

Turkey's Reform Experience: 2001 Economic Program

Cengiz Cihan
Senior Economist
UNDP Vietnam

Turkish Economy in 1990-2000: A Lost Decade

- In 1990s, some steps were taken towards market based economy, however there were major deficiencies on
 - institutionalization and effectively functioning of market economy
 - efficiency of public sector in governance mechanism of the regulatory structure and competition conditions
- In this period, Turkey faced with many economic, geopolitical crises and natural disasters
 - The Gulf War in 1991
 - The currency crisis in 1994
 - The East Asian financial crisis in 1997 and Russian financial crisis in 1998
 - Two massive earthquakes in 1999

Macroeconomic Landscape in 1990s

- The populist policies significantly deteriorated the public finance
- The deterioration of public finance and funding requirements of public banks resulted with crowding out effect
- The slump in the financial structure of the state banks destructively damaged the financial system
- The dollarization in the economy accelerated

Disinflation Program in 2000

- It was aimed to reduce inflation and to revitalize economic growth.
- Tight fiscal policy and structural reforms were imposed.
- At the beginning, interest rates and inflation significantly decreased and domestic demand started to increase which triggered imports of consumption goods.
- The capital inflows diminished due to the cautious approach of global capital markets to the emerging economies.
- Since the program based on a FX anchor and liquidity creation tied to the FX inflows:
 - The decline in capital inflows led to a slowdown in the liquidity which increased the short-term interest rates.
 - The financial markets started to fluctuate and financial structure of banking system deteriorated
 - Many private banks had to be taken over by the Savings Deposit Insurance Fund (SDIF)
 - The crawling peg regime was abandoned and currency floated
 - The increases in interest rates and inflation and the volatility in exchange rates led to uncertainty in the economy and severe impact on real economy through real sector's debt servicing.

Transition Program for Strengthening the Turkish Economy in 2001

- Key characteristics of the 2001 Economic Program:
 - Restoring economic stability and promoting structural change
- Economic Stabilization:
 - Strong political commitment and support
 - Price stability ensured by the central bank independency
 - Banking sector reform
 - Public sector reform to improve public sector governance
 - Discipline in the public finance
- Institutionalization of market economy:
 - Regulatory reforms to ensure well-functioning of the market economy

Financial Sector Restructuring

- Central Bank's independency:
 - Primary objective is to achieve and maintain the price stability
 - It has instrument independence and has implemented a full-fledged inflation targeting regime since 2006.
- Amendments in the Banking Law:
 - State banks restructured with the principles of operational effectiveness and efficiency
 - In state banks, joint board of directors were authorized to restructure and to prepare them for privatization
 - SDIF banks' ability in collecting the receivables and expedited the collection process was increased and Asset Management Unit was established to manage bad debts
 - Five of the 13 banks merged into a single bank in the SDIF banks
 - The Treasury issued papers to the state banks and the SDIF banks in order to strengthen their financial standing.

Financial Sector Restructuring

- In case of private banks;
 - Capital requirements increased
 - Restructuring plans were carried out within a fixed time frame
 - Supplementary measures were taken to facilitate M&A
 - Operation effectiveness improved
 - Investments in non-financial institutions reduced
 - Taxes and required reserves amended to support long-term investments and to eliminate yield differences between savings and investments

Public Sector Reform and Strengthening Public Finance

- Measures were taken for duty losses of SOEs
- Privatization of SOEs and/or increasing autonomy from the state in the management by introducing governance standards
- Public borrowing law for transparency and accountability in international standards
- Expropriation and Public Tender Laws
- Budgetary and Extra-Budgetary funds were abolished
- Privatization revenue and increases in taxes improved public sector revenues
- Strengthened social security system through extending the retirement ages and discipline in other expenditures progressed public sector expenditures
- Individual pension system was introduced

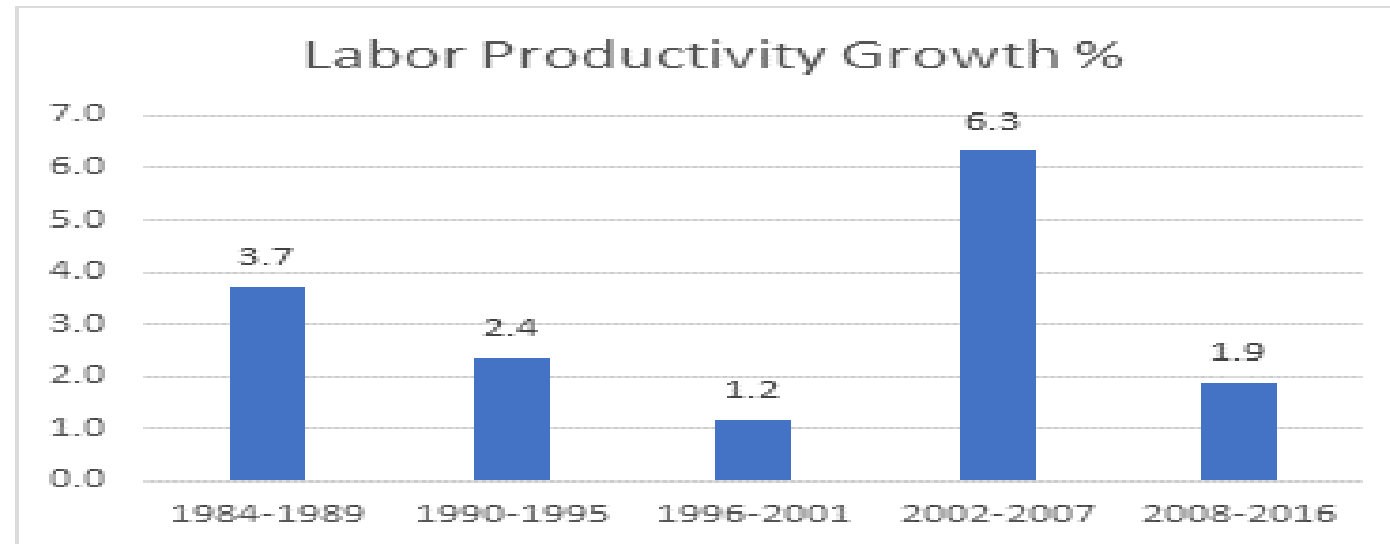
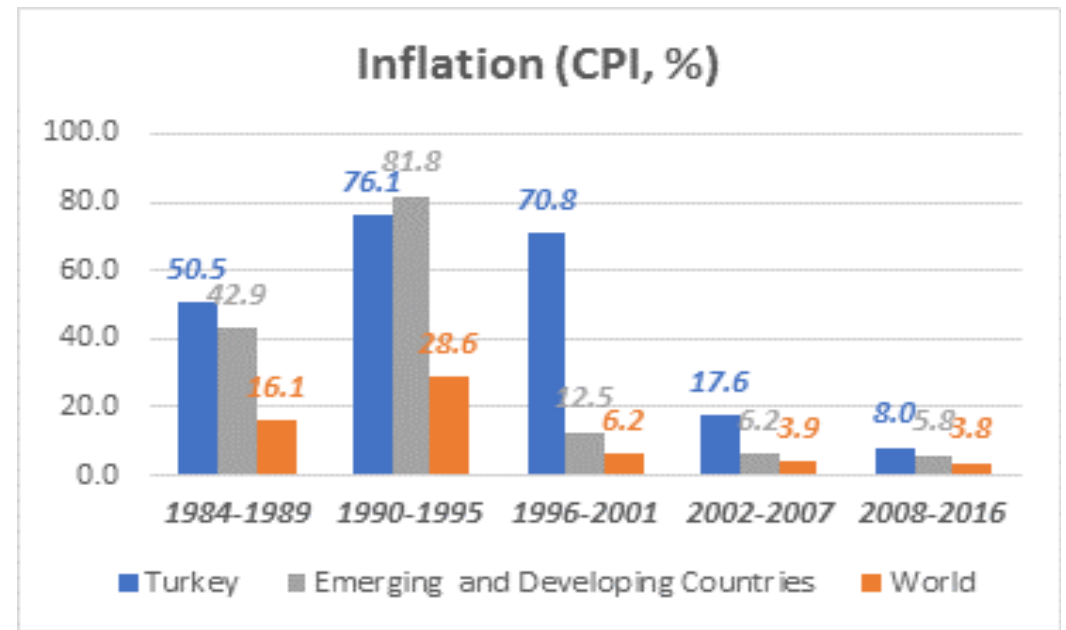
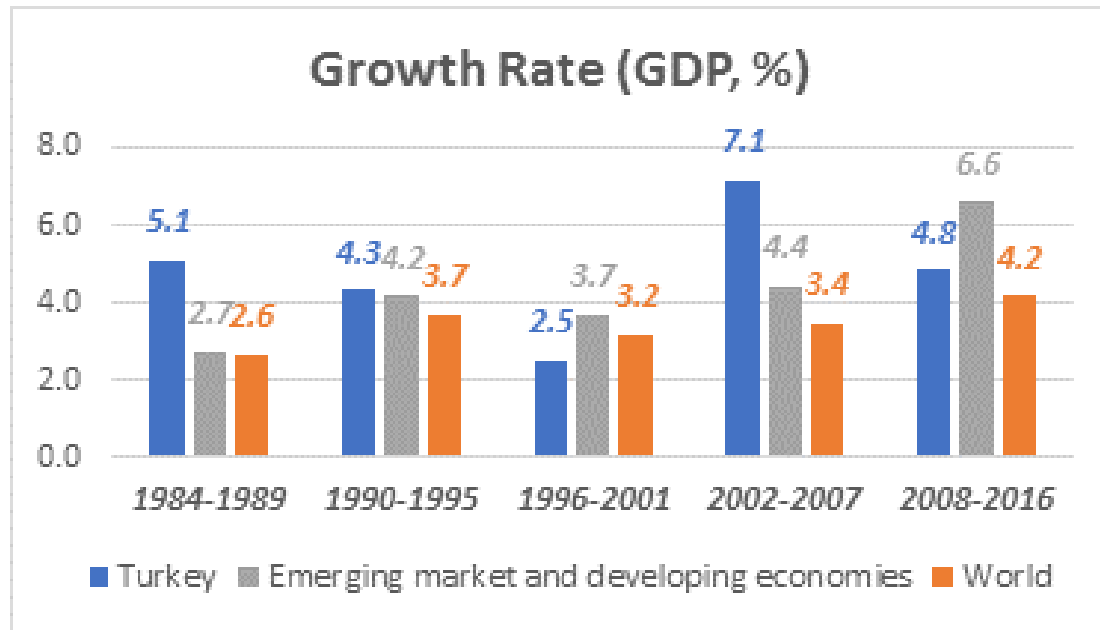
Institutionalization of Market Economy

- To enhance competition and efficiency in the economy;
 - Sugar, tobacco, natural gas and civil aviation laws were introduced and regulatory boards were established
 - Direct income support was implemented in agriculture to reduce price distortions which is consistent with the WTO's Agreement on Agriculture and the EU framework
 - Labor law was amended for greater flexibility in the labor market
 - The economic and social council was introduced to take support of all parts of society
 - All legal amendments were approved by the Grand National Assembly
 - Legal reforms including judiciary system, human rights were introduced to strengthen the rule of law and to support the accession of Turkey to the EU

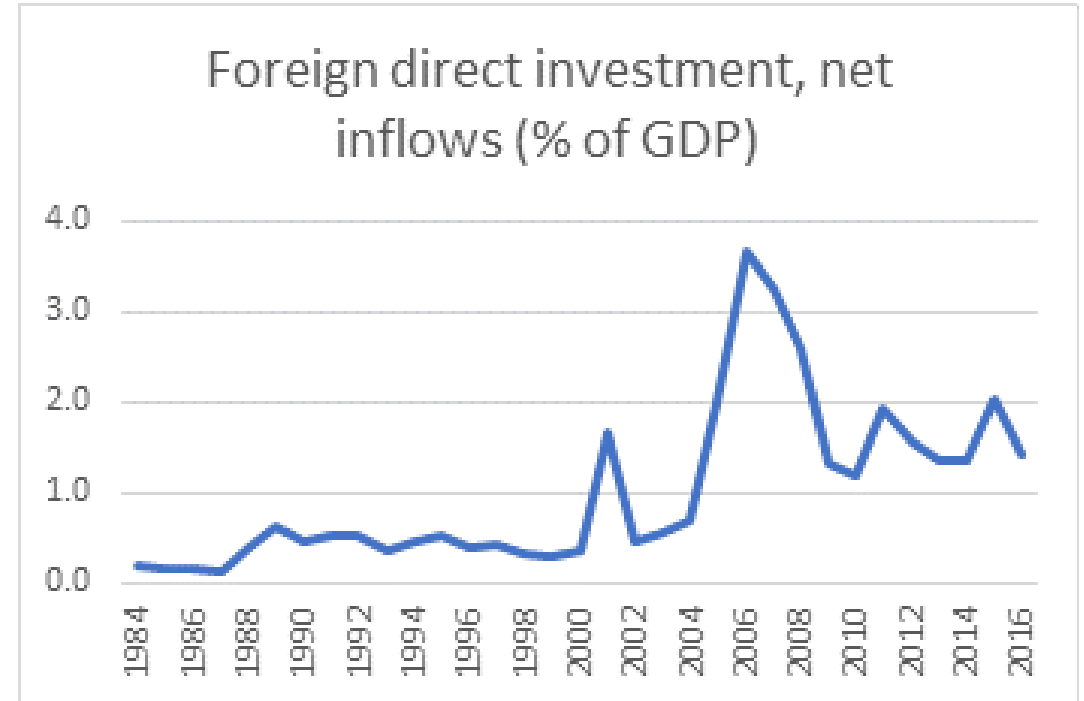
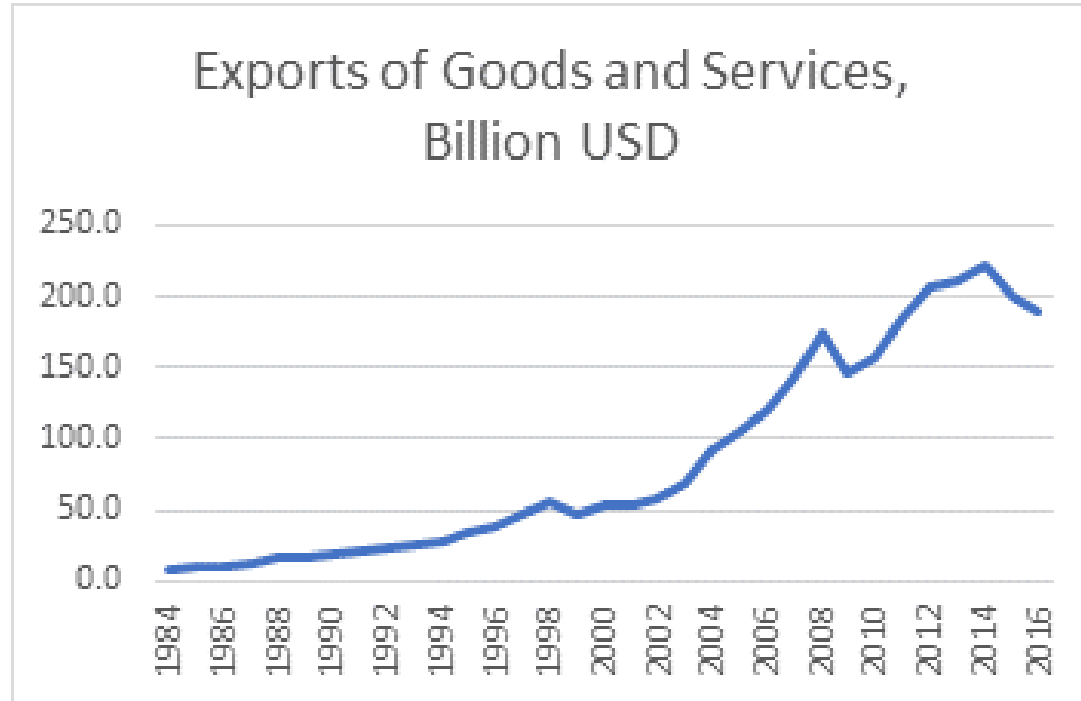
The Post-2001 Crisis Period: 2002-2008 and after 2008

- After the 2001 economic program, the rule based policies strengthened the financial structure, empowered the private sector and disciplined the public sector. These developments significantly increased the potential output growth from 4% to 5.5% levels in the period 2002-2008.
- Macro prices stabilized in low levels, productivity significantly increased, Turkey's international integration was accelerated, and per capita income level has more than tripled and reached to 10 thousand US\$ in 2008. However, per capita income level did not change significantly after that.
- Even though Turkey has significantly increased its per capita income, it remained in the middle income status.
- It has to be emphasized that the 2001 Economic Program improved macroeconomic framework and institutional structure of the Turkish economy.
- After 2002-2008 period, economic growth rate decelerated and productivity growth significantly decreased mostly due to the lack of innovation.
- In the post 2008 period, some reforms have suffered such as central bank independence, public procurement law, rule of law and observed political interventions to the independent regulatory agencies.
- In this period, many significant changes happened in education system and healthcare.

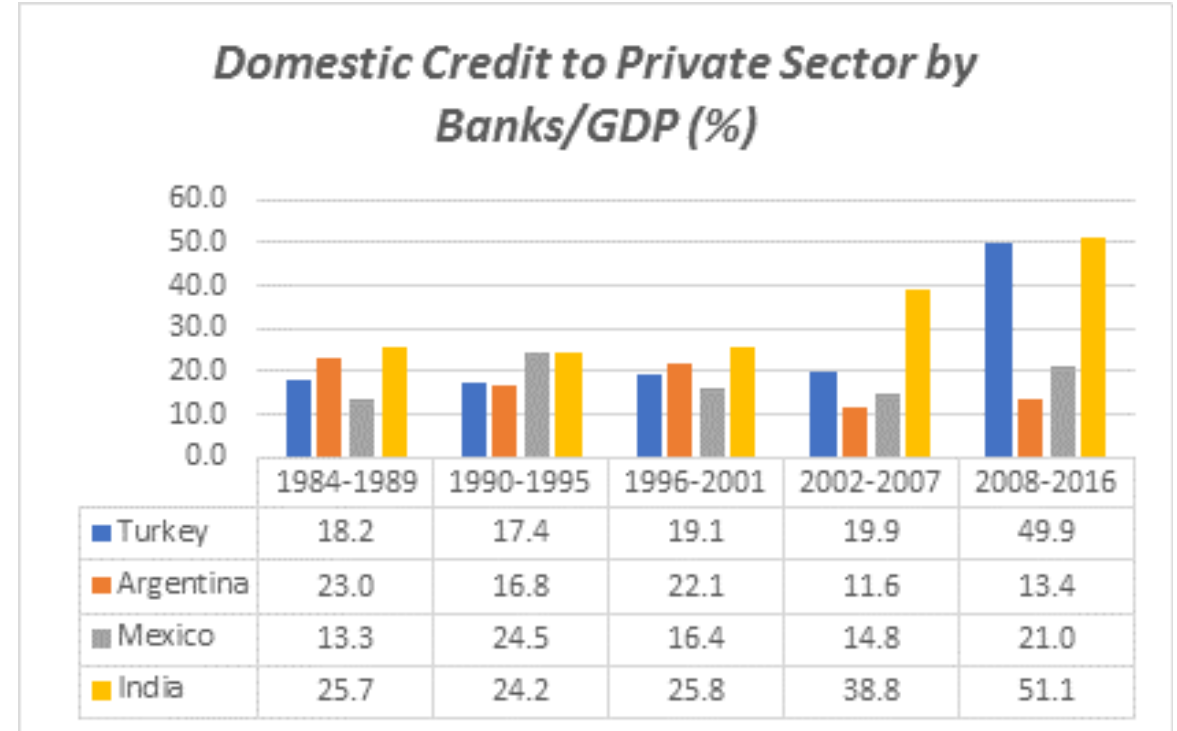
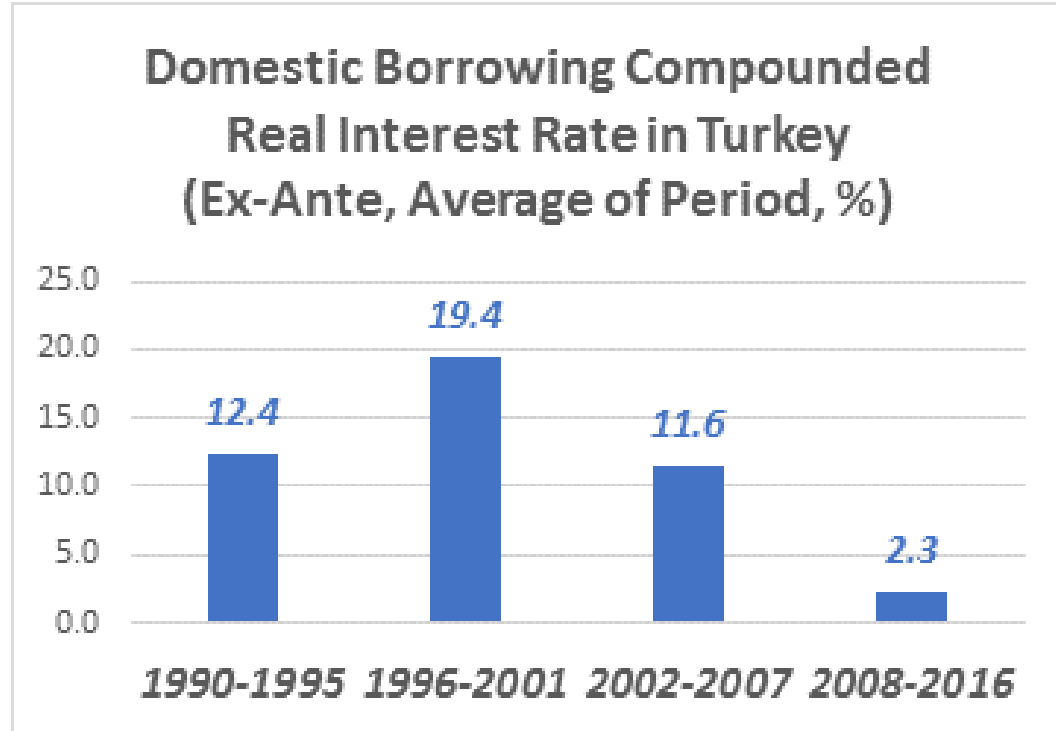
Achievements of the 2001 Economic Program



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- It is obvious that the types of shocks that Turkey had in 1990s may differ from the Viet Nam case.
- Turkey's reform experiences may provide some insight for Viet Nam. However, it should be noted that Turkey implemented these reforms after the economic crises.
- Even though these reforms are interlinked to the Middle Income Trap (MIT), they are not sufficient to increase productivity and competitiveness in a sustainable way in the long run.
- In the context of Turkey's reform experience;
 - Turkey has taken necessary steps for regulatory capacity enhancement which were consistent with the international standards in the period 2002-2008.
 - Turkey has changed its economic structure by imposing comprehensive public sector reform including tight fiscal policy, enhancing transparency and accountability, rule of law, and fighting against corruption between 2002-2008.
 - Turkish economy has performed remarkably well after consistently implementing the macroeconomic reforms in the period 2002-2008.
 - Turkey's reform agenda have stagnated since 2008. However, Turkey needs to implement both institutional and micro-based productivity and competitiveness reforms to continue the transformation in the economy and to surpass the MIT

- Viet Nam may prioritize these reforms especially banking sector, SOEs, social security system, central bank, rule of law, and productivity and competitiveness reforms.
- SOEs;
 - In SOEs reform, Turkish experience denote that privatization may not be the only option.
 - The efficiency and transparency of SOEs can be improved by introducing governance standards which are consistent with international norms
- Increasing productivity, competitiveness and innovation;
 - Access to finance for MSMEs
 - Improving labor market flexibility
 - Promoting industrialization process by taking into account regional development dynamics
 - Developing input supply strategy for reducing import dependency
 - Improving quality of education system, such as vocational education in international standards, strengthening the interlinkage between tertiary education and industry
 - Improving product market regulations in terms of state control of business enterprises, legal and administrative barriers to entrepreneurship

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