

Turkey 2000-2010: A Decade of Transition

Discussions Among Experts



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Purpose and background

- Basic question: In what ways was the decade transformational for the political economy of Turkey?
- The project attempts to distinguish:
 - what changed and what did not
 - what old problems were addressed and what new problems emerged
 - what parts of the transformation set the stage for permanently better macroeconomic performance and what parts were more ephemeral
- Methodology: Based on discussions in three workshops held in October 2011 in Istanbul, Brussels and Washington DC, each with 12-15 individuals with expertise on some aspects of Turkey's political economy
- The objective of the book is to present a sense of these discussions.

Organization of the presentation

- Macroeconomic policy framework and growth
- Macroeconomic vulnerabilities
- The labor market
- Economic inclusion
- The imprint of globalization: exports and the EU
- Conclusions

Macroeconomic policy framework and growth

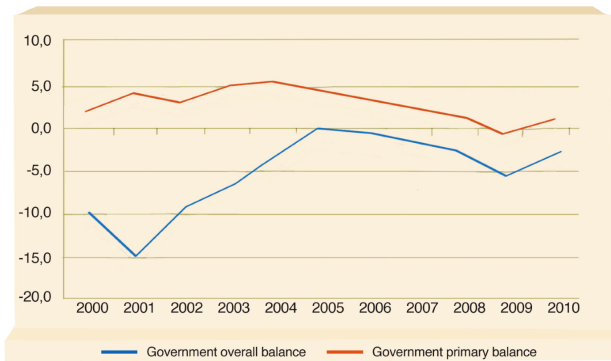


Macroeconomic policy changes were most obvious and clear

- Fiscal policy was anchored on a target for the primary surplus
- Monetary policy framework shifted to a floating exchange rate
- The Central Bank was granted independence vis-à-vis policy actions
- Inflation targeting was adopted
- The financial sector was subjected to many reforms: banks were recapitalized, supervision was strengthened, supervision and regulatory practices were brought in line with international practices, and new banking laws were adopted to refine the framework.

On the macroeconomic and financial side, Turkey had overcome longstanding sources of instability

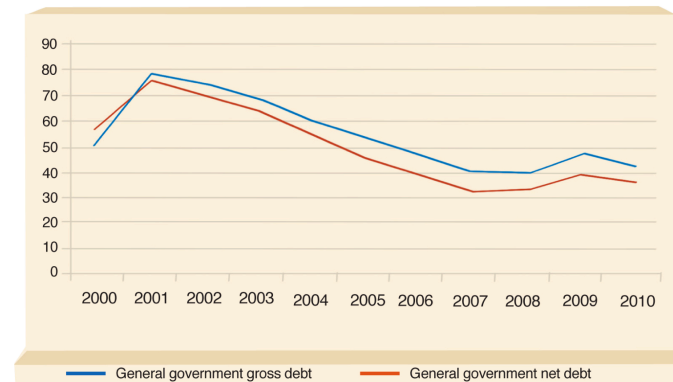
Public Sector Finances
(Percent of GDP)



Sources: International Monetary Fund, World Economic Outlook Database, September 2011 and Article IV Consultation Reports (various issues).

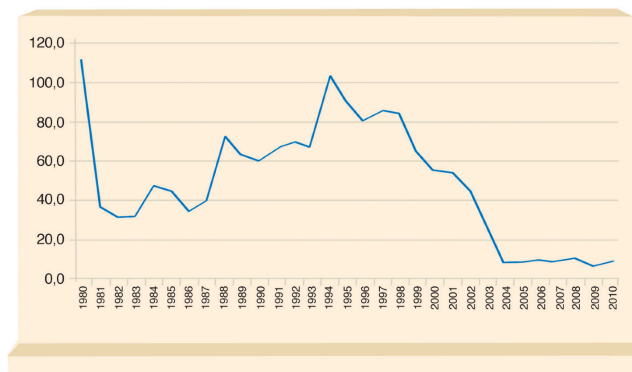
Note: There is a discontinuity in the data series between 2000-02 and 2003-10 because of a change in the content of government category.

Government Debt
(Percent of GDP)



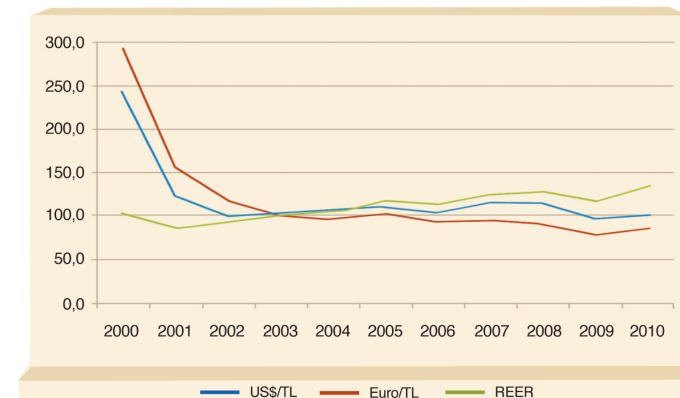
Source: International Monetary Fund, World Economic Outlook Database, September 2011.

Inflation
(Average consumer prices, percent)



Source: International Monetary Fund, World Economic Outlook Database, September 2011.

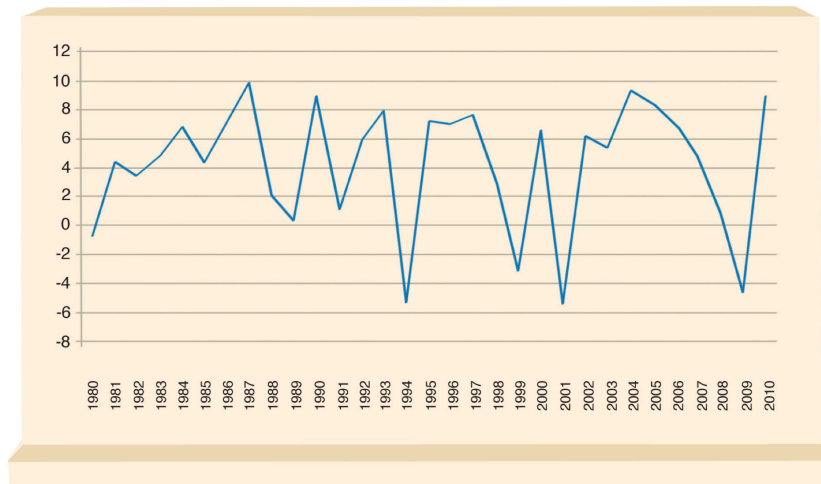
Exchange Rates
(2003=100)



Sources: Central Bank of Turkey and Turkey Data Monitor.

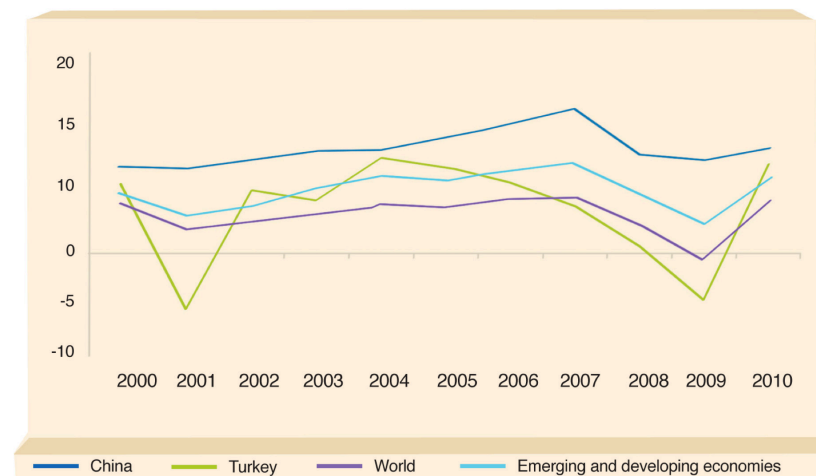
The shift to more stable macroeconomic policies had not had as strong an effect on growth as might have been wished

**Real GDP Growth
(Percent)**



Source: International Monetary Fund, World Economic Outlook Database, September 2011.

**GDP Growth Comparisons
(Percent)**



Source: International Monetary Fund, World Economic Outlook Database, September 2011.

Discussions on macroeconomic policy, financial sector reform, and growth

- Had strong enough policy frameworks been put in place to ensure that macroeconomic and financial sector stability would be permanent?
 - fiscal stabilization
 - monetary and exchange rate policy
 - financial sector reforms
- Had growth during the decade been disappointing in light of the extent of the improvements in policies?
 - general perception
 - facts and the underlying factors
- Had the new macroeconomic policy stability improved Turkey's resilience to shocks?

Macroeconomic vulnerabilities

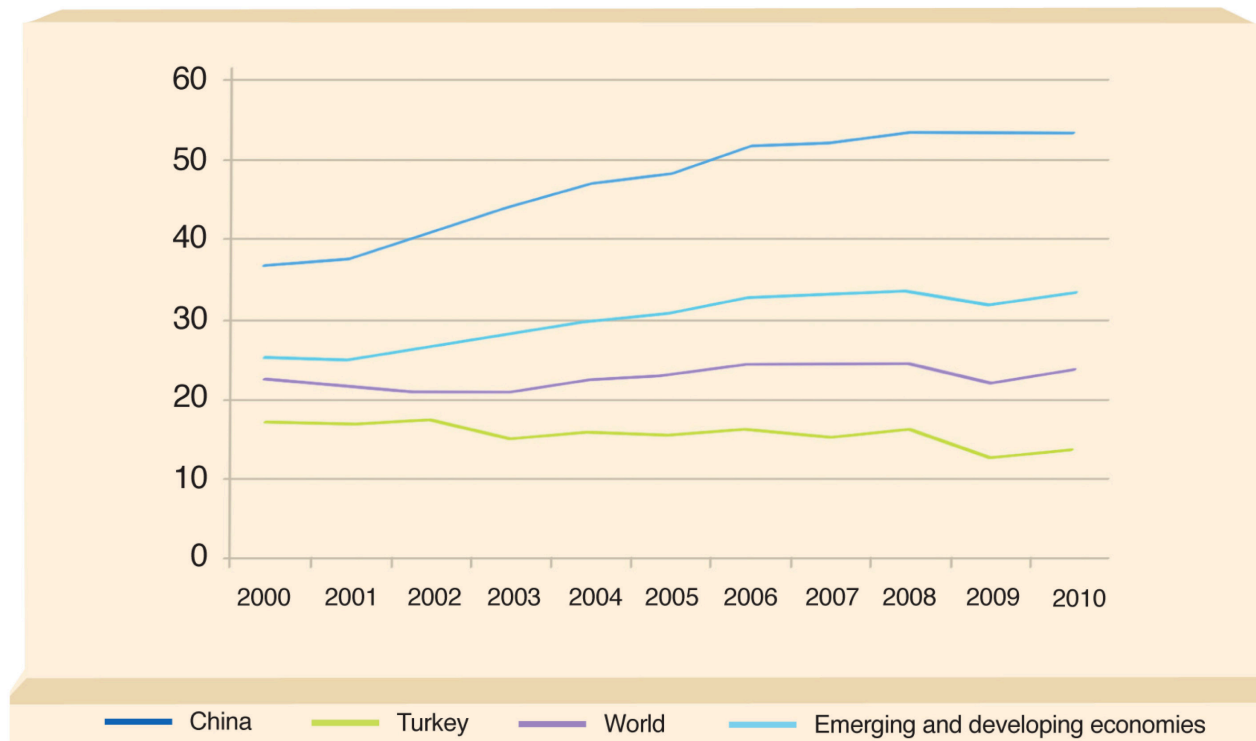


Macroeconomic stability had opened the door to new vulnerabilities

- In an environment of ample liquidity, capital inflows surged
- Turkish lira appreciated, bank lending surged, private savings continued to fall, private investment rose, and imports increased
- These influences created strong pressures on the current account balance
- The new vulnerabilities centered on a large current account deficit and exposure to sudden stops, variable risk premiums, and exchange rate volatility

Savings rate -- low and declining

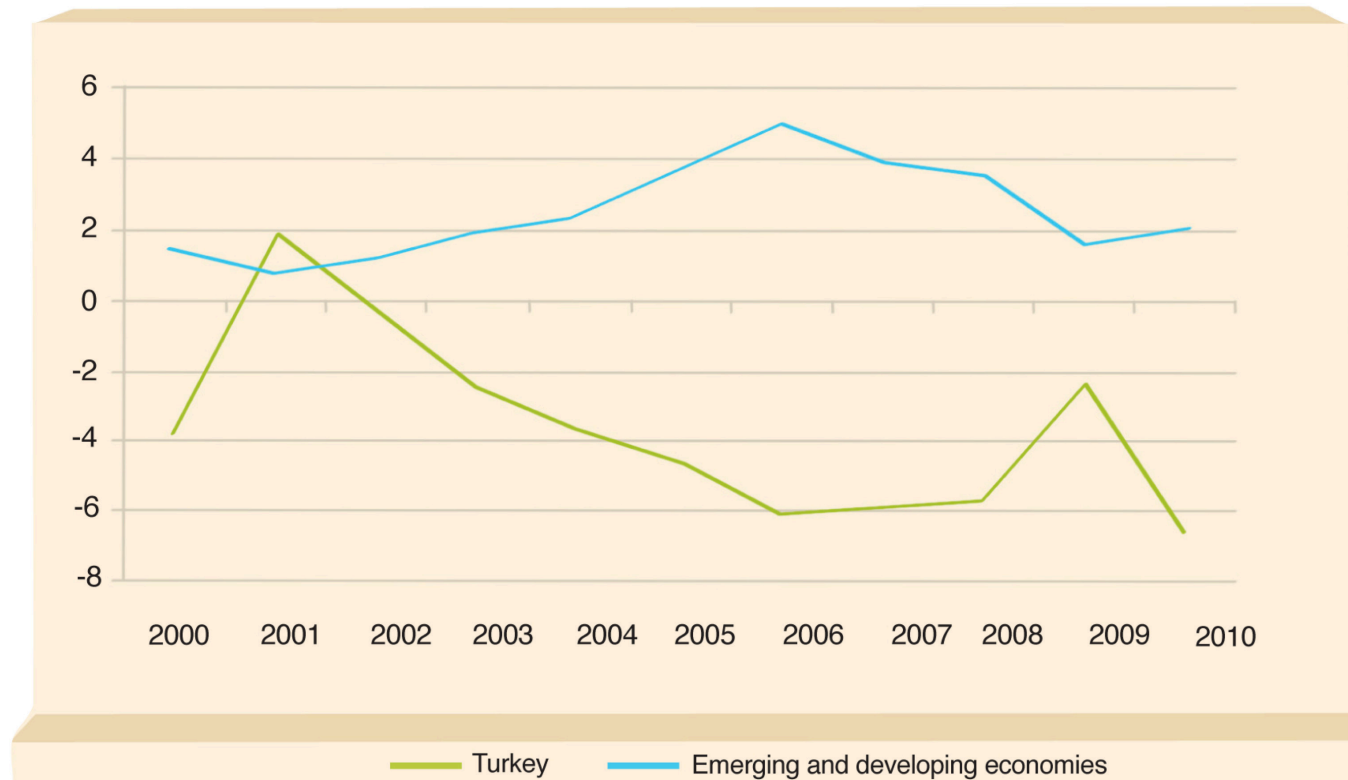
**Gross National Savings
 (Percent of GDP)**



Source: International Monetary Fund, World Economic Outlook Database, September 2011.

Current account deficit—large and rising

**Current Account Balance
(Percent of GDP)**



Source: International Monetary Fund, World Economic Outlook Database, September 2011.

Vulnerabilities

- Low and falling savings
 - What caused the drop in savings?
 - Was it a problem?
 - Was the policy response adequate?
- Large and rising current account deficit—2 views
 - Glass half full: domestic and foreign savings financing high productive investments
 - Glass half empty: Heavy dependence on foreign savings was a critical vulnerability, especially when much of foreign savings came as “hot” inflows

Labor market



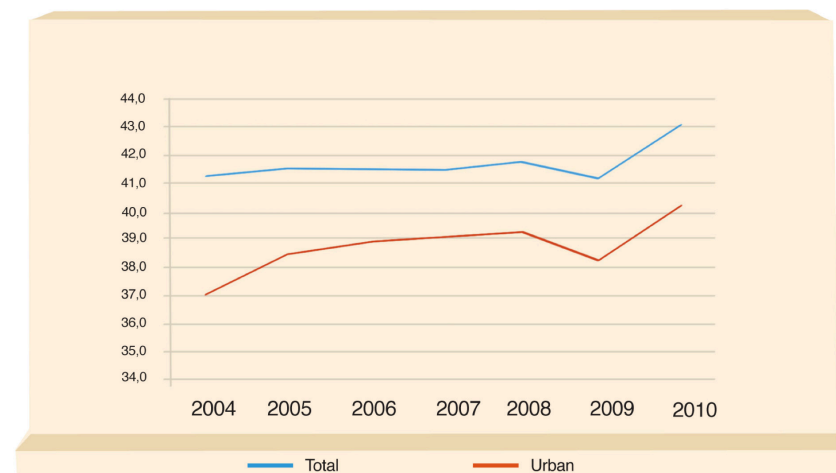
Job growth lagging working age population growth meant unemployment remained high

Unemployment
(Percent of total labor force)



Source: Turkish Statistical Institute.

Employment Rate
(Formal employment as percent of population over age 15)



Source: Turkish Statistical Institute.

Labor Market Challenges

- Diagnosing the causes of low job growth
 - macroeconomic impediments: overvalued exchange rate, middle-income employment trap
 - microeconomic impediments: excessive regulations, high/undifferentiated minimum wage, high labor taxes
 - globalization: increased specialization, pressures to adopt more productive techniques
 - demographics/effective supply of labor exerted opposing influences: women/older workers with low participation rates, bulge in younger population, but many staying in school longer
- Government missed opportunity to tackle structural labor market problems after macro stabilization

Economic inclusion



Spreading Prosperity

- Measures of inclusiveness improved, but slowly
 - income inequality continued to fall, but remained high
 - incidence of poverty fell, but remained high
 - changes in the approaches to social policies
- Education system
 - improvements: literacy rates, enrollment rates, infrastructure, internet access, spending, experimentation with decentralization
 - problems remained: uneven quality, too focused on nation building objective at expense of teaching critical thinking skills
 - Government program for reform insufficiently cohesive
- Social conservatism
 - shift from suppressed role of religion in the public sphere to more open expressions of Muslim identity in political, social, economic life

What held back action on inclusion?

- Income distribution and Poverty:
 - did changes in social policies make them more effective?
 - were the government's social policy objectives clear?
- Education:
 - Key fault lines in education system: quality, equity, politicization, underlying cultural paradoxes
 - Priority areas for education reform: curriculum reform, better use of high school, depoliticization
- Social Conservatism:
 - Whether the rising open expressions of social conservatism had supported economic inclusion and Turkey's economic aspirations
 - Fault lines in Turkey's mix of religiosity, social conservatism, and economic ambition

The imprint of globalization: exports and the EU

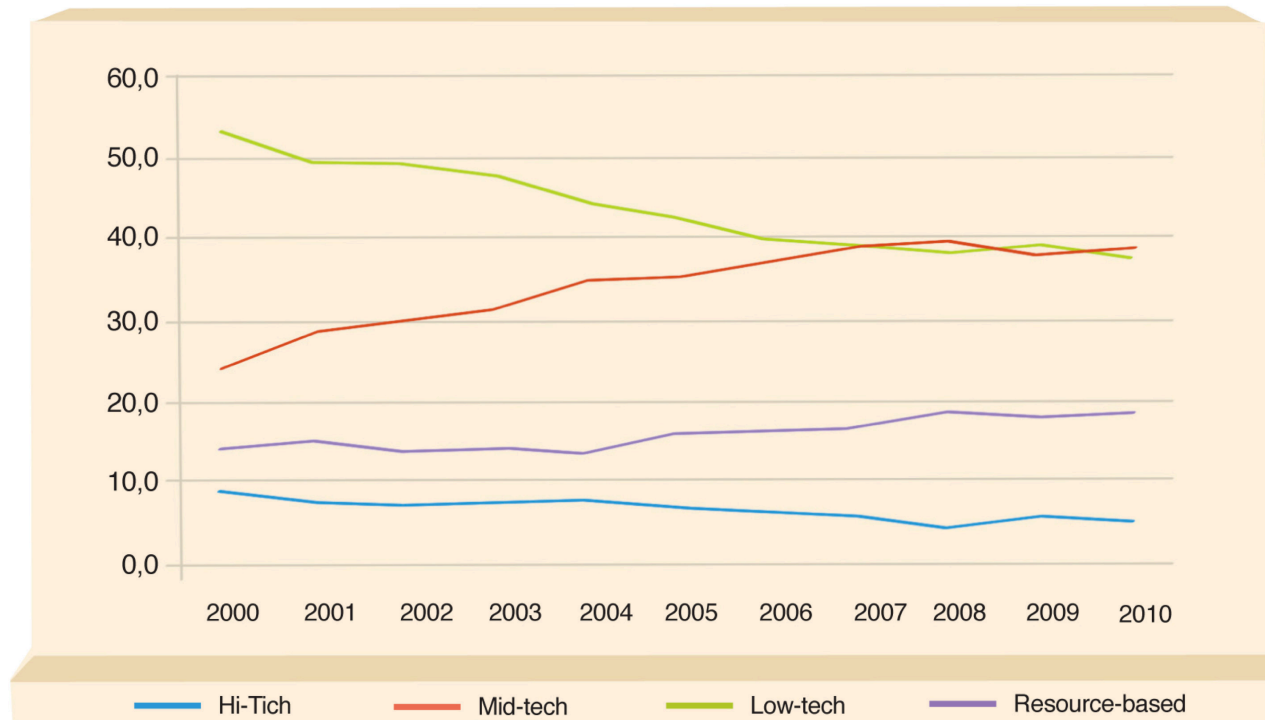


The export sector

- Environment for exporters changed substantially
- Exporters successfully navigated new terrain
 - significant structural changes (commodity composition, technology content, import content)
 - export market diversification
 - diversification in the sourcing of exports within Turkey
- Record could have been better with more supportive policies
- What new challenges did the change in the structure of exports brought?
- Did the governments missed an opportunity by not having a more active export policy?

Changing Structure of Exports

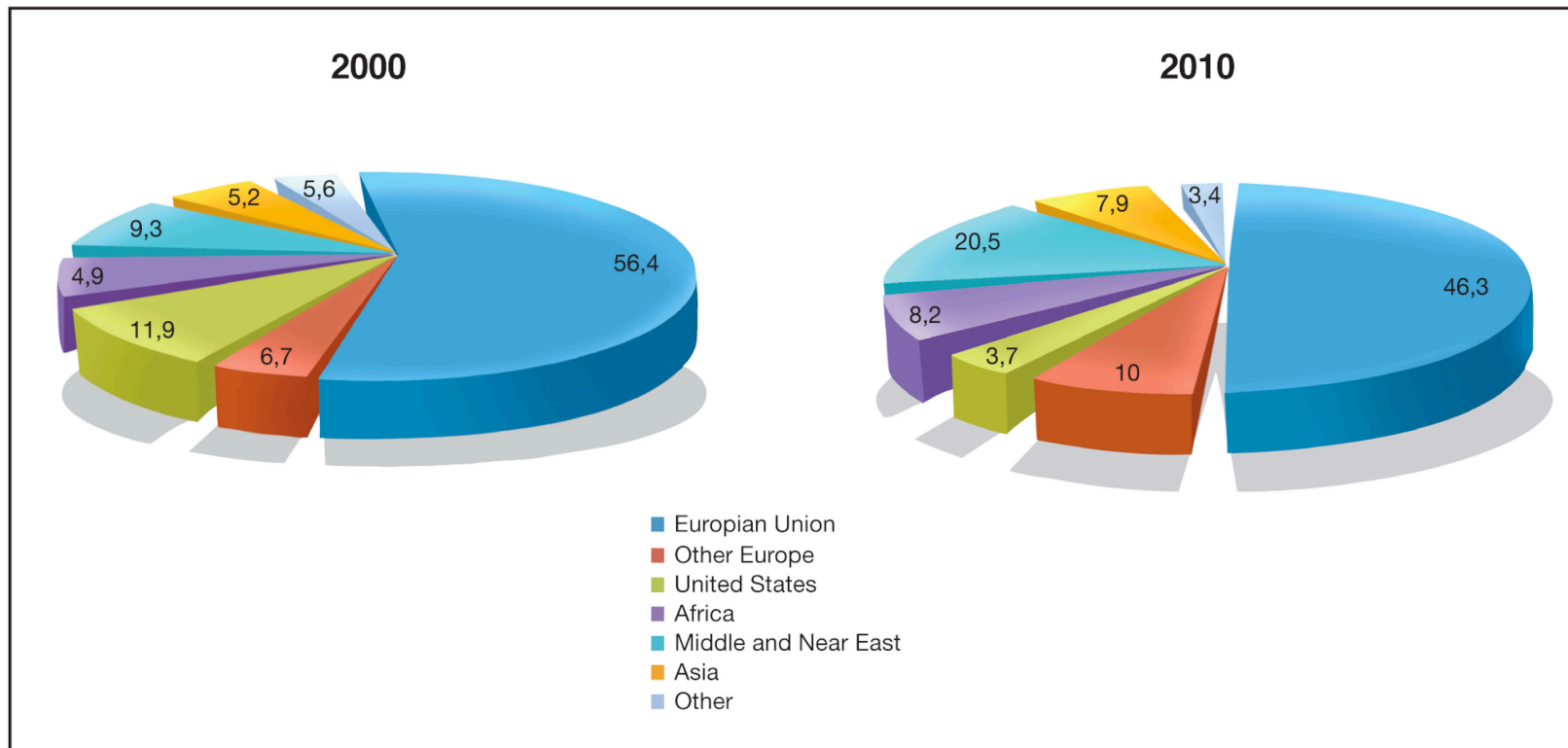
**Export by Technological Content
 (Percent of total export)**



Source: TEPAV.

Export market diversification was very successful

**Export Markets Shares
 (Percent of total exports)**



Source: Turkish Statistical Institute.

The EU

- Turkey's relationship with the EU took several turns during the decade
- The relations with the EU had been an important marker at times hastening some policy changes and at times pushing Turkey to consider its national interest in a scenario without EU membership or with a long-delayed accession process
- To what extent the EU membership process had important effects in three interrelated spheres: economic, democratization, and political?
- What factors had led to a halt in the negotiations in 2006 and to what extent the halt had been responsible for the slowdown in the domestic reform process?
- How much did Turkey need the EU accession process to forge ahead with modernization and institutional reform?

Conclusions



What transpired in the decade?

- A “New Turkish economy”—more prosperous, more stable decision making environment, continued development of the export culture
- Policy successes—regaining control over the chaotic fiscal, monetary and financial policies
- Missed opportunities to do better in structural and social policies—most seriously from an economic perspective, in reforming labor markets and creating an effective education system
- The beginnings of major transformations—the freer expressions of religiosity and social conservatism and the EU accession process, with as yet unclear economic implications
- Too soon to tell whether the accomplishments had produced permanent changes as even they were themselves opening the door to new conflicts, challenges, and vulnerabilities.

Policy challenges ahead: maintaining macroeconomic and financial stability

Policy framework to maintain macroeconomic and financial stability was in place, if the will to use it to these ends is present.

- primary fiscal balance in balance or small surplus
- public debt ratio at or below current levels
- inflation in mid-single digits
- financial institutions strictly supervised and regulated
- fiscal policy needs firmer anchor/rule
- Monetary policy
 - reinforce independence of the central bank
 - challenges of multiple objectives (preventing undue changes in competitiveness, targeting low inflation, protecting financial stability, avoiding high interest rates)

Policy challenges ahead: managing vulnerabilities

- New vulnerabilities and some old ones had changed the form more than the seriousness of Turkey's vulnerabilities
- The priority was to address the large current account deficit that had its origin in cyclical overheating, highly liquid global financial markets, and the longstanding problem of low savings rate
- The longer term structural causes of low private savings needed to be addressed with reforms to change the incentives to work, the availability of jobs, and the motivation to save

Policy challenges ahead: managing growth potential and inclusive growth

- In the short term, rates of growth similar to the average of the past decade were possible, assuming a benign global environment, abundant external financing, and containment of overheating
- Over the longer term, growth rates of 5 percent or higher required reforms to increase total factor productivity and the absorption of labor into non-traditional manufacturing
- To reignite these sources of growth as well as inclusiveness and equality of opportunity, the most important challenges were improving the use and the quality of Turkey's human capital through reform of the labor market and the education system
- How the rising expressions of social conservatism were handled would have consequences for economic efficiency and prosperity

Policy challenges ahead: grasping opportunities of globalization

- Structure of exports needed to push further/faster up technology ladder, exports needed to penetrate more dynamic markets, more private investment (including FDI) needed in export sectors
- Cost competitiveness/better trained labor force were essential. Investments in infrastructure to complement private investment in the export capacity would help. Views on the need for more active industrial policy differed.
- Given the dynamism of the Turkish economy, the economic benefits from EU membership were less critical now for near-term prospects.
- In the longer term, accession to the EU would be beneficial to both sides and the nature of membership could depend on the EU structure in the future. The key question: would the Turkish people and their political leaders recommit to the process of membership?