central Bank of the Republic of Turkey.
In the face of this “trilemma”, the CBRT moved away from a pure inflation targeting approach in 2010, adopting financial stability as an additional objective and focusing also on credit growth and the real exchange rate, as discussed in the previous Economic Survey (OECD, 2012a). The medium-term inflation target is set at 5% for 2014, 2015 and 2016. The central bank views annual nominal credit growth of about 15% as a prudent benchmark, and trend real effective exchange rate appreciation as consistent with a catch-up process and measurement bias due to quality improvements.

This multiple-objective approach has called for the use of a variety of policy instruments. A key one has been an asymmetric and relatively wide interest rate corridor, delineated by overnight borrowing and lending rates. The CBRT has been steering interest rates within this corridor on a daily basis, allowing it to react quickly to capital inflows (Figure 7).

Another tool is the Reserve Option Mechanism (ROM), introduced in late 2011. The ROM allows banks to meet their lira reserve requirements with foreign exchange (up to 60%) or gold (up to 30%), and indeed banks have built up their foreign exchange liquidity buffers and accumulated around US$ 50 billion through the ROM at the CBRT. However, reserves accumulated through the ROM are not under the full control of the central bank. Since the beginning of the financial market turmoil in May 2013, the CBRT has been forced to conduct foreign exchange selling auctions to stem depreciation pressures since banks did not release much foreign exchange from the ROM amid rising costs of domestic funding.

**Figure 8. Inflation and inflation expectations are high**

Year-on-year percentage changes

A. CPI inflation and inflation targets

B. CPI Inflation expectations¹

1. Based on the Central Bank of Turkey’s Survey of Expectations Descriptive Statistics.

*Source:* OECD, OECD Economic Outlook database and Central Bank of the Republic of Turkey.
The record of this framework has been mixed. During periods of benign external conditions it helped reduce exchange rate, capital flow and credit growth volatility (Oduncu et al., 2013, Aysan et al., 2014). However, it has not delivered low and stable inflation. Moreover, inflation expectations have become increasingly de-anchored from the inflation target and have trended up since 2013 (Figure 8). Higher inflation expectations may become entrenched through wage setting mechanisms and may lead to real exchange rate appreciation pressures and competitiveness losses.

In January 2014, the CBRT tightened the monetary stance sharply and streamlined its operating framework. The one-week repo rate became the key policy rate again and was raised from 4.5% to 10%. Then, in a context of benign global liquidity conditions and improvement in Turkey’s risk premia, the policy rate was cut in May and June, by respectively 50 and 75 basis points. A restrictive monetary stance is needed, and may have to be stiffened further, to ensure inflation falls back towards target and to help anchor expectations. It may also be advisable to narrow the interest rate corridor, to strengthen the commitment to the inflation target. Without a credible inflation target, inflation expectations may become increasingly backward-looking, forcing monetary policy to react more to temporary inflation shocks, and causing greater volatility in output and unemployment. Once disinflation is on track, any room for manoeuvre could be used to help smooth the exchange rate and capital flows. The authorities could also use foreign exchange purchases to build up reserves, which are not particularly high (Figure 9). However, if used over an extended period, such purchases would run into the “trilemma” and thereby undermine inflation targeting. In this environment, preserving trust in the independence of the central bank is essential.

In January 2014, the CBRT tightened the monetary stance sharply and streamlined its operating framework. The one-week repo rate became the key policy rate again and was raised from 4.5% to 10%.

Figure 9. Gross official reserves

![Figure 9. Gross official reserves](image)

*Source: Central Bank of the Republic of Turkey.*

**Financial market policies**

Over the past decade, the private sector has rapidly increased its leverage, though from a low base. Growing availability of credit enabled low-income households and small and medium enterprises to increase borrowing and expand consumption and investment. Credit growth had reached almost 40% between late 2010 and early 2011 before both the central bank (at the end of 2010) and the Banking Regulation and Supervision Agency (BRSA) (in June 2011) took measures to slow loan growth. Credit growth re-accelerated sharply in the first half of 2013, far exceeding the central bank’s 15% reference rate (Figure 10) but the BRSA started to take further macroprudential measures only in October 2013. While credit expansion has supported inclusive growth and living standards, it may raise concerns related to some debtors’ capacity to repay. Risks have increased since May 2013, as financial conditions in Turkey have deteriorated.

Nevertheless, the banking sector appears robust in international comparison. Both capital and leverage ratios are high in international comparison and the regulatory capital to risk-weighted asset ratio well exceeds legal and target ratios of 8% and 12%, respectively (Figure 10). To build in further safeguards, the authorities recently introduced leverage-based reserve requirements. The overall non-performing loan (NPL) ratio remains below 3%. In addition, banks’ liquidity adequacy ratios for total and foreign exchange liquidity have been well above the legal thresholds of 100% and 80% respectively.
Figure 10. Leverage has increased substantially but the banking sector remains robust

1. 2004 figure instead of 2003 for Poland.

2. Annualised growth rate of the loan stock, calculated as the 12th power of 3-month moving average of monthly growth rates. For total and commercial loans, growth rates are foreign exchange rate adjusted using a basket consisting of 70% US dollar and 30% euro.

3. The OECD average is calculated as an arithmetic average of available countries.

Source: IMF, International Financial Statistics; Banking Regulation and Supervision Agency (BRSA) and IMF, Financial Soundness Indicators.

The supervisory framework has also been strengthened. The Basel II (2.5 principles) framework was fully adopted by mid-2012 and most of the draft regulations pertaining to Basel III are complete. The BRSA has used various macroprudential tools to rein in credit growth in recent years, such as hikes in risk weights on consumer loans or loan provisioning requirements. The establishment in 2011 of the Financial Stability Committee (FSC), which comprises the CBRT, the BRSA, the Treasury, the Deposit Insurance Fund and the Capital Market Board, has improved coordination. The macroprudential framework is being strengthened further, notably through countercyclical capital requirements. It could be reinforced even more via dynamic provisioning.
The banking sector faces several risks. Banks’ maturity mismatch may hurt profitability in the near term, as higher external and domestic funding costs cannot readily be passed on to customers. Banks’ direct exchange-rate risk is low, as their net foreign currency liability position is almost fully hedged by off-balance sheet transactions (mostly swaps), but they are indirectly exposed through their lending to the non-financial corporate sector. That sector’s foreign currency liabilities have more than quadrupled since 2004, opening up a short position in foreign currency of about US$ 170 billion (21% of GDP). Currency depreciation therefore raises debt servicing costs and puts pressure on corporate profits. However, most of the foreign currency liabilities are long-term, reducing rollover risks. Domestically operating banks are only allowed to lend in foreign currency if the borrower has income in foreign currency— or else loans must be at least US$ 5 million with at least one year maturity, which are mainly extended to large corporations, with better access to financial hedging. Nevertheless, there may be a case for raising risk weights and provisioning requirements for foreign currency loans extended to firms without revenues in the same currency, bearing in mind the provisions of the OECD Code of Liberalisation of Capital Movements.

Banks are also exposed to small and medium sized enterprises (SMEs) and to credit card loans. Loans to SMEs expanded rapidly in the recent past as did credit to low-income households. SMEs borrow predominantly at short maturities and may thus be hit harder by the recent interest rate hikes. The BRSA recently reduced general provisioning requirements on SME loans, to encourage such lending. With slower economic growth, household NPL ratios may rise, in particular for low-income groups (Chapter 1). In October 2013, the BRSA linked credit card limits to income, increased card payments and risk weights and extended loan provisioning regulations to credit cards, overdrafts and vehicles loans. This has helped slow consumer loan growth. Recent empirical research suggests that DTI ratios are effective macroprudential tools to restrain credit growth and housing boom-bust cycles (Claessens et al., 2013), and such ratios should be implemented more broadly across the banking sector and consumer loan types. This would increase household balance sheet resilience, although it would disproportionately constrain poorer families.

Real house prices have increased by about 14% since the start of the official data series in January 2010. The authorities should continue to monitor housing market developments closely and stand ready to tighten macroprudential measures, for example through a decrease in loan-to-value ratios (while also taking into account equity implications for borrowers).

**Fiscal policy**

Turkey has not yet caught up with OECD norms on fiscal transparency, notwithstanding improvements, such as better reporting of general government cyclically-adjusted balances. Annual Programmes, Pre-Accession Economic Programmes and Public Debt Management Reports contain relevant information but accrual-based consolidated general government accounts need to be published timely and aligned further with international standards.

As discussed in the previous Economic Survey (OECD, 2012a), fiscal analysis would be considerably facilitated if all one-off and cyclical revenue and spending items were better identified. A more detailed structural analysis of the general government budget should be included in Turkey’s Pre-Accession Economic Programmes and other policy and budget documents, according to international standards. Investment and debt of public entities, such as the public housing agency (TOKI) and municipally-owned enterprises, should also be better monitored; some welcome progress in this direction has already been achieved. There are also plans to more comprehensively account for government liabilities which arise in the context of expanding public-private partnerships (Chapter 1). In addition, the prospective financial costs of the expanding social security system call for close scrutiny. This is particularly important as health and pension costs have started to increase rapidly.

A regular Fiscal Policy Report (similar to the central bank’s Inflation Report) containing a full set of cyclical adjustments and relevant information on the long-term balances of the social security system and on the activities of public entities not included in the general government sector would improve fiscal transparency. An independent Fiscal Council, along the lines of those existing in a number of OECD countries, could draw on the work of the Court of Accounts, which has been vested with wider auditing powers by a 2010 Court of Accounts Law that has yet to be fully implemented (Chapter 1). These institutional innovations would help implement Turkey’s plans to reform spending and revenue structures (World Bank, 2014).
Notwithstanding these caveats, Turkey's overall public finance position and sustainability appears to remain robust. Fiscal policy continues to outperform the objectives published in the successive medium-term programmes, mainly thanks to stronger-than-projected revenue growth, which was not all spent. According to official estimates, the general government deficit stood at 1.6% of GDP in 2013 and the debt-to-GDP ratio, now at 36.3%, will continue to fall (Figure 11). The immediate impact on public finances from the recent depreciation and hike in risk premia will be less than in the past, as the share of foreign-currency-denominated debt has fallen, debt maturities have lengthened and most of the debt has been issued as fixed-rate bonds.

Figure 11. The fiscal position is strong
In per cent of GDP

1. Data for 2013 are estimates from the 2014-16 Medium Term Programme.
2. 15 first members of the euro area.

Source: Undersecretariat of Treasury and OECD Economic Outlook database.

The government targets set out in the October 2013 Medium-Term Programme foresee further reductions in the general government budget deficit to 0.7% of GDP, and public debt to 30% of GDP by 2016 (Government of Turkey, 2013). This implies a tightening of the fiscal stance in the context of below-potential growth. A prudent fiscal stance should help preserve credibility and confidence in the context of the current electoral cycle and political tensions. Should downside risks materialise, for example in the form of a sudden stop in capital inflows, the existing room for discretionary stimulus could be used.

Primary spending, in particular for personnel, infrastructure and social expenditures (education, health, social protection and pensions), increased markedly in recent years, but general government primary spending is to be restrained at around 36% of GDP according to latest Medium-Term Programme. However, these spending targets, based on ex-ante budget appropriations, have repeatedly been breached in the past – though usually not by much. The general government spending targets should become a hard spending ceiling, even if implementation may be constitutionally challenging. Outcomes should be reported transparently so as to improve compliance. In the event of revenue windfalls, keeping to such a general government spending ceiling would help preserve a tight fiscal stance and boost national saving.
Macroeconomic and financial policy recommendations

Monetary and financial market policy

- Ensure the monetary stance is sufficiently restrictive to better align inflation and inflation expectations with the inflation target.

- Consider introducing dynamic provisioning and debt-to-income caps across more loan types.

- Further encourage the development of savings and long-term investment.

Fiscal policy

- Continue the ongoing fiscal consolidation. Provide discretionary stimulus should downside risks materialise.

- Further improve fiscal monitoring by publishing general government accounts according to international standards as well as a comprehensive report on fiscal policy covering all fiscal and quasi-fiscal activities.

- Adopt a multi-year general government spending ceiling and report outcomes transparently to improve compliance.

Fostering strong and inclusive growth by promoting structural change in the business sector

There is ample room to foster productivity gains in the business sector through structural change. Over one fifth of the workforce is still in low-productivity agriculture, and the bulk of those working outside agriculture are in low-productivity businesses. With greater productivity gains inside enterprises ("within" gains) and more of a shift of employment to higher-productivity firms ("between" gains), aggregate productivity and the competitiveness of the economy could be significantly improved. Turkey would thereby achieve faster and more sustainable growth, with less dependence on foreign savings.

However, there are important regulatory and institutional obstacles to such structural changes and major improvements are needed in the general business environment. Progress would help unlock additional productivity and growth potential in all enterprises. Preliminary OECD indicators for 2013 suggest that product market regulations are not competition-friendly, including in network sectors (Figure 12), while a number of service sectors remain sheltered from international competition (Figure 13). Labour market regulations, notably those determining the flexibility of employment, are among the most rigid in the OECD (Figure 14). Non-compliance has long prevented these regulations from hindering growth (OECD, 2012a). As a consequence, many new firms have opted for semi-formality, stunting their natural growth and their maturation into higher-productivity entities. Despite ever-expanding government incentives to promote formal businesses in selected regions and sectors, resources do not flow sufficiently from lower to higher-productivity activities.
Figure 12. Product market regulations hinder competition
Scores from 0 to 6 - from least to most restrictive, 2013

1. The reported indicators for Luxembourg, Mexico, Poland and Turkey are based on preliminary estimates as some of the underlying data has not been validated with national authorities. Subsequent data validation may lead to revisions to the indicators for these countries.

Source: OECD, Product Market Regulation Database.
Figure 13. There is room for trade liberalisation in services

Services trade restrictiveness indices by sector, from 0 to 1 - from least to most restrictive, 2014

*Note:* The STRI indices take values between zero and one, one being the most restrictive. They are calculated on the basis of the STRI regulatory database which contains information on regulation for the 34 OECD Members, Brazil, China, India, Indonesia, Russia and South Africa. The STRI database records measures on a Most Favoured Nations basis. Preferential trade agreements are not taken into account. Air transport and road freight cover only commercial establishment (with accompanying movement of people). The data have been verified and peer reviewed by OECD Members.

*Source:* OECD Services Trade Restrictiveness Index Database.
Figure 14. Labour market regulations are still among the most rigid in the OECD
Scores from 0 to 6 - from least to most restrictive, as of 2013


Turkey's business sector is highly segmented, ranging from a myriad of micro, informal, low-productivity firms to a small core of modern, high-productivity enterprises. As shown in Chapter 2, five types of firms co-exist, differing in human and physical capital, management quality, and degree of access to domestic and international product, capital and labour markets: i) micro-enterprises (which represent about 45% of total business sector employment outside agriculture), ii) small-and-medium-sized businesses (about 35% of employment), iii) large family firms (about 15% of employment), iv) institutionalised corporations listed on the stock exchange (no more than 3% of employment), and v) “skilled stars” (sophisticated start-ups representing less than 1% of employment). The productivity of these firms varies enormously, and most of the workforce is still concentrated in the low-productivity end of the associated distribution. This holds back economy-wide productivity and creates a social divide between workers of different types of enterprises, whose earnings, work conditions and human capital development prospects diverge (Figure 15).
Figure 15. The business sector is highly segmented

1. Number of firms by size classes (according to number of employees).
2. Productivity is measured by the value added per person employed.
3. Ratio of value added per person employed for enterprises of more than 250 employees to value added per person employed for enterprises of 1 to 19 employees. 2008 figure for Mexico. Size classes are different for Mexico (0-50, 51-250, 251+).

Source: Turkstat; OECD calculations based on data from OECD, Entrepreneurship at a Glance 2013 and Turkstat.
In addition to structural gaps in human capital endowment, Turkey's rigid regulatory framework means that the relative cost of doing business for formal firms is fairly high. This handicaps the growth of modern enterprises, especially in trade-exposed manufacturing, where Turkey faces intense international competition. Likewise, size-specific provisions in the Tax Code expose different categories of firms to different types of taxation, even though tax rates (corporate as well as personal rates which apply in certain businesses) do not vary with firm size. Further, shortcomings in the predictability of rules for doing business seem to make the environment more friendly for owner-managed medium-sized firms with lower capital intensity, than for larger, institutionalised, professionally managed firms.

On top of legal provisions, and perhaps more importantly, are less formal differences in practice. Smaller firms are less transparent financially and can evade obligations regarding employment rules and taxes more easily than large firms. More generally, non-compliance creates an unfair business environment for law-abiding firms and hinders their entry or expansion. This problem is particularly acute for institutionalised businesses such as FDI firms. The small share of institutionalised (more formalised) firms in Turkey deprives the country of an important source of productivity and employment growth.

Freer development of all types of firms would boost productivity gains within firms and, by allowing labour and capital to more easily move to more efficient uses, between firms (Andrews and Criscuolo, 2013). A level playing-field would foster: i) further corporate development of first-generation entrepreneurial firms in Anatolian Tiger regions; ii) further institutionalisation and stock market listing of traditional family firms and a wider presence of FDI firms; and iii) structural change in the large heartland of the economy made up of small businesses.

Stimulating structural change in this heartland is now a well-established policy goal in Turkey. A wide range of related policy initiatives have been launched and additional technology diffusion and know-how dissemination programmes are being phased in. To facilitate the financing of innovative investments in small firms, tax incentives have been offered to business angels and venture capitalists, an Emerging Companies Market was created, and counter-guarantees for SME loans were introduced (Çanakci, 2014). A Special Commission on SMEs (Ministry of Development, 2013b) has recently reviewed these policies, and proposed areas where they could be strengthened. The 10th Development Plan followed up by confirming “Increasing Productivity in Production” as its first “priority transformation programme” for 2014-18. This programme aims at accelerating total factor productivity growth in the business sector and focuses notably on small businesses. It will rest on stronger co-ordination between the involved ministries and agencies (Ministry of Development, 2013a).

Programme outcomes will need to be monitored and efforts should be concentrated on the more successful schemes. State-of-the-art impact assessment techniques have begun to be implemented in Turkey (Hirshleifer et al., 2014). They should also be applied to SME support schemes, which attract expanding public resources and can contribute substantially to structural change. As intended in the National Development Plan, all SME support programmes presently on offer – discussed in Chapter 2 – should be evaluated to identify the most effective schemes and concentrate resources accordingly.

Further corporatisation and institutionalisation of firms in the higher strata of the business sector has attracted comparatively less policy focus, but is crucial and calls for policy action in three areas: i) the high degree of informality (mostly benefitting low-productivity firms) should be reduced by modern labour market rules applicable to all firms; ii) business taxation should be made as size-neutral as possible, through reforms in tax schemes as well as in their administration, so that higher-productivity firms can grow without being held back by tax considerations; iii) the broader regulatory framework should be made more friendly for large, modern business organisations, in line with OECD best practices.

Managing the social implications of structural change

Upgrading the business environment along these lines would deliver productivity and growth gains but would also have important social implications. Faster growth of higher-productivity firms would generate more rewarding and human-capital enriching jobs for a larger part of the population. However, low-productivity firms, in particular micro enterprises, the self-employed and low-skilled workers will need help. Properly designed, policies can facilitate the adjustments.
The formal sector will need to provide more job opportunities to the low-skilled. Lower employment costs would encourage higher-productivity firms to opt for more labour-intensive factor combinations. Reducing labour tax wedges is therefore a priority. Large social contribution reductions, adopted since 2008 (at different rates for different categories of workers and in different regions) successfully stimulated job creation, suggesting that applying them more broadly for unskilled workers across the country would boost job creation. Also, given the large gaps in informality across regions – which are related to differences in skills, productivity and living costs – minimum wages should be adapted to regional circumstances. This would facilitate the re-employment of the low-skilled in the formal sector.

Women’s labour force participation has increased from 29.3% in 2008 to 37.3% in 2012 for prime-age women between 25-54. Recent gains were helped by policy measures including social security contribution cuts. This in particular concerned women with low education, and contributed importantly to social inclusion and income gains in low-income households. However, a large proportion of women, especially those with low education, are employed informally. Labour market reforms reducing effective employment costs and facilitating flexible employment in the formal sector would help enhance the quality of female employment, strengthen incentives for female labour force participation and support social inclusion.

A far-reaching labour market reform (National Employment Strategy) was prepared by Turkey’s Ministry of Labour after thorough consultations with social partners. It was also included as a top priority in the 10th Development Plan 2014-2018 (Ministry of Development, 2013a) and was published in May 2014 (Ministry of Labour, 2014). This project, in line with OECD good practices, emphasises human capital and skills, vulnerable groups, dialogue with social partners and enabling labour legislation. It aims at reforming the costly severance payment regime and facilitating modern employment forms: permanent labour contracts with severance saving accounts (more secure for workers, and potentially more affordable for enterprises), less restrictive fixed-term contracts, temporary employment, employment through work agencies, employment at call and home-based work. Many of these forms had been prohibited or highly restricted in the formal sector, in contrast to their massive utilisation in the informal, small, low-productivity enterprises.

However, earlier efforts in this direction faced strong resistance from both unions and employers. Unions argued that as actual worker rights and protections – including union representation – were de facto restricted in Turkey, greater employment flexibility and wider recourse to non-standard employment forms would undermine industrial relations and social protection. Semi-formal and informal employers rejected any employment protection rules and social protection costs, from which they have been exempt to date. Formal employers viewed the transition to a fully-funded severance saving regime as unaffordable unless contribution rates were reduced. The lack of social consensus led the government to halt the discussion on severance payment reform in September 2013.

These reform efforts should be reactivated, with a view to agree on a new “social pact” based on greater flexibility and stronger social protection. Collective social protections in Turkey, including unemployment insurance, up-skilling for the unemployed, and Earned Income Tax Credit-type of transfers to the working poor are still limited in scope (Figure 16). The schemes in place do not offer a credible alternative to enterprise-level job protections, neither for the minority of formal sector insiders nor for the majority of workers aspiring to the same protections.

Strengthening social safety nets could help garner stronger social support for the necessary reforms. These are indispensable to overcome the entrenched divide between the high-productivity-but-rigid versus flexible-but-low-productivity parts of the economy. Segmentation could then be reduced, firms could grow more naturally, and resources could shift to more productive uses. Other OECD countries, notably in Southern Europe, have faced similar challenges in the past and progress in dealing with them has been slow, holding back productivity-enhancing restructuring (OECD, 2013a). Turkey should find more creative reform avenues.
Growth, well-being and environmental sustainability

As a result of broad-based industrial development and massive job creation throughout the country, growth became more inclusive in the 2000s (Figure 17). Income inequality, poverty and material deprivation all declined (Box 1). Income gaps between regions have narrowed. Relative income poverty also declined in Turkey’s all twelve regions between 2006 and 2012 (Doğan, 2014). Nonetheless, Turkey still compares unfavourably in a large number of dimensions of well-being (OECD, 2014a). Nationwide scores continue to fall short of OECD averages and gaps across groups remain wide, notably with respect to education, work/life balance, environmental quality and subjective well-being (Box 2 and Figures 18 and 19).
Figure 17. Growth has been quite inclusive during the 2000s

Box 1. Developments in income distribution

Turkey is one of the few OECD countries where inequality of household disposable incomes declined in the 2000s, even if some of the progress achieved was reversed following the onset of the global crisis. Various indicators of poverty have improved (OECD, 2012a; Şeker and Jenkins, 2013; Azevedo et al., 2014). According to OECD Better Life indicators, average net annual household income at purchasing power parity reached US$ 13,000 in 2011, against an OECD average of US$ 23,000. Average household financial wealth stood at US$ 10,000, against an OECD average of US$ 40,000. Standard indicators of income distribution improved: the Gini coefficient of income inequality declined from 0.49 in mid-1990s to 0.41 in 2011 — the largest improvement among OECD countries — against an OECD average of 0.33, 0.47 in Mexico and 0.50 in Chile. "Direct poverty" — defined as lack of access to basic nutrition, clothing and heating — declined from 29% in 2006 to 21% in 2010.

Box 2. Gaps in well-being

Education has seen progress but more is needed. Educational enrolment remains far below the OECD average, as does the quality of education (OECD, 2013c). However, between 2003 and 2012, Turkey's performance improved markedly in the three areas tested in PISA: mathematics, reading and science (OECD, 2014b). Much of the improvement was concentrated among students with the greatest educational needs. The degree to which students' socio-economic status predicts their performance also shrank. Students attending schools in smaller towns improved their performance more than students in cities.

Work/life balance is not satisfactory. Around 70% of men are in paid work (against the OECD average of 73%), compared with 28% of women. Those in employment work very long hours: 46% of employees report working excessively long hours, much higher than the 9% OECD average. Relatedly, the distribution of household work is the most imbalanced OECD-wide: men contribute an average of 21 hours per month to household tasks, much less than the OECD average of 74 hours.
Environmental quality leaves much to be desired. PM10 levels (tiny particulate matter inhaled into the deepest part of the lung) are 36.7 micrograms per cubic meter (with higher peaks in certain regions), far above the guideline limit of 20 by the World Health Organization and the OECD average of 20.9. Access to clean water is also not yet satisfactory: only 61% of people say they are satisfied with water quality, the lowest in the OECD. 33% of people feel that they have no access to green spaces, as against an average of 12% in OECD European countries.

Subjective well-being is low. Turks rated their life satisfaction 5.3 on a scale from 0 to 10 in 2012, below the 6.6 OECD average. In terms of balance between positive and negative feelings, 68% of people reported more positive experiences (pride in accomplishment, enjoyment, rest, and so on) than negative ones (pain, worry, sadness, boredom) on an average day. This was the lowest OECD-wide and far below the 80% OECD average.

Upgrading human capital for all is key to promote social cohesion and well-being over the longer term (OECD, 2012b). Structural upgrading in the business sector also has a major role to play. It can make existing human resources more productive, enhance the quality of workplaces, promote on-the-job
learning and improve income distribution. It would also help generate greater fiscal resources for social transfers and other policies that support social inclusion.

Remaining gaps in labour force participation and deep divides between types of employers and jobs underpin much of the remaining inequalities. The size of the firm and the formal versus informal status of jobs also make a major difference. Inclusive growth will require overcoming this segmentation (Figures 18 and 19).

**Figure 19. Well-being in Turkey in international comparison**

1. Each well-being dimension is measured by one to three indicators from the OECD Better Life Indicator set. Normalised indicators are averaged with equal weights. Indicators are normalised to range between 1 (best) and 0 according to the following formula: (indicator value - minimum value)/(maximum value - minimum value).

2. The ratio of well-being indicators for advantaged versus disadvantaged social groups. Groups depend on indicators, according to a standard cross-country definition. Results may vary according to the assumptions made for the calculation of average indicators in each well-being dimension. Here, all indicators have been given an equal weight within each dimension.

3. Ratios for income dimension range from 90 to 6 across countries. In the income dimension of the figure, the score is divided by 25.

**Source:** OECD (2013), How’s Life? 2013 Measuring Well-Being.
Environmental policy challenges

Turkey became a party to the UN Framework Convention on Climate Change (UNFCCC) in 2004 and ratified the Kyoto Protocol in 2009. Although Turkey's "special circumstances" as a developing country have been recognised in the UNFCCC framework, it remains the only OECD country (including Chile, Mexico and Poland) which does not have a national emissions target and which has not made an international emissions commitment for 2020. Even so, Turkey has set itself quantified objectives to increase the share of renewable energy in electricity production to 30% by 2023, from currently slightly above 25%, and to cut energy intensity by 20% by 2023 compared to 2011. Reaching these goals would not only “green” growth but also help reduce Turkey's external imbalance, as Turkey's energy deficit accounts for about 6 percentage points of the 8% of GDP current account deficit in 2013. It would be desirable to complement these goals with quantitative mitigation targets for greenhouse gas emissions.

Turkey's carbon footprint per capita is still relatively low, but greenhouse gas (GHG) emissions are increasing rapidly and have not yet been fully decoupled from GDP growth (Figure 20). There are favourable conditions for renewable energy, in particular wind and solar, and generating capacity is expanding rapidly. The main policy instruments to spur the deployment of renewable capacity include feed-in tariffs with extra bonuses depending on the share of domestically-manufactured generating equipment, VAT and customs exemptions for equipment, preferential allocation of land to renewable energy producers and licence exemptions for generation facilities up to 1 MW. To stimulate a swifter expansion of renewable energy, the comparatively low level and duration of feed-in-tariffs could be increased. In addition, licensing and permission procedures for medium to large-scale projects as well as grid connection for wind capacity could be facilitated, and the cost and availability of financing improved (IEA, 2013). In addition, the energy intensity of the economy, although below the OECD average, could be further reduced through stricter enforcement of existing policies such as minimum standards and required energy performance certificates, central heating and metering systems for new buildings, and mandatory energy audits for public buildings exceeding a certain size. Finally, transition to wider and more efficient use of economic instruments (such as explicit carbon taxes and cap-and-trade systems) would mitigate emissions at lower costs. In the medium-term, and also taking into account fiscal and social implications of such initiatives, there is room to reduce variations in implicit carbon tax rates (taxes per tonne of CO2) across fuels in different uses (OECD, 2013d).

Recommendations to foster strong and inclusive growth by promoting structural change in the business sector

• Improve the overall regulatory framework for doing business, make it more predictable and use OECD product and labour market indicators as benchmarks.
• Continue to reduce de facto differences in the tax and social obligations of firms related to their size.
• Eliminate restrictions on the full range of modern employment forms in the formal sector (including temporary work, employment through work agencies, home-based work and remote work).
• Consider reducing labour tax wedges for low-skilled workers across the country and expanding earned income tax credit type support.
• Continue to strengthen incentives for female labour force participation through reforms facilitating the hiring of women in the formal sector.
• Strengthen the social safety net and the up-skilling avenues for the unemployed, expanding the most successful schemes.
• Implement the legislated but not yet operational state aid monitoring system. Evaluate the outcomes of support programmes for the SMEs and workers affected by structural changes. Focus on the most successful schemes.
• Consider harmonising the implicit carbon tax rate across fuels in different uses in the medium-term.
Figure 20. Greenhouse gas emissions are low but have strongly increased

1. Including positive values of land use, land-use change and forestry (LULUCF), i.e. including sources of GHG emissions and excluding removals/sequestration of greenhouse gas, for carbon dioxide (CO2) emissions in tonnes CO2 equivalent. The model EDGAR is used to determine which emissions from LULUCF are included. “Positive” values refer to emissions of greenhouse gases, and negative values refer to removals/sequestration of greenhouse gases.

Source: IEA/EDGAR model results for 2010; OECD Environment database and OECD Economic Outlook database.
Bibliography


ANNEX A1
PROGRESS IN STRUCTURAL REFORM

This annex reviews actions taken on recommendations from the 2012 Economic Survey of Turkey. They cover the following areas: labour market reforms, education reforms and product market and other structural reforms. Each recommendation is followed by a note briefly describing the actions taken. Recommendations that are new in this Survey are not listed in this annex.

A) Labour market policies

- **The severance payment regime should be re-designed in line with international best practices to make permanent labour contracts more flexible. Temporary and agency employment should be allowed, without sectoral restrictions.**

  **Some action taken.** A National Employment Strategy adopted in May 2014 includes such reforms but implementation requires legislative changes which are opposed by several social partner organisations.

  - Making available modern employment forms in the formal sector, including permanent labour contracts with severance savings accounts (more secure for workers and potentially more affordable for firms), temporary employment and employment through work agencies are among the top priorities of the 10th Development Plan 2014-2018.

- **Official minimum wages should be kept in check. Wage adjustments to productivity gains should be sought more through collective bargaining at enterprise level.**

  **No action taken.** Starting from 2014, the official minimum wage for workers above and below 16 will be unified.

- **The scope and eligibility conditions for the official unemployment insurance scheme should be broadened. This is key for progress towards “flexicurity” adapted to the Turkish context.**

  **No substantive action taken** but the scope and eligibility conditions of the official unemployment insurance scheme will be re-assessed in the context of the forthcoming National Employment Strategy.

- **Increase women’s labour force participation by providing high-quality and affordable child and elderly care.**

  **No substantive action taken** but an Action Plan on “Increasing Women’s Labour Force Participation and Employment” is being prepared, encompassing child, patient and elderly care issues, regulatory innovations to promote gender equality in work, and vocational training programmes for female labour market entrants.

- **Offer effective lifelong education programme to upgrade the labor market skills for adults whose schooling was inadequate.**

  **Some action taken.** A number of policy initiatives are being carried out according to a Life Long Learning (LLL) Strategy Plan 2014-2018”. A National LLL Co-ordination and Information Centre and a LLL web portal are in operation.
B) Education policies

- Reduce the large quality gaps among both schools and universities by granting them more autonomy in exchange for more accountability for performance, and by shifting to per student funding, with adjustments for socio-economic disadvantages.

Limited action taken. The Ministry of Education launched an Information Management System Project for Education Finance and Training Expenditure and a Budget Based School Performance Monitoring Project. A Quality Assurance System for Vocational and Technical Education is in the works, requiring each school to prepare a quality improvement plan to which it will be held accountable.

C) Product market and other structural policies

- Liberalise agricultural product markets by reducing the high degree of price interventions, using less distortive forms of support and offering greater scope for import competition. Social cohesion policies in agriculture should rest on direct transfers to eligible farmers and rural development.

No substantive action. However, the National Development Plan 2014-2018 sets the goal of “making converge minimum welfare levels in rural areas to national standards”. Yearly plans are being prepared to strengthen rural economies, improve human capital, improve social and physical infrastructures and reduce rural poverty. Moreover, future cuts in agricultural tariffs are to depend on the outcomes of WTO negotiations. Alignment with the EU common agricultural policy framework is ongoing, but accession negotiations on the “Agriculture and Rural Development” chapter have yet to be opened.

- The comprehensive energy liberalisation plans prepared in the 2000s should be fully implemented.

Actions taken:

- The privatisation of electricity distribution companies in all of the 21 electricity distribution regions was completed in 2013.
- Three power plants were privatised in 2014 and four other privatisations are planned for the remainder of the year.
- The eligibility level for competitive electricity procurement was reduced to 4.500 kWh per year in January 2014. Competitive procurement will be generalised in 2015.
- A new Electricity Market Law No. 6446 was adopted in March 2013. It specifies new measures to facilitate the operation of generation, transmission, distribution, wholesale, retail sale and export and import activities in the electricity sector.
- Amendments are planned in the Natural Gas Market Law. The state-owned gas company BOTAS will be unbundled into different companies specialised in transmission, trade and storage, and LNG activities. This should facilitate new entries in the gas sector.

- Review the structure of fuel taxes and harmonise the implicit carbon tax rate on different fuels in different uses. Co-ordinate fuel taxation initiatives with Climate Change Action Plan priorities.

No action taken but new measures are under consideration to promote the utilisation of renewable energy sources.
Chapter summarises

Chapter 1. Reducing macroeconomic imbalances

Turkey recovered swiftly from the global financial crisis but sizeable macroeconomic imbalances arose in the process. High consumer price inflation and a wide current account deficit are sources of vulnerability. Even though below-potential growth helps rebalancing and disinflation, these imbalances endure. The financial sector still looks resilient thanks to buffers built up mainly prior to the financial crisis. However, private sector balance sheet risks have gained prominence as leverage increased. Macroeconomic and structural policy levers need to steer a passage between robust but externally unsustainable growth and externally viable but low growth. Monetary policy needs to bring inflation and inflation expectations closer to target. Macropudential policies could more systematically lean against capital inflows and credit cycles to reduce private sector balance sheet vulnerabilities. The fiscal stance is broadly appropriate, but compliance with a multi-year general government spending ceiling would help avoid pro-cyclical loosening in case of revenue surprises and help boost domestic saving. Overall, policies should help reduce the risk of disruptions in capital flows as monetary policy stimulus is being withdrawn in the United States.

Chapter 2. Fostering inclusive growth by promoting structural change in the business sector

Turkey’s business sector dynamism has underpinned broad-based and inclusive growth in the 2000s. However, the business sector is highly segmented, with modern high-productivity corporations, but also myriad small, less formal and low-productivity entities. This hampers efficient resource allocation and tends to entrench social inequalities. It also makes it difficult to build on-the-job human capital for the large number of low-skilled. This segmentation needs to be overcome to raise productivity in the informal, low-skill and low-productivity sector, and to facilitate resource transfers from low to higher productivity business entities. This ought to be achieved by aligning Turkey’s formal regulatory and tax framework with OECD best practice, rather than through “second-best” arrangements where non-compliance with rules co-exists with selective subsidies to parts of the formal sector. Labour market and business taxation reforms are particularly important to enable all categories of enterprises to operate flexibly on a rule-based, level playing field and to achieve productivity enhancing and socially inclusive restructuring.
This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of Turkey were reviewed by the Committee on 12 June 2014. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 4 July 2014.

The Secretariat’s draft report was prepared for the Committee by Rauf Gönenç, Oliver Röhn, Fethi Öğünç and Evren Erdoğan Coşar under the supervision of Vincent Koen. Research and editorial assistance was provided by Béatrice Guérard.

The previous Survey of Turkey was issued in July 2012.

Further information

For further information regarding this overview, please contact:

Vincent Koen, e-mail: vincent.koen@oecd.org; tel.: +33 1 45 24 87 79;
or
Rauf Gönenç, e-mail: rauf.gonec@oecd.org; tel.: +33 1 45 24 94 04; or
Oliver Röhn, e-mail: oliver.roehn@oecd.org; tel.: +33 1 45 24 91 50; or
Evren Erdoğan Cosar, e-mail: evren.erdogancosar@oecd.org; tel.: +33 1 45 24 94 82.

See also http://www.oecd.org/eco/surveys/turkey.

How to obtain this book

This survey can be purchased from our online bookshop:
www.oecd.org/bookshop.

OECD publications and statistical databases are also available via our online library: www.oecdilibrary.org.

Related reading

OECD Economic Surveys: OECD Economic Surveys review the economies of member countries and, from time to time, selected non-members. Approximately 18 Surveys are published each year. They are available individually or by subscription. For more information, consult the Periodicals section of the OECD online Bookshop at www.oecd.org/bookshop.

OECD Economic Outlook: More information about this publication can be found on the OECD’s website at www.oecd.org/eco/Economic_Outlook.


Additional Information: More information about the work of the OECD Economics Department, including information about other publications, data products and Working Papers available for downloading, can be found on the Department’s website at www.oecd.org/eco.

Economics Department Working Papers: www.oecd.org/eco/workingpapers

OECD work on Turkey: www.oecd.org/turkey