This Overview is extracted from the 2016 Economic Survey of Turkey. The Survey is published on the responsibility of the Economic and Development Review Committee (EDRC) of the OECD, which is charged with the examination of the economic situation of member countries.

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Executive summary

- Growth has been robust despite adverse circumstances but must be rebalanced
- Removing structural bottlenecks would boost productivity
- Deeper participation in global value chains could help rebalance growth


**EXECUTIVE SUMMARY**

**Growth has been robust despite adverse circumstances but must be rebalanced**

Growth has been robust in recent years despite very adverse regional and domestic conditions. Job creation has been strong, in particular for vulnerable groups and less-developed regions. Turkey is no longer experiencing “boom-and-bust” cycles, but external deficits expanded and the net external investment position has deteriorated somewhat over the past decade. To achieve strong and sustainable growth, domestic saving should be increased and demand rebalanced between domestic and external sources. The needed competitiveness gains must be achieved by reducing wage and price inflation and boosting productivity growth. Following a period of stalling reform progress, the authorities launched an ambitious economic reform agenda in early 2016 aiming at raising productivity and living standards.

**Removing structural bottlenecks would boost productivity**

Turkey’s manufacturing sector has expanded considerably, but a core of well-performing firms is still hindered by shortcomings in the policy framework. A second category of firms sustain competition and deliver jobs, but have fallen behind in productivity. A large, third group of firms employ many low-skilled workers, but have low productivity and survive in an “informality trap” due to ineffective enforcement of rules and regulations. Improving this situation requires a comprehensive upgrading of the business environment to boost productivity and allow the most promising firms to grow faster.

**Deeper participation in global value chains could help rebalance growth**

While the import content of Turkey’s exports has increased, Turkey’s capacity to provide intermediate inputs to other countries remained limited. This partly reflects Turkey’s specialisation in final products, but also hints at obstacles in trade and investment policies, underdeveloped human capital and still insufficient investment in innovation, R&D and knowledge-based capital. The adjustment towards a more export-oriented economy operating on a level playing field needs to be supported by social policies to ensure displaced workers can find productive employment.

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**Figure 1:** Growth has picked up but inflation remains high

**Figure 2:** Employment is concentrated in less productive firms

**Figure 3:** A large trade deficit has built up (2015)
## MAIN FINDINGS

### Strengthening macroeconomic resilience, institutions and social cohesion

<table>
<thead>
<tr>
<th>Main Finding</th>
<th>Key Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>The economy remained resilient under very adverse circumstances and stronger growth is within reach. The authorities rebooted the structural reform process in early 2016.</td>
<td>Fully implement the reforms of the 2016 Action Plan and enact systematic monitoring and reporting on actual implementation.</td>
</tr>
<tr>
<td>The credibility of governance institutions could be improved.</td>
<td>Strengthen the rule of law, judiciary independence and the fight against corruption.</td>
</tr>
<tr>
<td>Women’s participation in the labour force has increased but remains very low in international comparison.</td>
<td>Upgrade child care facilities throughout the country.</td>
</tr>
<tr>
<td>External liabilities are tilted towards debt. The foreign direct investment stock remains too low.</td>
<td>Reduce barriers to foreign direct investment.</td>
</tr>
</tbody>
</table>
| Domestic saving is too low and inflation has persistently exceeded the target, exacerbating the dilemma between disinflation and external price competitiveness. The credibility of monetary policy could be improved. | ● Continue to contain consumer credit.  
● Promote private pension savings.  
● Increase foreign exchange reserves.  
● Simplify the monetary policy framework.  
● Tighten monetary policy unless inflation declines faster than projected.  
● Encourage minimum wage moderation and engage social partners in a wage path consistent with disinflation and external rebalancing. |
| Consistent fiscal prudence successfully reduced public debt but there is a need to improve public finance statistics. | Publish consolidated quarterly general government accounts according to international accounting standards.  
Publish a regular Fiscal Policy Report including all contingent and long-term liabilities. |

## Key Recommendations

### Removing structural bottlenecks to boost productivity

<table>
<thead>
<tr>
<th>Main Finding</th>
<th>Key Recommendation</th>
</tr>
</thead>
</table>
| The business sector is vibrant but low skills and high employment costs, amplified by the recent minimum wage hike, foster informality, as the burden of going formal is too high. Informality and semi-formality, in turn, slow down productivity growth. | ● Implement the education reforms foreseen in the 2016 Action Plan to improve curricula and increase the autonomy of schools and universities.  
● Reduce labour tax wedges and employment costs for the low-skilled. |
| High-productivity firms are not growing at full potential, due to shortcomings in basic governance, the regulatory framework and business taxation. | ● Enhance the flexibility of employment rules for all firms.  
● Avoid tax thresholds for higher productivity and larger firms. |
| Many small entrepreneurs and workers have low skills, inhibiting the growth of productivity and incomes. | Focus upskilling programmes for small entrepreneurs on basic management, foreign languages and digitalisation. |
| Many low-productivity firms will need to exit. This will raise adjustment challenges for their workers and reduce employment prospects for refugees. | Improve the social safety net for displaced workers by upgrading active labour market programmes, including those adapted to refugees. |

### Reaping the benefits of global value chains

<table>
<thead>
<tr>
<th>Main Finding</th>
<th>Key Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participation in GVCs is below potential, consistent with the low share of exported value-added in Turkey’s total value added and relatively subdued export performance.</td>
<td>Align the Customs Union agreement with the EU with the most open and all-encompassing international trade agreements, and develop similar agreements with other countries.</td>
</tr>
<tr>
<td>Turkey’s export share for intermediate goods in the world market is particularly low, especially in high value-added sectors, reflecting limited human and knowledge-based capital.</td>
<td>Invest more in vocational training and research-and-development.</td>
</tr>
<tr>
<td>Less stringent environmental regulations may attract polluting activities, fostering Turkey’s participation in global value chains for the wrong reasons.</td>
<td>Improve the monitoring of polluting activities and the enforcement of environmental regulations, and use economic instruments such as pollution taxes, carbon taxes and emission permits.</td>
</tr>
</tbody>
</table>
Assessment and recommendations

- Recent economic developments and short-term macroeconomic outlook
- Economic rebalancing to make growth sustainable and more inclusive
- Strengthening the resilience of the economy
- Restructuring the tradable sector by upgrading the business environment
- Reforms and green growth
Economic growth has proved remarkably vigorous given the very adverse circumstances of the past two years, which included four national elections, wars across the southern border, severe domestic tensions in the Eastern regions, trade restrictions with Russia and the inflow of millions of refugees. Domestic demand retained momentum. Public spending pressures were strong but the fiscal deficit was kept in check. The external deficit declined thanks to falling oil prices and market share gains especially in the European Union, but is still very large in underlying terms. Growth remains disproportionately centred on domestic demand and is overly funded by debt-creating capital inflows.

The combination of strong growth and external imbalances has characterised Turkey’s growth pattern over the past 15 years. Major institutional and structural reforms introduced after the 2001 crisis helped overcome the earlier “boom-and-bust” cycles, but external deficits expanded (Figure 1). This pattern has helped draw capital to Turkey, but features two important imbalances: i) private consumption contributes excessively to growth and reduces domestic savings; and ii) the output and employment composition of the economy is skewed to servicing the domestic market, with too low a share of tradables. This situation creates a tension between strong growth and external sustainability. To rebalance the growth pattern, the international competitiveness of the economy and the export sector should be considerably strengthened.

To shift to a more balanced, sustainable and stronger path, the authorities pushed ahead with a wide-ranging reform strategy after the general election in late 2015, building on the Priority Transformation Programmes of the National Development Plan 2014-18. An Action Plan for 2016 was announced in January, containing 216 measures to be

Figure 1. Long-term macroeconomic performance

A. Turkey is no longer experiencing boom-and-bust cycles

Real GDP growth, %

B. External imbalances have developed

Current account balance as % of GDP


StatLink ¦ http://dx.doi.org/10.1787/88893388789
implemented on a specific schedule (Table 1). This plan is retained by the new government established in May 2016 and provides a blueprint for important structural initiatives. The 2016 Action Plan was meant to be followed by longer-term reforms to upgrade the business and regulatory environment along international standards. Priorities included additional labour market reforms to reduce informality, the simplification of business entry and exit rules, and new trade policies to foster exports – notably updating the 1995 Customs Union Agreement with the European Union along the lines of the most advanced international free trade agreements.

Table 1. The 2016 Action Plan

<table>
<thead>
<tr>
<th>Policy areas</th>
<th>Selected measures 1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Numbers in brackets refer to the reference number of each measure in the Plan)</td>
</tr>
<tr>
<td>Fundamental rights and freedoms</td>
<td>(21) International conventions on fundamental human rights and freedoms will be transposed in national legislation; (110) A “judicial assistance” right will be established in national law.</td>
</tr>
<tr>
<td>Transparency</td>
<td>(3) A “political ethics” law to promote transparency, openness and accountability in political life will be adopted along international good practices; (5) real estate capital gains resulting from public land planning decisions will be made transparent and taxed.</td>
</tr>
<tr>
<td>Social policies and working life</td>
<td>(10) Labour legislation will be extended according to flexicurity principles, on the basis of EU good practices; (11) temporary work agency contracts will be liberalised, (12) severance compensation will be reformed, (54) all ongoing active labour market schemes will be made subject to impact analysis and re-designed; (88 and 89) skilled foreign professionals’ work in Turkey will be facilitated.</td>
</tr>
<tr>
<td>Economy, finance and commerce</td>
<td>(56) personal income and corporate income taxes will be merged into a simple income tax regime along international good practices; (65) custom procedures will be consolidated into a single-shop system; (67) corporate governance of state-owned firms will be aligned with international codes; (84) railway transportation will be liberalised.</td>
</tr>
<tr>
<td>Justice</td>
<td>(26) The settlement of labour litigations will be accelerated; (25) benchmarks will be set and enforced for the duration of different categories of court cases; (36) a strategy and action plan against cyber-crime will be adopted.</td>
</tr>
<tr>
<td>Education</td>
<td>(130) Current curricula in all education layers will be updated according to targeted “basic skills” for each level; (40) vocational school curricula will be aligned with professional standards; (41) a new tertiary education law will promote the autonomy and quality orientation of universities; (133) schools will be funded on a per student basis via their own budget.</td>
</tr>
<tr>
<td>Investment environment</td>
<td>(78) Enterprise creation and liquidation rules will be re-evaluated and streamlined; (76) business licencing rules will be unified across government levels; (71) new measures will be introduced to attract foreign direct investment; (81) Islamic finance instruments and institutions will be developed; (146) specialised courts will be established, especially in the finance and information technology sectors; (141) the Public Procurement Law will be revised; (16) the Istanbul Arbitration Center will become functional.</td>
</tr>
<tr>
<td>Savings</td>
<td>(79) Automatic enrolment in private pension schemes will be generalised with opt-out rights; (140) the Public Financial and Management Control Law will be updated.</td>
</tr>
<tr>
<td>Science, technology and innovation</td>
<td>(32) A “Digital Turkey” masterplan will be prepared; (84) a new Patent Law giving stronger support to high value-added activities will be adopted; (90) employment of foreign researchers by Turkish firms will be facilitated.</td>
</tr>
<tr>
<td>Environment, local administration</td>
<td>(115) The relation between central and local governments will be re-modelled according to the European Chart of local governments; (96) the resources of district municipalities inside metropolitan areas will be augmented; (164) a new greenhouse gas emission monitoring system will be implemented; (92) a new Water Law will be adopted.</td>
</tr>
<tr>
<td>Foreign policy</td>
<td>(100) An impact assessment of Turkey’s development aid policies will be produced.</td>
</tr>
</tbody>
</table>

1. Additional industry-relevant measures of the 2016 Action Plan are reported in Chapter 1, Table 1.2.

Source: Prime Ministry (2016).

Turkey’s strong growth over the past decade has paved the way for convergence in living standards with higher-income OECD countries. Improvements in life expectancy and expected years of schooling have fostered human development (Figure 2, Panel B). Employment rates, in particular those of the most vulnerable groups, have increased (Figure 2 Panels C and D). While income inequality remains high, the recent growth period has also seen less-developed regions catch up (Figure 2 Panels E and F).

Nonetheless, gaps with other OECD countries remain sizeable for many dimensions of well-being (Figure 3). Despite the gains achieved by low-income groups in the 2000s and the decline in poverty, average household disposable income per capita was still 54% of the...
Figure 2. Growth and social inclusion

A. Long-term growth
Real GDP per capita

B. Human development index

C. Urban employment rates

D. Employment of vulnerable groups

E. Income convergence
Growth of real average disposable incomes, 2007-13

F. Regional employment convergence
Employment growth in manufacturing 2004-13

Source: OECD National Accounts database (panel A); United Nations Development Programme (2015), Human Development Report (panel B); ILO, LABORSTA (http://laborsta.ilo.org , panel C); Turkish Statistical Institute (panel D to F).

http://dx.doi.org/10.1787/88893388799
OECD average in 2014 (at current PPPs). Working conditions are, on average, below OECD standards and, for those at work, work-life balance is affected by excessive working hours (OECD, 2015a). Educational achievements are modest, with 36% of Turkish adults aged 25-64 having completed upper secondary education. Partly as a result, the employment rate is low. Air and water quality too are still far below OECD averages.

Gender inequality is more pronounced than in other OECD countries, with few women in parliament and large gender pay gaps. Housing conditions are affected by restricted access to waste water treatment. The healthiness of the sea water is reduced by limited awareness in Turkey of its rich natural capital and by the adverse effects of tourism as coastal protection initiatives remain insufficient (Ocean Health Index, 2016). Likewise, the
share of protected terrestrial areas is lower than in other OECD countries (Environmental Performance Index, 2016).

Absolute poverty, measured as the share of people living below the national poverty line declined sharply, from 28.8% in 2003 to 13.3% in 2006, and settled at 1.6% in 2014 according to national sources (Turkstat, 2006 and Turkstat, 2014). However, relative poverty as measured by the poverty rate (share of the population earning less than 50% of the median disposable income) is higher (at 18% in 2012, and, according to national sources, 15% in 2014) than the OECD average (11%). While market income inequality is below the OECD average, the tax- and-benefit system contributes less to inequality reduction than in other countries. Turkey still exhibits the second highest level of disposable income inequality in the OECD (Figure 4). Broadening the tax base, including through a reduction of informality, would generate fiscal revenues that would provide scope to enhance the redistribution system and reduce income inequality further.

Figure 4. **Income inequality has declined despite low redistribution**

In addition, inter-regional disparities are large: in Istanbul, where 20% of the population live and where living costs are higher, average household income is nearly three times higher than in south-eastern Anatolia, the highest regional gap among OECD countries. While less than 5% of people in Istanbul live with less than half of the national median income, this share is 50% in some areas of south-eastern Anatolia. Similarly large regional differences are observed with respect to educational attainment, access to broadband connection and life expectancy.

These shortcomings affect children in particular. Child-poverty rates were close to 30% in 2011. Underdeveloped pre-school programmes and unequal access to education impede social mobility. In 2013, only 36% of the four-year olds were enrolled in early childhood education against an OECD average of 88% (OECD, 2015b). At the same time, over 40% of the children with a lower socio-economic background were deprived from at least four out of...
seven educational items (a desk to study, a quiet place to study, a computer for school work, educational software, access to internet, books for school and a dictionary) against less than 10% on average across OECD countries (OECD, 2015a). Broad-based access to high-quality education, notably for the young, would not only lift human capital and foster growth; it would also make sure that the benefits of strong growth are more widely shared by preparing more people for better jobs (OECD, 2015; Keeley, 2015).

Important progress has been made in the provision of critical services for well-being and social cohesion, such as health care and old-age support, with the transition to universal health insurance (Atun et al., 2013) and to universal old-age benefits (Devlette, 2015). Still, wide inequalities remain in the quality and accessibility of services between regions and social groups (Canatan and Yıldırım, 2015). The accessibility of all essential services would be improved if public policies focussed more on a quality, made results transparent, and enhanced outcomes by tracking and selecting the most efficient delivery channels (OECD, 2014c; World Bank, 2015).

Employment and job quality largely determine household living standards. Greater job creation in formal wage-earning occupations rather than informal self-employment and low productivity jobs in semi-formal firms would enhance incomes and improve social inclusion. Upgrading existing firms to higher productivity and quality levels, and enabling the more successful firms to expand faster are the most promising avenues to improve the material foundations of well-being and increase economic participation of vulnerable groups. While growth remains higher than in most other OECD countries, reflecting stronger labour force growth, the rebalancing of demand from domestic to external sources is needed to resume the convergence of GDP per capita toward the upper half of OECD countries (Figure 5 Panel A). The required acceleration of exports per capita has not yet started (Figure 5 Panel B).

Figure 5. Convergence with the upper half of OECD countries has slowed

![Chart](http://dx.doi.org/10.1787/888933588820)

1. OECD peers comprises lower income OECD countries: Czech Republic, Slovenia, Portugal, Slovak Republic, Estonia, Greece, Hungary, Poland, Chile and Mexico.

Source: OECD National Accounts database.
Against this backdrop, the main messages of this OECD Economic Survey are:

- Increasing domestic savings and rebalancing demand between domestic and external sources is indispensable for stronger and sustainable growth. The launch of the 2016 Action Plan by the previous government boded well for the reforms that are necessary to achieve such rebalancing, strengthen the resilience of the economy and raise living standards for all.

- Manufacturing is undermined by a deep segmentation between high-quality modern corporations and low-quality semi-formal and informal firms. Ensuring a level-playing field for businesses and improving the quality of human capital are essential to revive productivity growth, accelerate the convergence between different types of firms and generate broad-based formal employment.

- Turkey’s integration in global value chains remains below its potential due to structural bottlenecks. This calls for changes in trade and investment policies to make export orientation more profitable and attract more foreign direct investment. Substantial investment in human and knowledge-based capital will be necessary to catch up with international best practices.

**Recent economic developments and short-term macroeconomic outlook**

GDP growth was in 2015 driven by household consumption (Figure 6). Contrary to expectations, the sharp deterioration in household confidence following severe regional conflicts and domestic political uncertainties has not held back consumption. Household spending has increased in the run-up to the national elections, which involved promises of a large hike in the minimum wage and substantial increases in social transfers. The influx of refugees from Syria also stimulated demand, partly funded from government sources. In contrast, private business investment remained subdued, increasing by less than 3% for the year. Government consumption contributed 0.7 percentage points to growth, and public investment 0.3 percentage points.

As a result of sharp contractions in regional markets such as Iraq and Russia, weak growth in the main EU market and subdued tourism, total exports remained weak despite competitiveness gains stemming from exchange rate depreciation through the year (by about 13% against a basket of dollars and euros). Manufacturing exporters managed to widen their market share in the EU as well as in the US market. Still, aggregate goods and services exports contracted by nearly 1% in volume. Imports grew slightly and net trade contributed negatively to growth by 0.3 percentage points. Nonetheless, the trade and current account balances improved thanks to terms-of-trade gains (due notably to dropping oil prices) and the normalisation of gold trade. The current account deficit shrank from to 5.5% of GDP in 2014 to 4.4% in 2015.

At the start of 2016, the minimum wage was increased by 30%, to about 90% of the estimated median wage, although cost pressures will be temporarily mitigated because the government will subsidise between 25% and 40% of the cost increase for employers for one year. The impact of this jump in the minimum wage, which is earned by at least a quarter of all workers, remained difficult to assess as of mid-2016. Various informal employment and remuneration responses and practices appear to have tempered the impact of the hike (for example, part of the official minimum wage increase has been reportedly withheld by some employers).
On the other hand, business confidence was strengthened in early 2016 by the introduction of a new 2016 Action Plan which included important structural reform targets in eleven areas (Table 1 above). In contrast, the escalation of tensions with Russia led to an embargo on Turkish exports and an additional fall in tourism and construction service revenues. Furthermore, a series of terrorist attacks affected general confidence.

The government was replaced in May by a new cabinet in the context of discussions on constitutional changes. Macroeconomic policies remain supportive, and the projections of this Survey assume that the new government will stick to the basic orientations of the Medium-Term Economic Programme 2016-18 published in January. The fiscal stance is expected to be expansionary in 2016, with the fulfilment of November election promises, but spending restraint is planned from 2017. General government spending according to one measure is projected to increase from 41% of GDP in 2015 to 42% in 2016 before declining to 41% in 2017 and 40% in 2018. Although inflation is well above target, monetary policy was eased from early 2016 in the context of more supportive global capital market conditions, with a decline in the average funding rate of the Central Bank and cuts in the upper bound of the interest-rate corridor. The Central Bank considers that, as of mid-2016, positive real interest rates combined with a horizontal yield curve denote a tight monetary stance. Macro-prudential measures regarding instalment caps were relaxed somewhat, to facilitate the use of credit cards for certain categories of consumer purchases. To support

Table 2. Macroeconomic indicators and projections
Annual percentage change, volume (1998 prices)

<table>
<thead>
<tr>
<th></th>
<th>2012 Current prices (billion TRY)</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016 (projected)</th>
<th>2017 (projected)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP1</td>
<td>1 417</td>
<td>4.2</td>
<td>3.0</td>
<td>4.0</td>
<td>3.9</td>
<td>3.7</td>
</tr>
<tr>
<td>Private consumption</td>
<td>994</td>
<td>5.1</td>
<td>1.4</td>
<td>4.5</td>
<td>4.2</td>
<td>4.0</td>
</tr>
<tr>
<td>Government consumption</td>
<td>210</td>
<td>6.5</td>
<td>4.7</td>
<td>6.7</td>
<td>8.0</td>
<td>2.7</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>287</td>
<td>4.4</td>
<td>-1.3</td>
<td>3.6</td>
<td>1.8</td>
<td>4.0</td>
</tr>
<tr>
<td>Final domestic demand</td>
<td>1 492</td>
<td>5.2</td>
<td>1.4</td>
<td>4.7</td>
<td>4.3</td>
<td>3.8</td>
</tr>
<tr>
<td>Stockbuilding2</td>
<td>-2</td>
<td>1.4</td>
<td>-0.1</td>
<td>-0.3</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total domestic demand</td>
<td>1 490</td>
<td>6.5</td>
<td>1.3</td>
<td>4.6</td>
<td>4.5</td>
<td>3.9</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>373</td>
<td>-0.2</td>
<td>7.4</td>
<td>-0.8</td>
<td>2.7</td>
<td>5.2</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>446</td>
<td>9.0</td>
<td>-0.3</td>
<td>0.3</td>
<td>5.6</td>
<td>5.4</td>
</tr>
<tr>
<td>Net exports2</td>
<td>-73</td>
<td>-2.9</td>
<td>2.0</td>
<td>-0.3</td>
<td>-1.0</td>
<td>-0.3</td>
</tr>
<tr>
<td>Other indicators (growth rates, unless specified)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Potential GDP</td>
<td>.</td>
<td>4.5</td>
<td>4.3</td>
<td>4.2</td>
<td>4.0</td>
<td>3.8</td>
</tr>
<tr>
<td>Output gap3</td>
<td>.</td>
<td>-0.3</td>
<td>-1.5</td>
<td>-1.7</td>
<td>-1.8</td>
<td>-1.9</td>
</tr>
<tr>
<td>Employment</td>
<td>.</td>
<td>2.9</td>
<td>5.1</td>
<td>2.9</td>
<td>3.0</td>
<td>2.8</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>.</td>
<td>9.0</td>
<td>10.0</td>
<td>10.3</td>
<td>10.1</td>
<td>10.2</td>
</tr>
<tr>
<td>GDP deflator</td>
<td>.</td>
<td>6.2</td>
<td>8.3</td>
<td>7.5</td>
<td>7.0</td>
<td>6.5</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>.</td>
<td>7.5</td>
<td>8.9</td>
<td>7.7</td>
<td>7.4</td>
<td>7.5</td>
</tr>
<tr>
<td>Core consumer prices</td>
<td>.</td>
<td>6.3</td>
<td>9.2</td>
<td>8.0</td>
<td>8.7</td>
<td>7.8</td>
</tr>
<tr>
<td>Current account balance4</td>
<td>.</td>
<td>-7.7</td>
<td>-5.5</td>
<td>-4.4</td>
<td>-4.8</td>
<td>-4.6</td>
</tr>
<tr>
<td>Three-month money market rate</td>
<td>.</td>
<td>6.9</td>
<td>10.3</td>
<td>11.0</td>
<td>11.4</td>
<td>11.1</td>
</tr>
<tr>
<td>Ten-year government bond yield, average</td>
<td>.</td>
<td>7.7</td>
<td>9.2</td>
<td>9.3</td>
<td>10.2</td>
<td>10.0</td>
</tr>
</tbody>
</table>

1. Working day-adjusted.
2. Contributions to changes in real GDP, actual amount in the first column.
3. As a percentage of potential GDP.
4. As a percentage of GDP.

Figure 6. Recent economic developments and outlook

A. Economic growth

B. Expenditure

C. Labour market

D. Real wages and productivity

E. Effective exchange rates

F. Inflation

StatLink http://dx.doi.org/10.1787/888933388837
the squeezed tourism sector, banks will be allowed until the end of 2016 to restructure loans in this sector before declaring them non-performing.

The domestic and regional geopolitical environment continues to present risks, which are tilted to the downside. Any major deviation in macroeconomic policy from the targets enshrined in the medium-term economic programme 2016-18 issued in January might weaken confidence and increase exchange rate volatility. Tensions on the Syrian border and relations with Russia might improve or worsen. Internal tensions in the Southeastern regions are exposed to similar symmetric risks. In addition, even if direct trade with China is limited, Turkey stays exposed to the indirect global risks arising from China’s prospects, lower than expected growth in Europe, as well as from the expected normalisation of US monetary policy. In contrast, the removal of the international embargo on Iran may boost Turkish exports more than foreseen. Table 3 presents some specific risks which are hard to quantify.

Table 3. **Shocks that might affect economic performance**

<table>
<thead>
<tr>
<th>Shock</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>The fiscal and monetary framework of the medium-term economic programme 2016-18 is breached.</td>
<td>International confidence may weaken, affecting capital inflows and exchange rate volatility. Reserve assets may shrink and reduce the central bank’s fire power further.</td>
</tr>
<tr>
<td>Further escalation in regional and domestic tensions.</td>
<td>Growth would be weaker due to falling tourism revenues and severe spillover effects (tourism accounts for 4% in GDP and 7% in employment). Additional weakening in business and household confidence would curb investment and consumption. Export markets would shrink.</td>
</tr>
<tr>
<td>An exchange rate or other shock pushes inflation into double-digit territory.</td>
<td>Inflation expectations could become unanchored, fuelling a further wage – price – exchange rate spiral calling for sharp monetary policy tightening and leading to lower private domestic spending.</td>
</tr>
</tbody>
</table>

**Economic rebalancing to make growth sustainable and more inclusive**

Demand became excessively tilted towards private consumption during the high-growth period (Figure 7, Panel A), and final demand was financed too much by foreign savings (Panel B). As a result, the current account deficit has been high for some time (Panel D; OECD, 2014a). Concurrently, FDI inflows have been small (Panel C), resulting in debt finance and limiting benefits such as technology transfer. Policymakers introduced several measures to slow down the utilisation of consumer credits and credit cards to curb credit-financed private consumption, but some relaxation took place recently.

Increasing domestic saving will be crucial for rebalancing growth. The past decade’s strong consumption expansion was driven simultaneously by employment, wage and credit growth. Increasing domestic saving requires not only a containment of credit, but also an increase in saving incentives. A government-backed private pension saving scheme was put in place in 2013, whereby the government tops up participants’ savings by up to 25%, subject to a cap. As of May 2016, TRY 54.1 billion (2.7% of annual GDP) had been accumulated in this scheme and the authorities plan to automatically enrol all wage-earners (with a possibility to opt out).

Successful rebalancing requires not only slowing down domestic consumption, but also substituting it by external demand. Improving competitiveness is crucial for this. Turkey’s price competitiveness worsened during the high-growth period (Figure 8, Panel A). Sharp nominal exchange rate depreciation since the financial crisis has allowed Turkey to recover some of the lost ground, even though the gains were partly offset by persistently high inflation (Panel B). Concomitantly, Turkey’s share in world exports has increased, but
this reflected vibrant growth of trade partners rather than market share gains (Panel C). In contrast to OECD peers (i.e. the bottom third of OECD countries in terms of GDP per capita, listed in Figure 3), the cumulated growth of exports relative to the cumulated growth of Turkey’s markets (referred to as export performance), has only slightly improved since 2003, much less than in peer countries (Panel D). Total exports of goods and services as a share of GDP increased from 22% in 2005 to 28% in 2015, while they increased from 37% to 45% in Korea and from 35% to 49% in Chile in the same period.

Vigorous and sustainable growth underpinned by stronger price competitiveness and exports is needed to expand high-quality jobs throughout the country. This is required to foster simultaneously economic rebalancing and social inclusion, and in particular gender equality. The employment rates of those with no secondary education, of the 55-64 age cohorts and of youth have increased over the past decade, but remain below OECD standards. About 40% of the men and 75% of the women with no secondary education were jobless in 2014. About 28% of youth aged 15 to 29 were neither in education nor in employment (NEET) – 17% of the men and 46% of the women. Stronger growth would help
include such people, notably in the less advanced regions, where their demographic weight is larger. As well, Turkish women’s very low average employment rate (34% in 2014 against an OECD average of 63%) calls for facilitating their participation in the labour market, inter alia through broad-based development of child care infrastructure across the country.

Turkey currently exhibits one of the lowest shares of employment related to exports in the OECD, highlighting the importance of external competitiveness for social inclusion (OECD, 2015g). The challenge of job creation in sustainable export-oriented activities is heightened by the presence of 1.4 million working-age Syrian refugees. Better integrating them in the labour market would strengthen supply potential but will be challenging in the short term (Box 1).
Box 1. Integrating Syrian refugees

Turkey has been experiencing massive inflows of refugees from Syria since 2011. As of early March 2016, more than 2.7 million registered Syrian immigrants resided in Turkey according to the United Nations Refugee Agency. This corresponds to 56% of the total number of registered Syrian immigrants worldwide. These numbers exclude immigration from other countries (in particular around 300,000 from Iraq) as well as unrecorded illegal immigration. Thus, Turkey should be commended for shouldering a disproportionate burden in the global refugee crisis.

In order to respect the non-refoulement principle, the Turkish authorities issued new legislation and offered “temporary protection status” to immigrants. While this status provides all immigrants with shelter, only those who enter into Turkish territory via customs are allowed to apply for work visas. Field research conducted by the Turkish Confederation of Employer Associations revealed that less than 5% of Syrian immigrants fall into this category (Erdoğan and Ünver, 2015). The overwhelming majority was excluded from the labour market until February 2016. Since then, a new regulation allows every immigrant to seek a job albeit with a number of restrictions such as local authority approval requirements and firm-level quotas. Immigrants are also allowed to set up firms and are supported through training programmes.

Accommodation conditions differ considerably across immigrant groups. The Disaster and Emergency Management Authority (AFAD) data indicates that around 10% of immigrants live in the camps established along the border. The remaining part is dispersed throughout the country, including the most developed western regions. In terms of demographic structure, immigrants form a young population. More than half are below 18 years old and 20% below 11 years old. Those over 65 account for only 2%. Gender-wise the population is balanced.

In terms of school attendance, AFAD finds a big difference between those who live inside and outside the camps. For the 6-11 year-olds, the school attendance ratio is 83% in the camps, but it falls below 15% outside the camps, which undermines the United Nations’ “no lost generation” strategy.

Turkey’s Ministry of Foreign Affairs stated that, by the end of 2015, total government spending for Syrian immigrants exceeded USD 8 billion (1.1% of 2015 GDP). Around 5% of this amount has been co-financed by the international community. The 19 March 2016 agreement between the EU and Turkey, which includes a financial assistance package of EUR 6 billion until 2018, would increase co-financing. At the same time, further spending needs are building up in the areas of education, health and language training, which are essential for the integration and social inclusion of immigrants, and will continue to put pressure on Turkey’s public finances.

The labour market integration of immigrants in the short term will also be demanding. AFAD found that only 20% of Syrian immigrants have a secondary education background or more. The estimated number of working age immigrants attained about 1.4 million (5% of Turkey’s labour force) and their entry in the labour market will represent a major expansion in the lower-skilled end of the market. Studies by Ceritoğlu et al. (2015) and Del Carpio and Wagner (2015) suggest that immigrants started to replace Turkish employees in significant numbers in certain market segments, such as seasonal agricultural work, informal work and female service jobs. They also find positive signs that Turkish employees in border regions secure better-paying, formal jobs due to increased spending by and for the immigrants.

Overall, the opportunities for low-skilled immigrants to find jobs in the formal sector are low under existing employment rules and regulations (including the new minimum wage). This is why many immigrants work in the informal sector. Labour market reforms would considerably facilitate the legal employment of refugees in higher-quality jobs in the formal sector.
Strengthening the resilience of the economy

The European Commission developed a range of cross-country indicators of macroeconomic imbalance (Table 4). In Turkey’s case, despite improvements in a number of sub-indicators, vulnerabilities are apparent in three main areas: i) dependence on external capital inflows, ii) credit-dependence of domestic demand, and iii) inflation inertia. As highlighted in related OECD research, macroeconomic imbalances risk being perpetuated by exceptionally supportive global capital market conditions (Roehn, 2016).

### Coping with a high dependence on capital inflows

Large current account deficits have eroded Turkey’s net international investment position. Moreover, between 2007 and 2015, the composition of gross external liabilities has shifted towards debt while the share of FDI and equity has declined over the decade – notwithstanding some improvement in 2015 (30% of external liabilities in 2015 against 45% in 2007 and 2010). Over the same period, the share of short-term debt in total external debt has nearly doubled and reached more than 33% in 2013-14, before dropping to about 30% in late 2015 (Figure 9). As a result, gross external financing needs including the funding of the current account deficit and maturing external debt are projected to reach around 25% of GDP in 2016. Turkey remains vulnerable to volatile international capital flows and erratic exchange rate movements. Worldwide, large debt inflows have tended to increase the probability of banking crises or sudden stops (Catão and Milesi-Ferretti, 2014; Ahrend et al., 2012; and Furceri et al., 2011). Further FDI inflows and accumulation of foreign exchange reserves would reduce exposure to such shocks.

Foreign exchange selling auctions and several interventions by the Central Bank to alleviate exchange rate pressures over recent years have reduced foreign exchange reserves, whose level as a share of GDP is low compared with many other countries and below adequate levels according to the latest IMF Article IV report on Turkey (IMF, 2016). In early 2016, amid a gradual easing of perceived global risks, international reserves, measured in US dollars, rebounded from their 2015 lows albeit without reaching levels observed in 2012-14. Given the large structural current account deficit and the volatile external environment, the central bank should accumulate more international reserves.

As a response to the increasing share of short-term external debt positions, reserve requirement ratios for short-term loans, in particular forex loans, have been increased.

---

**Table 4. Macroeconomic imbalances**

<table>
<thead>
<tr>
<th>Statistic</th>
<th>Current account balance</th>
<th>Net int. investment position</th>
<th>Real effective exchange rate</th>
<th>Export market shares</th>
<th>Nominal/unit labour cost</th>
<th>Deflated house prices</th>
<th>Private sector credit flow</th>
<th>Private sector debt</th>
<th>Public debt</th>
<th>Unemployment rate</th>
<th>Financial sector liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turkey (2015)</td>
<td>-5.9</td>
<td>-51.2</td>
<td>-6.5</td>
<td>12.3</td>
<td>26.0</td>
<td>11.1</td>
<td>10.3</td>
<td>88.7</td>
<td>32.9</td>
<td>9.8</td>
<td>3.2</td>
</tr>
<tr>
<td>Average EU</td>
<td>1.8</td>
<td>-31.6</td>
<td>-1.1</td>
<td>-1.1</td>
<td>2.6</td>
<td>3.2</td>
<td>1.0</td>
<td>148.1</td>
<td>72.5</td>
<td>10.4</td>
<td>5.1</td>
</tr>
<tr>
<td>Average OECD peers among EU</td>
<td>1.1</td>
<td>-69.1</td>
<td>-2.2</td>
<td>-2.2</td>
<td>1.9</td>
<td>3.8</td>
<td>5.0</td>
<td>104.6</td>
<td>77.4</td>
<td>11.7</td>
<td>4.4</td>
</tr>
</tbody>
</table>

Note: OECD peers among EU countries are: Czech Republic, Slovenia, Portugal, Slovak Republic, Estonia, Greece, Hungary and Poland. Data refers to 2015 or latest year available.

several times (most recently in March 2015) resulting in a slowdown of forex loan growth in the course of 2015.

The resilience of large enterprises, which hold the bulk of external private debt, is further strengthened through the use of hedging vehicles. However, the share of the inward FDI stock remains low in international comparison despite the recent acceleration of inflows. Turkey is generally open to FDI but has restrictions in a number of sectors, in particular in certain transport and business services (OECD, 2015c). Lifting the remaining restrictions and, more importantly, making the business environment more attractive for large formal firms would facilitate FDI in all sectors, reduce the relative weight of external debt, and strengthen the economy’s resilience.

Figure 9. **Gross external debt**

![Gross external debt](image)

**Note:** Panel B: Numbers above bars indicate percentage share of short-term debt in total external debt.

**Source:** World Bank, Quarterly External Debt Statistics.

**Preventing excessive credit growth and mitigating contagion risks**

Consumer credit growth exceeded 20% per annum on average between 2010 and 2013, prompting the introduction of a set of macro-prudential measures in late 2013, as documented in the previous OECD Economic Survey (OECD, 2014a). The growth of credit card and vehicle loans subsequently declined but housing loan growth has remained relatively strong, spurring vibrant housing construction. At the same time, the introduction of loan-to-value ceilings at the end of 2010 has reduced the risk that sudden price corrections could generate substantial losses for banks on their mortgage books. The ban of variable interest rate and forex loans for consumers has further strengthened the resilience of household balance sheets.

The recent surge in price-to-income and price-to-rent ratios has heightened the risk of sudden price corrections in the housing market. Yet, much of the measured increase in house prices can be attributed to demographic developments, the liberalisation of the real estate market and the improved quality of the housing stock (Hülagü et al., 2016). Moreover, the ratio of gross rents to house prices in Istanbul, though falling, is still higher...
than in most other European countries’ major cities – suggesting that prices may not yet have peaked (Global Property Guide, 2016).

Corporate debt has continued to expand at a sustained pace (Figure 10, Panel A), although, as a share of GDP, it remains low in international comparison (Panel B). Nonetheless, Turkey is the only OECD country alongside Italy where both the ratio of debt-to-equity and the ratio of short-term liabilities to short-term financial assets exceed 1 (Panels C and D). The number of bankruptcies has increased at a rather moderate pace in recent years (UYAP, 2016), but a number of experts anticipate a spurt in 2016, as many medium-sized firms with weak capital structures face more difficult market conditions (Özüner, 2016), for example in tourism. Even if some bankruptcy applications may seek to exploit loopholes in bankruptcy legislation (Hisarcıkloğlu, 2016), stronger capital structures would help reduce these vulnerabilities.

Figure 10. Private sector debt

A. Turkey’s private sector debt¹

B. Debt of non-financial corporations (NFC), 2014²

C. Debt-to-equity ratio for NFC, 2014²

D. Short-term liability-to-assets ratio for NFC, 2014²

Note: All debt figures come from non-consolidated financial accounts.
1. Debt definitions according to European Commission (loans and debt securities).
2. Debt definitions according to IMF (gross liabilities minus equity and financial derivatives).
Source: Central Bank of Turkey; and OECD Financial Dashboard (2014).
On the back of fast credit growth, and in a context of exchange rate pressures and falling returns on equity, domestic banks' capital adequacy ratios have declined until late 2015, before improving thanks to higher profits. Overall, equity buffers remain strong in the banking sector and leverage ratios (which are not risk-based) easily exceed the minimum legal requirement of 3% (Figure 11, Panel B). Non-performing loan ratios are also lower than in most peer countries (Figure 11, Panel C). Further measures such as accepting foreign exchange reserves as collateral or increasing remuneration of TRY-denominated reserves have supported banks’ liquidity management and their core liabilities. Credit conditions tightened from the second half of 2015, however, amid domestic uncertainties and as capital requirements started to constrain lending.

**Curbing inflation and reducing exchange rate volatility**

Despite collapsing international oil prices in 2015 and early 2016, consumer price inflation has continued to overshoot the official 5% target (Figure 6, Panel F). Inflation appears entrenched at high single-digit levels, reflecting strong and asymmetric pass-through from exchange-rate fluctuations (Kal et al., 2015), the indexation of many wages and service fees, and low downward flexibility of prices in several markets, including food products. Core inflation and inflation expectations also stayed consistently above target. In addition, the central bank projects that the 30% jump in minimum wages in January 2016 may add another percentage point to inflation by the end of 2016 (CBRT, 2016).

Under exceptionally supportive global financing conditions and a fully open capital account, the central bank continues to face an acute monetary policy dilemma: on the one hand, high domestic inflation calls for tight monetary policy; on the other hand, high interest rates tend to draw in capital inflows that fuel domestic credit and push up the real exchange rate. So far the central bank has handled this tension by operating an unorthodox interest-rate corridor, meant to help lean against volatile capital flows (Figure 12, Panel A). At the same time it tried to contain domestic demand with the help of...
an active macro-prudential policy. This instrument mix helped stabilise the real exchange rate, but failed to achieve the inflation target. The credibility of the target is currently very low (Figure 12, Panel B), while the Central Bank aims at regaining credibility in the short term by anchoring inflation expectations around its forecasts (as in some past episodes, see Başkaya et al., 2012).

The central bank projects that, under current policies, inflation will converge to target in 2018. However, there is a risk that inflation will fall considerably less, in which case monetary policy will need to be tightened to bring inflation back towards the target and prevent further erosion of central bank credibility.

Policymakers and social partners can support central bank’s efforts to regain credibility by moderating wage and price pressures. The official minimum wage is earned by a large number of workers, has spill-over effects throughout the entire wage spectrum and is determined by a commission where government, employee and employer representatives are equally represented. Consensus between social partners on a sustainable real wage path may help achieve disinflation. International experience suggests that minimum wage policy settings avoiding rigid nominal indexation on price or wage inflation can be helpful (OECD, 2015k).

The credibility of the central bank would be improved by further narrowing the policy-interest-rate corridor, in line with what has been recommended in the previous OECD Economic Survey (OECD, 2014a) and more recently by the IMF (IMF, 2016). Indeed, the current 7.25% to 9.00% corridor is still relatively wide by international standards.

**Figure 12.** Monetary policy and inflation expectations

<table>
<thead>
<tr>
<th>A. Central bank policy rate and interest rate corridor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate corridor</td>
</tr>
<tr>
<td>%</td>
</tr>
<tr>
<td>12</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>B. Inflation expectations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y-o-y % changes</td>
</tr>
<tr>
<td>12-month ahead</td>
</tr>
<tr>
<td>10</td>
</tr>
</tbody>
</table>

1. 5-day moving averages are shown.
Source: Central Bank of the Republic of Turkey.

**The role of fiscal policy**

As emphasised in past OECD Economic Surveys, the transparency of public finances should be improved to better assess fiscal outcomes and space. General government accounts should be consolidated and published according to international national accounting standards, validated by the Court of Accounts and Eurostat, and used as the central reference in fiscal policy-making and medium-term macroeconomic planning.
Progress has been achieved on individual components of these accounts, including on a quarterly basis, and alternative general government figures have been published by different ministries in different official documents. However, the objective of a standard consolidated data set has remained elusive so far. Fiscal transparency along international good practices would reinforce the hard-won credibility of public finances, and help manage the fiscal stance after controlling for cyclical and one-off effects.

In the absence of a unified national general government accounting system, IMF Fiscal Monitoring Reports are the best available source to evaluate Turkey’s fiscal position. According to IMF indicators, Turkey’s general government balances have remained on a broadly sound path over the past decade, despite an uptick in expenditures in 2016 due to election promises. Prospects appear sound in the short term (Figure 13). At the same time, these accounts do not include all relevant liabilities for long-term fiscal sustainability, such as long-term pension and health liabilities.

Figure 13. Fiscal performance in international comparison
In per cent of GDP

A. General government spending

B. General government revenue

C. General government balance

D. General government gross debt

1. 35 countries listed as advanced economies by the IMF.
2. 40 countries listed as emerging market and middle-income economies by the IMF.
The periodic publication of Fiscal Policy Reports would be useful to monitor the cyclically-adjusted and underlying fiscal stance, as well as the long-term sustainability of public finances. All explicit and implicit government guarantees should be covered, including those given to public-private partnerships and to the public banks having financed them. Quasi-fiscal activities in the public sector should also be included. Progress with fiscal transparency would facilitate the introduction of a formal fiscal rule, after an unsuccessful attempt in 2010.

Restructuring the tradable sector by upgrading the business environment

Macroeconomic rebalancing and social inclusion call for faster productivity growth, which would deliver competitiveness gains, boost exports and help reduce external imbalances, while fostering high-quality job creation throughout the country. Rebalancing would thus serve to overcome the enduring tension between growth and external sustainability. Faster productivity growth necessitates speeding up structural change in the business sector and requires improving the environment for doing business, a broad-based upgrading of the skill base, reliable governance institutions, level playing enforcement of the rule of law, alignment of product, labour and capital market rules with OECD good practices, and a streamlined tax and subsidy system. Many of these requirements were reflected in the 2016 Action Plan and in follow-up preparations.

A large potential for productivity-enhancing structural change

To foster rebalancing, the international competitiveness of the economy should be durably improved. As room is limited for reducing factor costs (wages and capital costs), this necessitates a substantial increase in productivity. Even if, in the long term, it is only by improving Turkey’s human capital that productivity can permanently improve, in the short and medium term there is significant room for achieving productivity gains under existing resources. An overly large share of employment is currently trapped in low-productivity informal and semi-formal firms. If this divide in the business sector can be overcome and a larger share of employment can shift to better-performing firms, productivity would significantly increase. This calls for:

- Fostering market entry, notably in new tradables with high value-added.
- Reorienting domestic market-driven firms to foreign markets, to stimulate “learning by exporting”.
- Strengthening productivity of existing exporters by more intense training, better management and additional R&D activities, including by enhancing R&D collaboration between exporters, universities and public research institutes.
- Promoting entrepreneurship in sectors that have high growth and export potential such as health related industries, biotechnology, information and communication technology and environmental technologies.
- Allowing high-productivity firms to grow faster by facilitating the reallocation of employment to these firms.

All these improvements would be accelerated by better integrating Turkish firms in global value chains (GVCs). Integration into GVCs facilitates market entry, boosts the productivity of existing operators through know-how and technology transfers, and fosters the growth of successful firms by offering access to large customer networks.
Reducing domestic productivity gaps

Manufacturing plays a particularly important role in employment creation in less advanced regions and in aggregate export performance. It includes a large proportion of domestic service inputs and ties them to the “global reach of manufactured products” (De Backer et al., 2015). Compared with other catching-up OECD economies, Turkey’s manufacturing sector has had slower productivity growth, lost competitiveness and fared less well in international markets. Manufacturing accounts for a smaller share in national output and employment than in many other emerging market OECD countries (Figure 14).

Weak productivity growth is rooted in substantial gaps in firms’ resources and capacities, i.e. their access to technology, capital, professional labour and international partnerships. A first divide resides in the degree of firm institutionalisation. The most formal enterprises comply fully with existing rules and regulations and issue regular and comprehensive financial statements. They are captured in the central bank’s balance sheets database. They have relatively high sales per worker and robust productivity growth, but represent a minority of firms in manufacturing.

Most firms, however, do not attain the same degree of formality and transparency. Performance gaps between the narrow population of fully formal firms in the central bank dataset (described below as the “fully formal” sector) and the total population of manufacturing firms (captured in a wider Turkstat dataset) hints at massive performance divergences between the two groups. In particular, labour productivity growth among fully formal firms has been much stronger over the past decade than in the rest of manufacturing (Figure 15, Panel A).

Divergences are also deep between “national frontier firms” (the top 10% firms in sales per worker), “laggards” (the bottom 20%) and “intermediary” or “follower” firms (the rest). These gaps are found both within the fully formal sector (Figure 15, Panel B), and in broader manufacturing (Panel C). Labour productivity growth between 2003 and 2013 was much stronger for the frontier firms than for followers, which in turn achieved stronger productivity gains than the laggards. This suggests that productivity diffusion works very poorly. Thus, strengthening the linkages between national frontier firms and others offers a big potential for productivity growth in the Turkish manufacturing sector, similar to integration into GVCs.

Average productivity is considerably undermined by the low performance of laggards (Figure 15, Panels B and C). Detailed information is not available on the characteristics of these firms, but available evidence suggests that they face challenges in two key areas: managerial quality, and employees’ human capital (Bloom et al., 2014). A large proportion of these firms likely consist of small businesses run by low-skilled entrepreneurs employing low-skilled workers (Figure 15 Panel D). These operate informally or semi-formally, and therefore face lower legal and regulatory costs than larger firms. Many would struggle to survive if the business environment were level. Their exit, however, would create challenges in terms of re-employing their workers.

A number of structural features perpetuate the deep segmentation between different types of firms, hinder productivity diffusion and curb higher-productivity firms’ share of total employment:

- Gaps in basic human capital across firms. These appear particularly severe in general management know-how, foreign language proficiency and basic digitalisation knowledge of business owners, as well as with respect to access to vocational training for their employees.
Many medium-sized family firms achieve only limited formalisation, sticking to semi-formal business practices. Minimising tax liabilities and maintaining family control may be slowing down their transition to formal corporate governance arrangements, to the professionalisation of management and to fuller financial transparency.

Lack of formalisation and transparency hampers firms’ access to banking and financial services, to the stock market and to international partnerships. As these services and resources become more important for firm performance, the gap between fully formal and less formal firms widens.

Fully formal firms, both domestic and foreign-owned, are highly sensitive to the quality of their business environment. They acknowledge that the rule of law, the fight against corruption and competition improved in their markets in the 2000s, but also caution against a deterioration in recent years, which harms foreign firms even more than domestic ones (Figure 16, Panel A).
Large formal firms are particularly hindered in labour-intensive activities, despite the recent liberalisation of temporary work agency contracts. Turkey’s employment regulations deprive law-abiding enterprises of the wide range of employment forms available in other OECD countries (OECD, 2014a). So far, more flexible employment forms have been mainly accessible for informal and semi-formal businesses, for both regulatory and practical reasons. These jobs are very precarious and lack the social protection associated with the flexicurity systems in place in other OECD countries.

There are also obstacles to the growth of young, human capital-intensive and high-performance firms. These firms declare being particularly affected by pressures arising from illicit practices, non-level playing competition and political unpredictability (Figure 16, Panel B). As they are generally law-abiding and financially transparent, they cannot escape taxes and find the prevailing tax system insufficiently supportive of their activities.

**Figure 15. Significant productivity divergences**

- **A. Fully formal firms and total manufacturing**
- **B. Frontier, follower and laggard firms in fully formal manufacturing**
- **C. Frontier, follower and laggard firms in total manufacturing**
- **D. Education of workers and informality across firm size**

1. Informality is defined as share of workers not registered with social security institutions.

Source: Turkish Statistical Institute; Central Bank of the Republic of Turkey.

StatLink [http://dx.doi.org/10.1787/88893388922](http://dx.doi.org/10.1787/88893388922)
Fostering integration into global value chains

The level of exported value added per capita has increased thanks to the dynamism of Turkey’s exporters and export markets but remains low (Figure 8, Panels C and D). The emergence of regional and world-wide supply chains has radically modified the organisation of global production over past decades. Capital has become increasingly mobile, including across borders, and production chains more and more geographically fragmented. Against this backdrop, reaping the benefits of GVCs is a major challenge for Turkey. Fostering integration into GVCs would not only boost growth and productivity, but also help rebalance final demand and reduce current account deficits. It can also generate ample benefits for employees and consumers owing to better quality products and improved working conditions provided that firms operate in the formal sector and are amenable to international codes and standards (Gereffi and Luo, 2015).

A major advantage of GVC data is that it can distinguish foreign from domestic content embodied in exports and final demand. A country’s backward participation measures the import content of exports and hints at the extent to which a country’s export industry relies on upstream international production chains. Forward participation reflects the extent to which a country’s exports are used as inputs in other countries’ exports, or in other words the extent it feeds into global downstream activities. TiVA data suggests that the integration of Turkish firms in GVCs falls short of potential (Figure 17). Backward participation more than doubled between 2000 and 2011, but is still below what could be expected given Turkey’s relatively favourable geographical position and the scarcity of its primary products. Forward participation has remained low since 2000.

Turkey’s still-low backward participation is partly explained by industry composition, as Turkey’s gross exports are more concentrated in low- to medium technology sectors that typically rely less on foreign intermediate inputs. Also, the particularly low import-intensity of service sectors in Turkey reduces average backward participation. Forward participation, on the other hand, tends to be weak across the board. Controlling for factors
that generally affect participation in GVCs does not significantly alter Turkey's relative position, hinting at bottlenecks in its policy framework. Turkey exhibits one of the lowest shares of employment that is sustained by foreign demand. Deeper GVC integration would generate new jobs and employment, including for the low skilled, and would further benefit better capital and human resource allocation. Innovation, more intense competition and better resource reallocation are also conducive to enhancing social mobility (Aghion et al., 2015).

Avenues to promote stronger integration of Turkish firms into GVCs include:

- Raise the quality of basic institutions. World governance indicators suggest ample room for improvement in voice and accountability, political stability, government effectiveness, regulatory quality, the rule of law and the control of corruption.
- Improve ICT infrastructure, in particular internet-based and software-based business solutions (E-purchases, E-sales, enterprise resource planning systems).
- Increase cross-border cooperation and reduce cumbersome custom procedures.
- Deepen trade agreements. Turkey has concluded many agreements to abolish tariffs on trade of manufactured goods, and agreements should also be reached on the liberalisation of services, investment, competition, intellectual property and public procurement.
- Reduce entry barriers for foreign capital in the services where they remain high.
- Improve business conditions to attract more FDI, which has been very low.
- Raise R&D spending, which has increased over the past decade but falls short of the government's own longer-term targets. Make the policy framework more experimentation-enabling, including by reducing the costs of failure.
- Better match skills and labour market needs by raising educational spending, improving attainment in literacy, numeracy and problem-solving skills, further raising enrolment in higher education, and developing vocational training.
● Raise the standards of corporate governance and managerial skills.

Progress along these dimensions would lift Turkey’s integration into GVCs, in particular its forward dimension. This would improve openness to trade which is arguably a significant driver of per capita GDP growth (e.g. Barro, 2015). Greater integration into international supply chains would also trigger new investments in Turkey and generate technological and skill spillovers thereby boosting productivity. Increased forward participation requires the production of competitive intermediate products and services which could also spill over to a reduction of the import content of domestic consumption. In the latter case, backward participation would be reduced, but both would contribute to reducing the structural current account deficit and make growth less dependent on external financing conditions.

GVCs extend the potential market for Turkish firms but also expose the economy to a greater number of shocks. To this extent, the resilience of the Turkish economy would benefit from greater product and regional diversification of export activities. Moreover, potential adverse distributional and environmental effects need to be monitored. Progress with GVC integration could, in the short term, increase the distance between national frontier firms and national laggards which could mechanically increase inequality, although all income levels would rise. Furthermore, Turkey’s environmental policies, which are the least stringent in the OECD (Botta and Kozluk, 2014), could draw a disproportionate share of resources into energy-intensive or polluting production (Kozluk and Timiliotis, 2016).

The 2016 Action Plan

Most of these policy issues are recognised in the 10th National Development Plan 2014-18, adopted in June 2013. The Plan included an extensive reform agenda with 25 “Priority Transformation Programmes”. However, in a difficult political context and amid four national elections over 2014-15, implementation lagged. Following the establishment of a single party government after legislative elections in November 2015, the authorities launched a new Action Plan. Unveiled in January 2016, it included an implementation deadline for each measure. However, this government was replaced by a new one in late May. The new government declared its continuing commitment to the reforms enshrined in the 2016 Action Plan in the new Government Program which is published on May 24, 2016.

The Plan comprised 11 sections, ranging from fundamental human rights to local administration (Table 1 above). The bulk of the package was dedicated to the practical needs of business enterprises. A total of 216 measures covered technical improvements in public services to firms, new incentives for vocational and on-the-job training, improvements in commercial courts and customs, new industrial zone development initiatives, etc. The Plan also included a number of reform orientations long advocated by the OECD, including measures to promote flexicurity in labour markets, initiatives to enhance performance transparency and accountability in the education system, and regulatory impact assessments in all future legislative initiatives.

Since the Plan’s launch in January 2016, the previous government repeatedly stated their commitment to implement the planned measures in the course of 2016. They reported that, despite an intense legislative agenda with the enactment of a new budget for 2016 and the completion of the legislative procedures for the visa waiving deal with the European Union, 70% of the actions scheduled for end-March had been completed. These
included a new package strengthening the rights of working parents and maternity leave entitlements, and new legislation improving the effectiveness of publicly-funded R&D and design centers.

Some of the most critical measures scheduled for end-March could, however, not be implemented. These notably include the severance pay reform. The strong opposition by unions and the reluctance of parts of the business sector once again delayed the adoption of this fundamental reform. Work agency services started to be liberalised with a new law adopted in May 2016. Further progress with labour market and flexicurity reforms should have particularly high priority. If the new government maintains the reform targets, regular implementation reports, including as much detail as possible on the actual progress achieved in each individual area, would uphold the credibility and momentum of the reform agenda.

The previous government had also started to work on a follow-up to the 2016 Action Plan. The objective was to make progress with a more comprehensive upgrading of the business and regulatory environment. To this effect, the Coordination Council for the Improvement of the Investment Environment (YÖİKK) (OECD, 2010) was revived. This body, created in the early 2000s to advise the government on reforms, was tasked with making concrete legislative and regulatory proposals to facilitate the conditions for doing business. As of May 2016, also building on the “Investment Climate Improvement Programme” of the National Development Plan 2014-18, this Council had elaborated some 50 proposals, most of which the previous government was envisaging to transform into law as a follow-up to the 2016 Action Plan.

**Priorities for reforms**

This section presents a comparative picture of parameters of the business environment which, according to the analysis in this Survey, are crucial for productivity growth, competitiveness gains, sustainable and high-quality job creation and progress with social inclusion. It focusses on four areas: i) human capital, ii) integrity of governance institutions, iii) quality of product and labour market regulations, and iv) the tax and subsidy system. It appraises Turkey’s relative position against OECD comparators and highlights areas which invite special attention. It could help authorities monitor progress with ongoing reform initiatives (including the 2016 Action Plan and follow-ups to it) and assess priorities for future reform efforts.

**Education and human capital**

Turkey has made substantial progress in the area of education and human capital, but gaps vis-à-vis OECD benchmarks remain very large. This is due on the one hand to the incremental nature of improvements in the human capital stock because of very gradual cohort effects, and, on the other hand, to the quality of education lagging behind quantitative changes in school years. Table 5 highlights Turkey’s position in key educational indicators in international comparison.

Figure 18 illustrates the room remaining for Turkey to converge with OECD educational standards. In each area, the average score of the top three OECD performers sets the frontier, and Turkey’s distance to this frontier is shown in form of bars. The average distances of catching-up OECD economies as well as the distance of the best three performers among these catching up OECD economies are also shown. Lower bars show a relatively good position and higher bars a large room for catching-up. The same...
OECD recommendations for Turkey’s education policies span a very wide set of areas, from children’s participation to pre-school education to teachers’ training and incentives (OECD, 2015b). Despite a real increase of 55% between 2005 and 2013, spending still falls far short of OECD averages. Turkey, like other OECD countries facing specific education challenges, should actively use international instruments such as the OECD PISA and PIAAC performance evaluation methods to investigate outcomes for vulnerable population groups.

In the short term, and taking the educational background of the existing working age population as given, two important labour market priorities emerge as: i) improving the basic capabilities of low-educated entrepreneurs, in particular in the areas of basic management, basic English, and basic digitalisation know-how; and ii) elementary upskilling for low-skilled workers, in particular the unemployed and those exiting declining low-productivity firms.

Table 5. Educational indicators in international comparison

<table>
<thead>
<tr>
<th>Key Indicators</th>
<th>TURKEY</th>
<th>Average OECD countries</th>
<th>Best 3 OECD countries</th>
<th>Average OECD catching-up countries</th>
<th>Best 3 OECD catching-up countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average schooling years of adults (25-34)</td>
<td>8</td>
<td>11</td>
<td>14</td>
<td>10</td>
<td>12</td>
</tr>
<tr>
<td>Percentage of adults (25-64) with at least secondary education</td>
<td>36</td>
<td>76</td>
<td>92</td>
<td>71</td>
<td>92</td>
</tr>
<tr>
<td>Percentage of young adults (25-34) with at least secondary education</td>
<td>50</td>
<td>83</td>
<td>96</td>
<td>79</td>
<td>94</td>
</tr>
<tr>
<td>Percentage of young adults (25-34) with at least tertiary education</td>
<td>25</td>
<td>41</td>
<td>59</td>
<td>33</td>
<td>40</td>
</tr>
<tr>
<td>Percentage of 25-34 year-olds that have attained an upper secondary VET qualification as highest level of education</td>
<td>11</td>
<td>28</td>
<td>55</td>
<td>31</td>
<td>53</td>
</tr>
<tr>
<td>Gender gap in average schooling years (in number of years)</td>
<td>1.84</td>
<td>0.42</td>
<td>0.04</td>
<td>0.50</td>
<td>0.14</td>
</tr>
<tr>
<td>PISA: Mathematics score</td>
<td>448</td>
<td>494</td>
<td>540</td>
<td>475</td>
<td>513</td>
</tr>
<tr>
<td>PISA: percentage of top performers in mathematics</td>
<td>6</td>
<td>13</td>
<td>25</td>
<td>9</td>
<td>15</td>
</tr>
<tr>
<td>PISA: percentage of low performers in science</td>
<td>26</td>
<td>18</td>
<td>8</td>
<td>22</td>
<td>9</td>
</tr>
<tr>
<td>PISA: variation of mathematics scores across schools (% of average OECD variation)</td>
<td>61</td>
<td>37</td>
<td>9</td>
<td>40</td>
<td>19</td>
</tr>
<tr>
<td>PISA: gender gap in mathematics performance (points)</td>
<td>8.0</td>
<td>10.9</td>
<td>2.5</td>
<td>9.9</td>
<td>4.2</td>
</tr>
<tr>
<td>Education spending per student (in 2012 USD PPPs)</td>
<td>3 514</td>
<td>10 220</td>
<td>18 509</td>
<td>6 284</td>
<td>8 222</td>
</tr>
<tr>
<td>PIAAC: percentage of low performers</td>
<td>39</td>
<td>15</td>
<td>7</td>
<td>21</td>
<td>9</td>
</tr>
<tr>
<td>Employment rate of the low-skilled (percentage of 25-64 with less than secondary education)</td>
<td>48</td>
<td>55</td>
<td>71</td>
<td>51</td>
<td>64</td>
</tr>
<tr>
<td>Employment rate of high-skilled (percentage of 25-64 with secondary education and more)</td>
<td>75</td>
<td>82</td>
<td>90</td>
<td>81</td>
<td>87</td>
</tr>
<tr>
<td>NEET: Percentage of youth 15-29 neither in education nor employment</td>
<td>28</td>
<td>16</td>
<td>7</td>
<td>18</td>
<td>13</td>
</tr>
<tr>
<td>Earnings premium for adults (25-64 years) with tertiary education over adults with upper secondary education (average earnings of upper secondary graduates= 100)</td>
<td>188</td>
<td>160</td>
<td>127</td>
<td>181</td>
<td>151</td>
</tr>
<tr>
<td>English Proficiency Index</td>
<td>48</td>
<td>...</td>
<td>71</td>
<td>58</td>
<td>64</td>
</tr>
</tbody>
</table>

Governance of the business environment

The soundness of governance institutions is a key driver of business performance and productivity convergence (Dorrucci, 2015). The rule of law is particularly relevant (OECD, 2013; Barro, 2015). The quality of governance institutions is also crucial for effective integration into GVCs, particularly in emerging economies (Kowalski et al., 2015).

As of 2014-15, Turkey substantially lags the most credible OECD countries in terms of perceived quality of governance. It also falls behind other catching-up OECD economies, and notably its best performing peers in this area (Figure 19). Four areas stand out: i) the judiciary system should operate more dependably and efficiently, with an assurance of full independence; ii) the effectiveness of the government should be enhanced as a provider of political stability and as an efficient regulator; iii) corruption should be curbed and an active anti-corruption strategy, including by drawing on OECD guidelines, should be implemented (OECD, 2014a); and iv) competition policy and the transparency of state aid should be reinforced.

Figure 19 captures Turkey’s standing in the area of informality by the share of firms reporting that they compete directly against unregistered firms. However, semi-formal practices of registered competitors are also severely distorting competition in Turkey. They are not captured in these indicators.
More restrictive product and labour market regulations are associated with less investment (Égert and De Serres, 2016). In addition, employment protection reduces investment further when product market regulations are too strict. According to OECD indicators, Turkey has particularly rigid rules concerning individual dismissals (notice periods and severance pay), standard fixed-term contracts and temporary work agency services (OECD, 2014a). A legislative amendment in May 2016 started to liberalise temporary work agency contracts and is an important step forward.

Turkey exhibits substantial gaps with both OECD best performers and other catching-up economies according to most regulatory indicators (Figure 20). This suggests important benefits from: i) further labour regulatory reforms (notably from reforming severance pay and standard fixed-term contracts); ii) a more efficient and sustainable utilisation of the official minimum wage (by increasing it in line with productivity, therefore not penalising formal firms); iii) easing the licensing and permit system (for example by introducing “zero licencing” type of initiatives; OECD, 2016a); iv) liberalising competition in all network industries (OECD, 2015h); and v) improving trade policies.

**Product and labour market regulations**

Product and labour market regulations are associated with less investment (Égert and De Serres, 2016). In addition, employment protection reduces investment further when product market regulations are too strict. According to OECD indicators, Turkey has particularly rigid rules concerning individual dismissals (notice periods and severance pay), standard fixed-term contracts and temporary work agency services (OECD, 2014a). A legislative amendment in May 2016 started to liberalise temporary work agency contracts and is an important step forward.

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**Tax and subsidy system**

Turkey scores unevenly in international comparison on tax policy and knowledge-based capital indicators (Figure 21):

- Corporate tax revenues are relatively low, which reflects a narrow base due to widespread informality. Broadening the tax base by bringing the informal sector within the reach of the tax system will improve economic performance. However, only a
detailed review of the current complex tax system can highlight what the top reform priorities should be.

- Environmentally-related taxes are among the highest in the OECD, but their distribution across pollution sources and types is uneven, with particularly high taxes on road transport fuels but much lower and sometimes zero taxes elsewhere (including for coal). Although differing pollution profiles can justify tax differentiation from an environmental point of view, current taxes are poorly aligned with pollution profiles implying that pollution is too high and current abatement not cost-effective. Systematic monitoring of all pollution emitters would allow designing and implementing a more cost-effective environmental tax system.

- R&D tax incentives were augmented over the past decade. This contributed to the increase of R&D expenditures and R&D employment. Nevertheless, knowledge-based capital use and supply, which also depend on several other factors, continue to fall short of OECD comparators.

An important dimension of the tax and subsidy system concerns Turkey's complex regime of investment tax subsidies (OECD, 2012). This regime is based on transparent rules, but subsidisation rates may reach very high levels for certain projects, depending on their product, regional and technological characteristics. Certain large investments may be subsidised for more than half of their cost. To ensure that these incentives do not distort competition excessively, the outcomes should be analysed with the help of the legislated but not yet implemented state aid monitoring system. The authorities plan to fully activate the implementation regulations of this system by the end of 2016.
Reforms and green growth

Implementing the reforms discussed so far would raise Turkey’s potential growth rate and promote social inclusion, but some of them will also help ensure that growth becomes greener. Progress with the formalisation of business activities would improve the transparency in this area, and shed light on environmental externalities, thereby contributing to the design and implementation of mitigation policies. Figure 22 brings to light Turkey’s present standing in some key environmental areas.

Two areas where gains from progress in transparency should be large are climate change strategies and local air pollution. Turkey’s greenhouse gas emissions per capita are still relatively low but are increasing rapidly. As shown on Figure 23, they have not yet been decoupled from GDP growth in comparison to the OECD average. In the context of COP 21, Turkey announced that it would reduce GHG emissions by up to 21% from the “business-as-usual” level by 2030. Nonetheless, this entails a more than doubling of emissions from 430 MtCO₂e in 2012 to 929 MtCO₂e in 2030.

Turkey’s 6th National Communication under the United Nations Framework Convention on Climate Change, issued in 2015, indicates that Turkey’s GHG emissions have increased by about 110% between 1990 and 2013. This resulted from a 137% increase in emissions in the energy sector, a 132% increase in industrial processes, a 20% increase in agriculture and a 87% increase in the waste sector. Concerning industrial processes, which are of special interest in this Survey, Turkey has tried to contain emissions by applying EU pollution prevention and control standards, and voluntary instruments such as the EU Eco-Management and Audit Scheme (OECD, 2015i). Given the emission record and future saving needs, more effective mitigation instruments should be used.
Figure 22. **Green growth indicators for Turkey**

**A. CO₂ intensity**

- Turkey (demand-based)
- OECD (demand-based)
- Turkey (production-based)
- OECD (production-based)

**B. Energy intensity**

- % of renewables in total primary energy supply, 2014
- Total primary energy supply per real GDP ( ktoe/USD)

**C. Population exposure to air pollution**

- Annual concentration of PM₂.₅ (μg/m³)

**D. Waste generation and recycling**

- Municipal waste (% of treated)
- Municipal waste generated (kg/person)

**E. Greening taxation**

- Environment-related taxes (% of GDP)
- Tax rate of unleaded petrol and diesel in 2014 (USD/LITRE)

**F. Environmentally related inventions**

- Inventions per capita
- % of all technologies


[StatLink](http://dx.doi.org/10.1787/88893388998)
Both more effective regulations and economic instruments (such as explicit carbon prices and tradable emission permits) will be required and all industrial emissions should be monitored and measured. In the process, in order not to penalise higher-productivity businesses, broad-based transparency should apply to firms of all sizes, sectors and regions. Formalisation and institutionalisation in manufacturing and the business sector at large is expected to facilitate this effort.

Local air pollution by fine particles in Turkey is higher than the OECD average (Figure 24, Panel A), and above World Health Organisation safety norms, particularly in more industrialised regions (Panel B). Recent progress in the transparency of exposures at NUTS 2 level is welcome, including concerning PM2.5 particles which have the highest potential adverse effects on human health (OECD, 2014b). Existing data suggests that industrial sources play an important role in particle pollution in Turkey. In a recent EU review Turkey was ranked highest among 19 different regions and countries with respect to the share of industry in PM2.5 sources at 29% (European Union, 2015b). The regional distribution of PM2.5 exposures analysed by the OECD on the basis of data developed for a headline Green Growth indicator (Mackie et al., 2016) confirms this, as industrial regions display particularly high pollution levels and a particularly low improvement between 1990 and 2013 (Figure 24, Panel B). Similar to GHG emissions, a firmer mitigation effort is needed for fine particles. This would necessitate progress in the transparency of emission sources and formalisation would help.

Coal used in electricity generation is a major source of both GHG and fine particles, sulphur oxides and mercury. Yet, a national “coal strategy” aims at raising the share of coal in electricity generation from 26% in 2013 to 35% in 2030. Unlike other fuels, coal is currently not subject to special consumption taxes and yearly coal consumption subsidies have been estimated at 730 million USD in 2013 (Acar et al., 2015; OECD, 2016b). Turkey’s climate change and air pollution mitigation strategies would need to tackle coal-originated emissions more actively, including by promoting cleaner technologies in new plants.
Turkey also faces important water management issues. Water competition across sectors is growing and is expected to become more challenging with increased urbanisation, expansion of irrigation areas (Turkey is the only OECD country planning to do so) and climate change. Pressures from agriculture are particularly strong, as it represents 85% of freshwater withdrawals – the second-highest proportion in the OECD (OECD, 2013b). In the face of these challenges, Turkey’s efforts to upgrade water management along the lines of the EU Water Framework Directive are welcome. However, progress with transparency is needed to support monitoring and contribute to the implementation of reforms. For example, groundwater use is growing disproportionately and calls for improved surveillance. Without adequate information systems it will not be possible to monitor and manage depletion rates and external effects (OECD, 2015f).

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ANNEX

Progress in key structural reforms

This Annex reviews the measures taken since 2014 in response to key recommendations from OECD Economic Surveys (recommendations identified as ES, year) and OECD Economic Policy Reform – Going for Growth (identified as GfG, year).
## A. Education

### Recommendations in previous Surveys

<table>
<thead>
<tr>
<th>Recommendations in previous Surveys</th>
<th>Actions taken and current assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce the persisting large quality gaps among both schools and universities by granting them more autonomy and resources per student, against greater performance accountability (GfG, 2015)</td>
<td>Several quality improvement projects have been implemented in the education system, but there was no action to increase the autonomy of schools and universities. Increasing the autonomy and performance transparency of universities was an objective in the previous government’s 2016 Action Plan.</td>
</tr>
<tr>
<td>Develop pre-school education (ES, 2006 and GfG, 2015).</td>
<td>Pre-school enrolment rates of three-, four- and five-year-old children have increased in the 2010s (reaching 43% for the four-five year olds in 2016) but remain below OECD averages. The 2016 Action Plan aimed at better enforcing the pre-school capacity development obligations of municipalities.</td>
</tr>
</tbody>
</table>

## B. Product and labour markets

### Recommendations in previous Surveys

<table>
<thead>
<tr>
<th>Recommendations in previous Surveys</th>
<th>Actions taken and current assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accelerate the liberalisation of all network sectors (GfG, 2015).</td>
<td>Eligible consumer thresholds for access to competitive procurement were reduced in 2014 and 2015 for gas, and in 2014, 2015 and 2016 for electricity. The 2013 Law on the liberalisation of rail transport has started to be implemented for freight.</td>
</tr>
<tr>
<td>Liberalise fixed-term and temporary work agency contracts (ES, 2014 and GfG, 2015).</td>
<td>A law including several clauses liberalising temporary work agency contracts (subject to a number of restrictions) was adopted in May 2016.</td>
</tr>
<tr>
<td>Limit the growth of the official minimum wage and promote minimum wage settlement at regional level through local consultations between government, employer and employee representatives. Make permanent the social security contribution cuts granted during the crisis and further reduce them for low-skilled workers throughout the country, financing this with a widening of the tax base (ES, 2014 and GfG, 2015).</td>
<td>Following an election promise, the official minimum wage was increased by 30% in January 2016. The government will subsidise up to 40% of the cost increase for employers for the first year. Some of the principal social contribution cuts for specific worker groups were extended. For example, incentives for the employment of women were extended until 2020.</td>
</tr>
<tr>
<td>Replace the severance payment regime (available and reliable for a minority of formal sector workers) with “portable” severance saving accounts available for all workers (ES, 2012 and GfG, 2015).</td>
<td>This reform was a top goal in the 2016 Action Plan but was delayed following strong union opposition and limited support from parts of the business sector.</td>
</tr>
<tr>
<td>Strengthen the social safety net and the up-skilling avenues for the unemployed, expanding the most successful schemes (ES, 2014 and GfG, 2015).</td>
<td>Unemployment insurance coverage is limited, but budget resources for active labour market policies more than doubled between 2015 and 2016. The number of participants in the subsidised on-the-job training programmes increased from 12 000 in January-February 2015 to 37 000 in the same period of 2016.</td>
</tr>
</tbody>
</table>

## C. Transparency

### Recommendations in previous Surveys

<table>
<thead>
<tr>
<th>Recommendations in previous Surveys</th>
<th>Actions taken and current assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improve fiscal transparency at general government level, on a unified accounting basis according to international national accounting standards, and publish a comprehensive report on fiscal policy covering all fiscal and quasi-fiscal activities (ES, 2014).</td>
<td>Quarterly Government Finance Statistics (GFS) started to be reported to the IMF in 2015. However, consolidated general government accounts according to international national accounting standards are still missing.</td>
</tr>
<tr>
<td>Implement the legislated but not yet operational state aid monitoring system (ES 2014). Evaluate the outcomes of the support programmes for the SMEs (ES, 2014).</td>
<td>The regulations regarding the implementation of the state aid monitoring system (Law 6015) are to come into force by the end of 2016.</td>
</tr>
</tbody>
</table>
## D. Environment

<table>
<thead>
<tr>
<th>Recommendations in previous Surveys</th>
<th>Actions taken and current assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consider harmonising the implicit carbon tax rate across fuels in different uses in the medium-term (ES, 2014).</td>
<td>No action.</td>
</tr>
</tbody>
</table>