Thanks to a decade of sound macroeconomic policies and reforms, Turkey weathered the global financial crisis better than many other countries in emerging Europe. While output was hit hard, with GDP contracting by 4.7 per cent in 2009 and the unemployment rate soaring to 14 per cent, the recovery was strong. By early 2011 the unemployment rate was back to its pre-crisis level, falling to 10.8 per cent in March 2011. In addition to stability-oriented macroeconomic policy, targeted measures to reduce non-wage labour costs introduced from 2008 have encouraged the recruitment of workers, increased employment outside agriculture and helped reduce informality. These have included: a general reduction of social security contributions; targeted reductions for hiring youth, women and long-term unemployed; reductions for workers involved in training and research and development; and significant social security and corporate and VAT tax reductions for enterprises investing in less developed regions. These cuts have been offset through public transfers to social security institutions.

**Across-the-board cuts**

In October 2008, employer social security contributions for disability, old age and death were reduced from 19.5 per cent to 14.5 per cent of gross wages. Employers found to have employed workers not registered with social security are not entitled to this reduction. As the 5 percentage point gap is covered by the Treasury, there is no impact on social security receipts. Some 5.5 million workers were covered by this measure in 2009, rising to 6.4 million workers by end 2010, at a cost of about €25 per month per worker. The total cost for the central administration budget was 3.3 billion Turkish lira (TRY) (€1.4 billion) in 2009 and TRY4.1 billion (€1.8 billion) in 2010.

**More job opportunities for women, youth and the long-term unemployed**

In an effort to encourage the hiring and retention of women and youth, the employer share of social security contributions for women and youth (aged 18–29) recruited between May 2008 and May 2010 has been covered for a period of five years by the Unemployment Insurance Fund (UIF). Starting at 100 per cent the first year, the subsidy gradually decreases to 20 per cent in the fifth. In order to benefit, the employer must have recruited women and youth who were registered as unemployed for at least six months. This measure appears to have had a rapid impact: 61,615 new jobs were created in 2009, including 31,482 for women, and 63,230 in 2010, including 33,395 for women. The cost was TRY81 million (€38 million) in 2009 and TRY137 million (€63.4 million) in 2010.

In addition, employer social security contributions for all new employees who were unemployed for at least three months prior to their hiring were also covered the UIF for a period of six months, as long as the additional worker represented an increase to the enterprise’s workforce level as of April 2009. In 2009, 64,505 workers benefitted from this programme, rising to 76,144 in 2010. Social security contributions for employees hired while receiving unemployment insurance payments are also paid by the UIF for the remaining months of their benefit period. Again, in order to be eligible for the subsidy, new hires had to represent an increase in the recipient enterprise’s workforce as of April 2009.

Several other new social security reductions incentive programmes to increase employment have also been implemented with new conditions and benefit periods for the employer that range from six to 54 months depending on the age, status and qualifications level of the employee.

**A boost to vocational training and research**

Training and research have been targeted as well. For example, employers who provide vocational education to their staff benefit from lower social security contributions, and employers who hire workers in the fields of technology and research and development are reimbursed half of their social security contributions.
In February 2011, 21,647 research workers were employed under this scheme, an increase of 150 per cent compared with 2008.

**Incentives for less developed regions**

Non-wage labour cost reduction measures to encourage investment in less developed regions have been in place for several years. Employer social security contribution cuts were first offered in 2004 to enterprises in the textile, clothing and leather sectors in developed regions that were willing to shift activities to less developed regions. Since 2007, these regional incentives have been available in all sectors and no longer require transfer of activities from more developed regions. Originally planned to be phased out in 2009, these measures were extended in 2010 in response to the crisis.

In this scheme, social security contributions for current and newly recruited workers are covered by the State for an average of five years, while corporate tax is reduced from 20 per cent to 5 per cent for five years. Interest rates on loans are also subsidized, and businesses receive VAT and customs duty exemptions for the procurement of machinery and equipment. The exact duration of social security exemptions depends on the level of regional development: two years in “first category” underdeveloped regions, rising to seven years in “fourth category” regions. A total of 626,649 workers were employed under these regional incentives in 2009, 722,891 in 2010 and 730,000 in the first two months of 2011 (17 per cent of total manufacturing employment in Turkey). The total cost for the central budget was TRY 741 million (€ 322 million) in 2009 and TRY 926 million (€ 402 million) in 2010.

**Women benefit from rise in manufacturing jobs**

The steady growth of manufacturing employment in the 2000s and its very rapid post-crisis recovery are a remarkable feature of the Turkish economy (figure 1). In February 2011, 4.33 million workers were employed in manufacturing, up 297,000 over a year earlier. The share of manufacturing employment in total employment was 19.9 per cent in February 2011. Job creation for women exceeded that for average male workers: between 2009 and 2010, manufacturing employment was up by 12.4 per cent for women and by 8.9 per cent for men. As a result, women’s share in total manufacturing employment rose to 22.5 per cent in 2010 from 21.8 per cent in 2009.

**Setback in reducing informality in export sector**

Informal employment, defined as employment of workers not registered with any social security institution, declined from 52.9 per cent of total employment in 2001 to 43.5 per cent in 2008, although it subsequently increased to 44.8 per cent in 2010 (figure 2). Much of the decline before 2008 was due to the contraction of agricultural employment, which is largely informal. Agriculture’s share in total employment fell from over 30 per cent in 2004 to 24 per cent in 2008. The weight of informal jobs in agricultural employment also decreased slightly, from 90 per cent in 2004 to 85.5 per cent in 2010. The Government’s strategy to reduce the informal economy also appears to have contributed to a steady decline in the share of informal employment in other domestic market-oriented activities over the same period, including retail trade (from 43 to 37 per cent), construction...
(from 66 to 52 per cent), transportation (from 38 to 34 per cent) and restaurants and hotels (from 49 to 43 per cent).

In contrast, the decline of informal employment in trade-exposed manufacturing activities was reversed in the wake of the crisis. After initially declining from 31 per cent to 25.5 per cent between 2004 and 2008, its share increased, reaching 26.6 per cent in 2010 and likely rose further in the first half of 2011. This occurred despite the loss of many unprotected informal jobs in the crisis. Arguably, this somewhat unexpected development is due to the intensity of competitive pressures in trade-exposed manufacturing from low-cost countries compounded by real currency appreciation. In particular, this expansion of informal manufacturing employment is observed in central and eastern provinces where newly developing manufacturing activities, notably in textile and clothing, are more directly exposed to fierce international price competition than the medium-technology industries in the western regions. In the less developed areas, productivity levels and living costs are low, and formal sector minimum wages and total employment costs are admittedly well above actual reservation wages. The most rapidly expanding form of manufacturing employment there is home-based informal self-employment by women working as sub-contractors to manufacturing enterprises. Largely as a result, manufacturing employment in these provinces increased by as much as 30–40 per cent between 2008 and 2010 (though from a low base), especially in the regions geographically closest to the new importers of Turkish manufacturing goods, such as Iraq and other Middle Eastern and Northern African countries.

**Focus on quality jobs**

Despite vigorous employment growth in the 2000s, the structural weaknesses of Turkey’s labour market endure. The aggregate employment rate remains very low at 43 per cent of the working-age population in 2010, with a large share in low-productivity informal activities, particularly in agriculture. A very large part of employment, including in urban areas, is in predominantly low-productivity informal self-employment. In the years ahead, job creation outside agriculture will need to be strong enough to absorb a growing urban labour force, which is increasing at about 3.5 per cent each year and includes rising participation of women, and exits from agriculture, estimated at 2.5 per cent per year, or 0.7 per cent of total labour force. The authorities are therefore looking to boost job creation in high-productivity, sustainable, human-capital-enhancing formal sector jobs.

**International experience in social security contribution reductions**

From the mid-1990s onward, several European countries have cut employer social security contributions as a means to increase the demand for low-paid workers. During the recession, similar cuts were introduced or extended to protect enterprise cash flows and investment, and to reduce labour costs in many countries. Subsidizing employer social security contributions raises various challenges, however. First, it increases public debt. Second, the boost to employment may not last if taxes are subsequently increased to cover the associated costs. The replacement of taxes on (formal) labour by taxes on consumers also raises equity issues, especially in countries with high informality. In addition, financing social security through general revenue instead of through contributions provides no stable source of income for the social protection scheme and consequently for the pension system, making benefit levels subject to annual budget decisions. The decrease in social security contributions is therefore an acceptable means to boost labour demand in the short run if losses of social security receipts can be guaranteed by subsidies from the state budget to...
social security funds. But the reduction in non-wage labour costs should not be linked to lower benefits, as this could potentially increase poverty and reduce aggregate demand. Further analysis of the long-term effects on the budget deficit, benefits levels, employment and aggregate demand is needed to examine the effects of these trade-offs in the Turkish case.

Challenges ahead

Depending on such an analysis, Turkey’s still very high employer social security contributions could be reduced further either across the board or by targeting specific groups of workers at risk of unemployment or exclusion from the labour market, provided this is accompanied by other demand-side labour measures and training incentives. In a similar fashion, the use of the UIF to finance extended public employment services raises the issue of the long-term sustainability of the Fund, as both employers and workers could start questioning their contribution level. In the crisis context, however, this scheme did provide valuable employment services to new categories of workers. All in all, two observations suggest that employment growth in Turkey is also driven by other factors, which equally deserve the attention of policy-makers: a large number of jobs continue to be created in the less developed regions by circumventing labour market regulations; and proximity to export markets is an important determinant of job creation, suggesting that the economy’s competitiveness and export performance are crucial for labour market performance.

References: