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Moving Forward: An Investment Climate Assessment for Turkey

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Agenda

- Recent Economic Developments
- Changing Binding Constraints for Private Sector
- Investment Climate Assessment
  - Objectives, Methodology and Examples
- Starting a Policy Dialogue
  - Government-Stakeholders
  - World Bank Country Assistance Strategy

Changing Binding Constraints…

- The binding constraints of the 90s:
  - → **Macroeconomic** (inflation, debt, RER, unemployment)
  - → **Political** (unstable coalition governments, domestic tensions, terror)
  - → **Institutional** (red tape, corruption)

↓

2000-2001 crisis

Turkey's Recovery since 2001 (1)

- **Macroeconomic Environment**
  - Declining Inflation, but…
  - Declining Real Interest Rates, but…
  - Productivity Growth, but…
- **Political Environment**
  - Stable one-party government, but…
  - Improved policy certainty, but…
- **Institutional Environment**
  - Time to <u>start up</u> a business significantly shorter, but…
  - Equal treatment for domestic and foreign investment, but…

Turkey's Recovery since 2001 (2)

- Stabilisation and Healthy Growth
- Structural Transformation at the corporate sector

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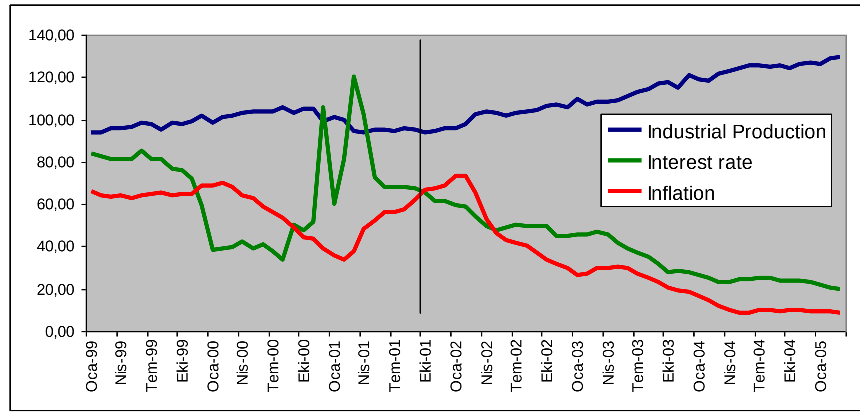
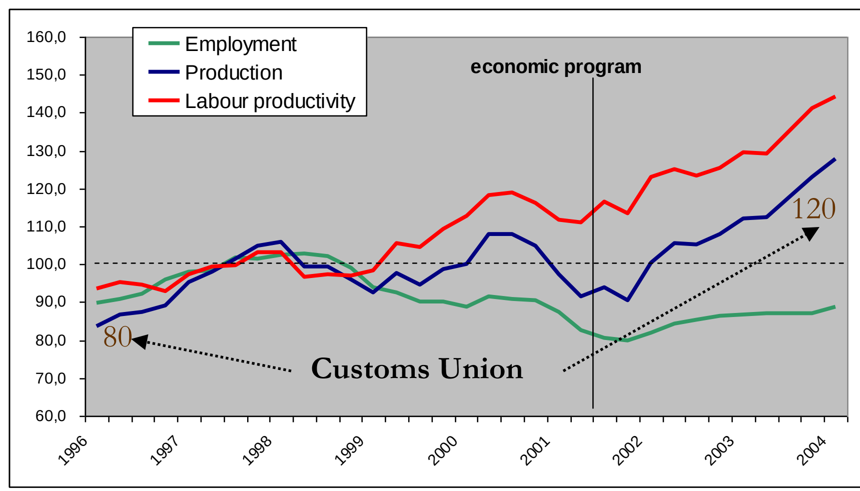
- Rising Productivity and Competitiveness

Non-inflationary growth



Productivity Increases



Source: Central Bank of Turkey

Turkey's Recovery since 2002 (3)

- Transformation ➔ Relative Stability ➔ Superior Economic Growth

	2001	2004
GNP (billion $)	150	300
Growth (%)	-9,4	9,9
Inflation (CPI%)	70	10
Public debt (% of GNP)	95%	65%
Budget Deficit (% of GNP)	17	10
Exports (billion $)	31	60
Foreign Reserves (billion $)	19	35

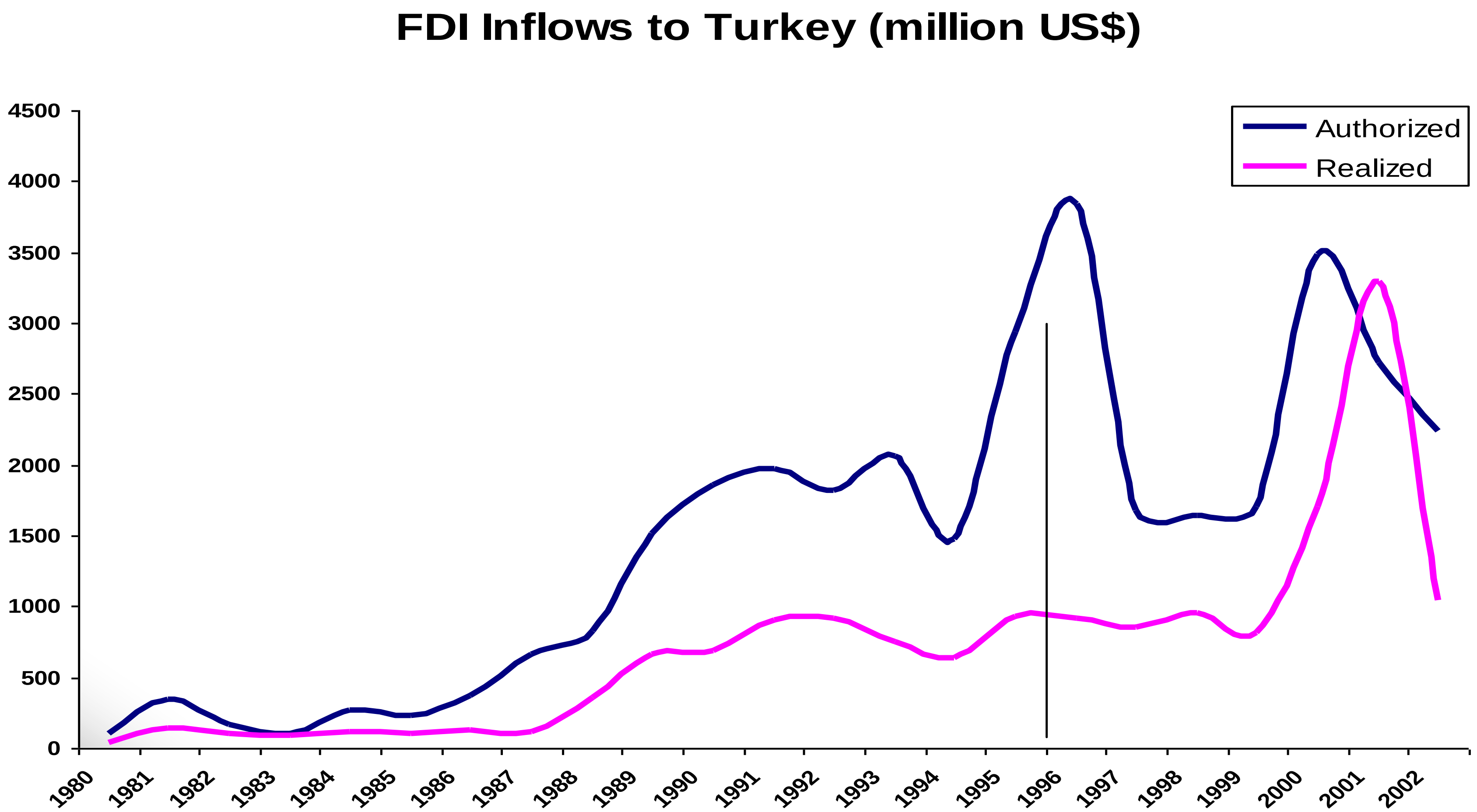
Not everything is rosy… (1)

- Productivity increase not sustainable?
- Current Account
  - → Imports of intermediate and capital goods are increasing… more than exports
  - → Rising Trade Intergration has not led to an adequate Financial Structure
  - → …yet patterns & trends seem promising
- FDI inflows
- Unemployment

Not everything is rosy… (2)

- Investment Climate Problems:
  - → Tax System and Administration
  - → Labor Regulations
  - → Informal Economy and Anti-competitive practices
  - → Access to and Cost of Finance
  - → Access to Land
  - → Local Administrative Barriers (i.e. Licenses and permits)
  - → Corporate Governance and Restructuring
  - → Low Technological Base
  - → Lack of Innovative Capabilities
  - → Lack of Skills

An Example: Institutional Environment Matters…



Source: Foreign Investment Directorate, Treasury

Which one is binding now?

- For whom?
  - Sectors
  - Sizes
  - Regions
  - Domestic vs. Foreign
- Why matters?
  - Low Investment
  - Lack of competitiveness of local industries
- How can we find out?

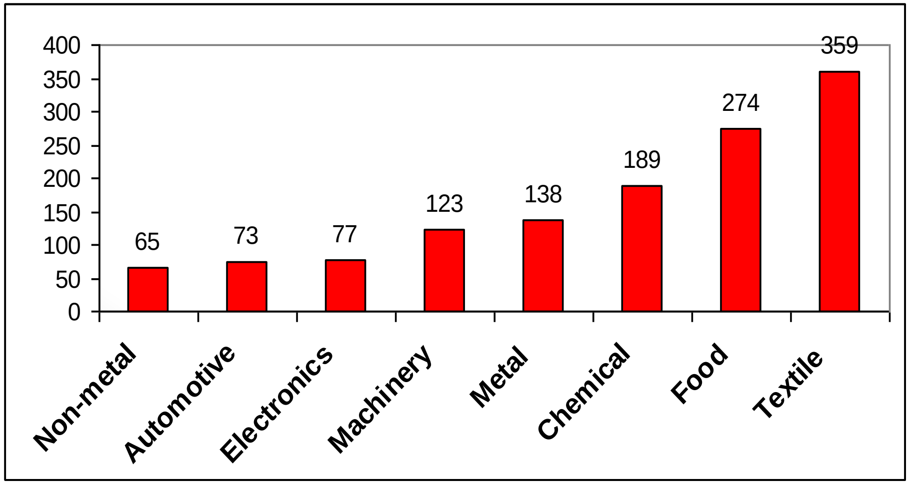
Role of Investment Climate Assessment

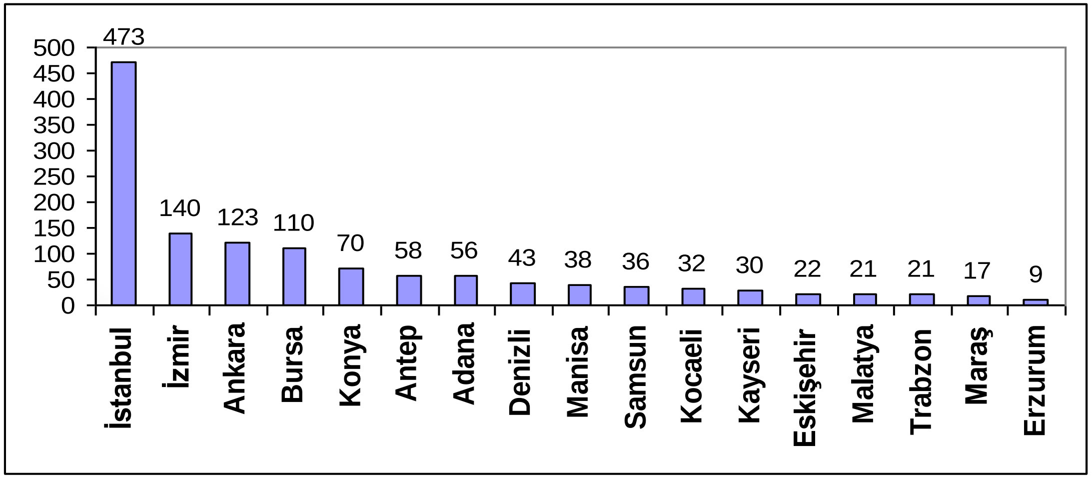
- What are ICAs?
  - Survey
  - Background Papers
  - Report

- Policy Dialogue
- World Bank's Country Assistance Strategy

Survey Sample

- 1300 manufacturing + 200 hotels
- 8 subsectors
- 5 regions, 19 cities
- 15% foreign and exporting firms
- 80% representation
  - ➔Value added
  - ➔Employment
  - ➔ # of firms

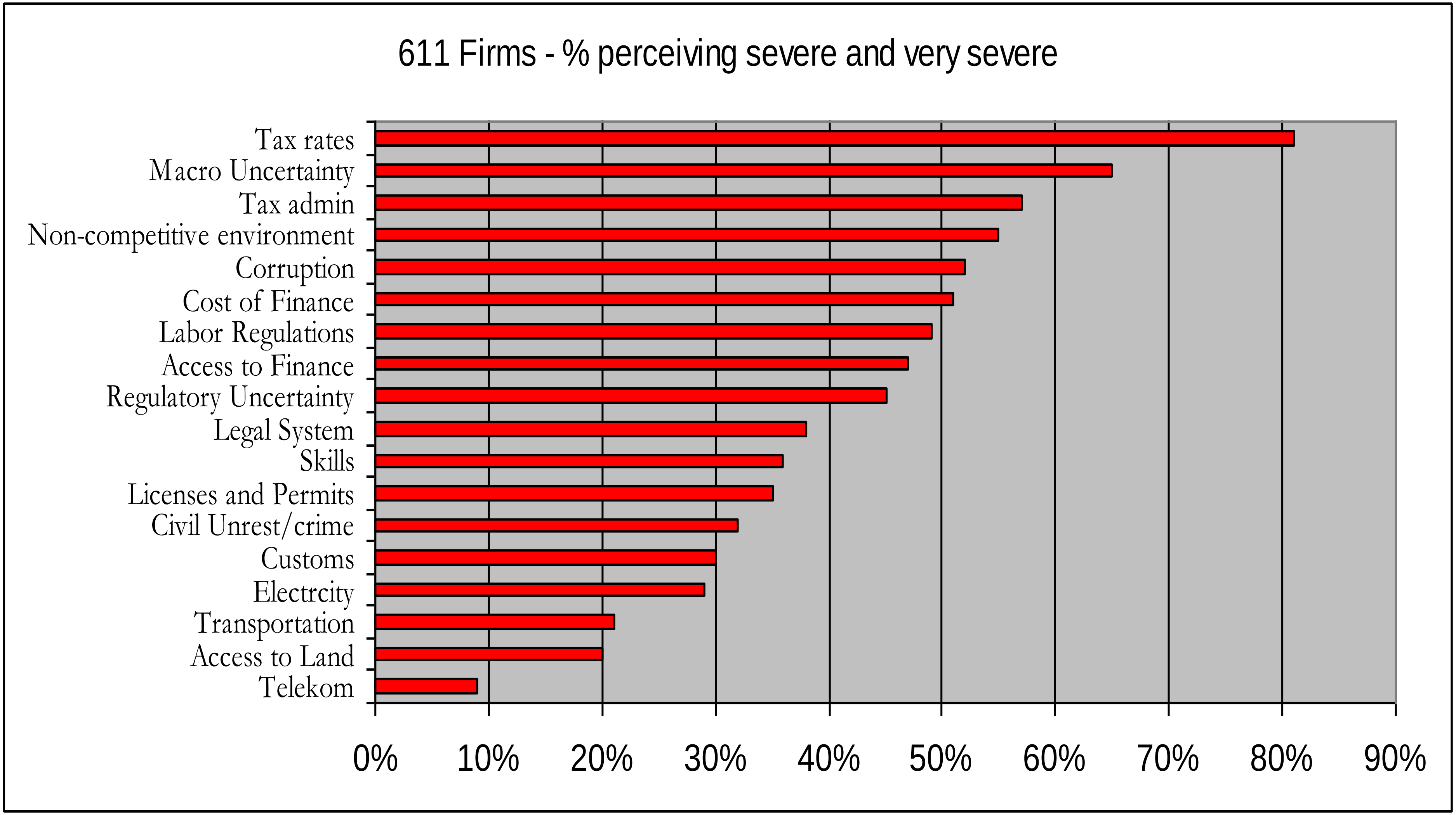




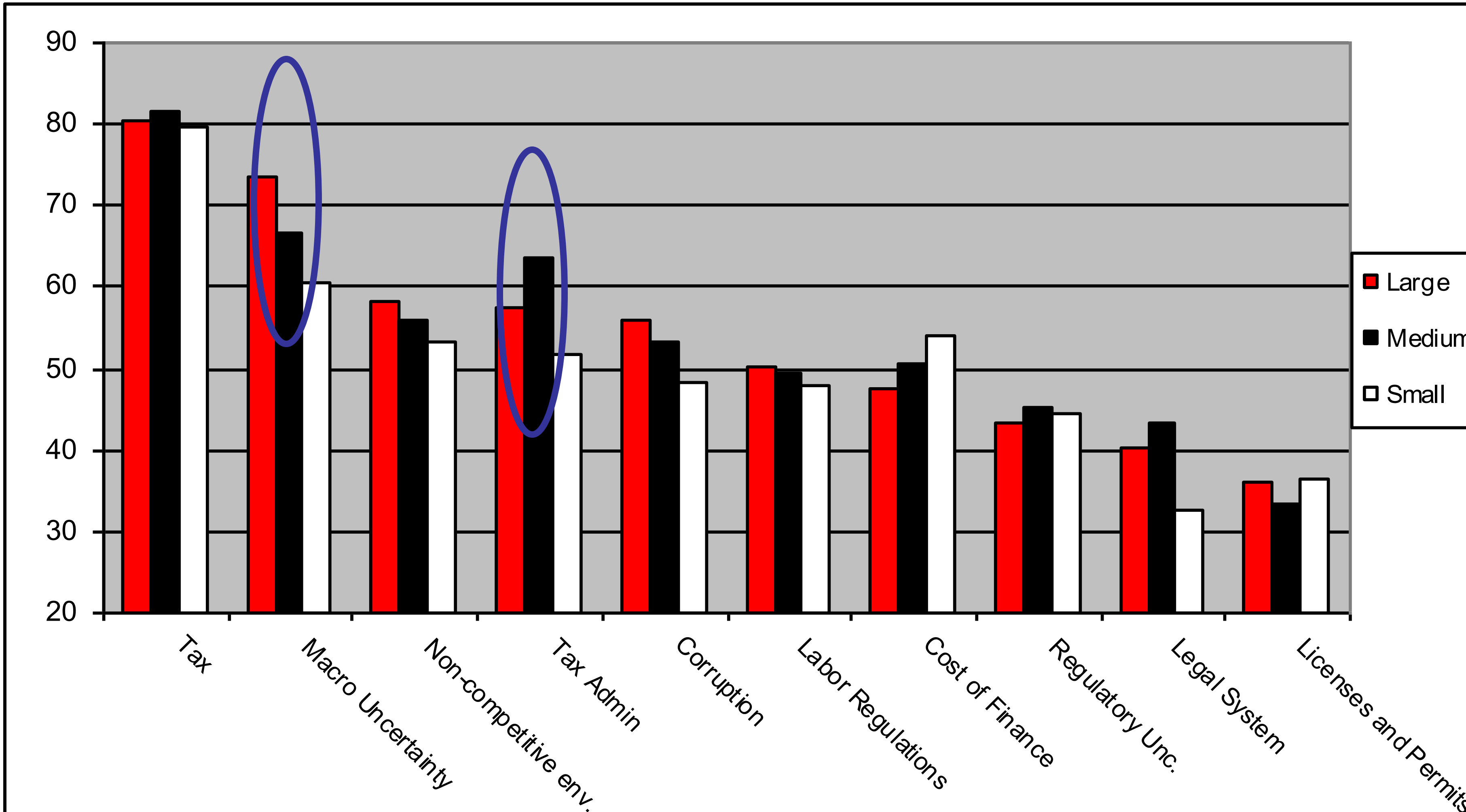
What does an ICA provide? (1)

- Identifying the appropriate binding constraints to doing business
  - ➔ Variations across sectors / regions / firm sizes
- Assessing the relationship between firm performance and investment climate components
- Benchmarking against
  - ➔ China
  - ➔ New and potential EU members
  - ➔ Other comparable countries (Argentina, Russia)
- Policy recommendations and best-practices

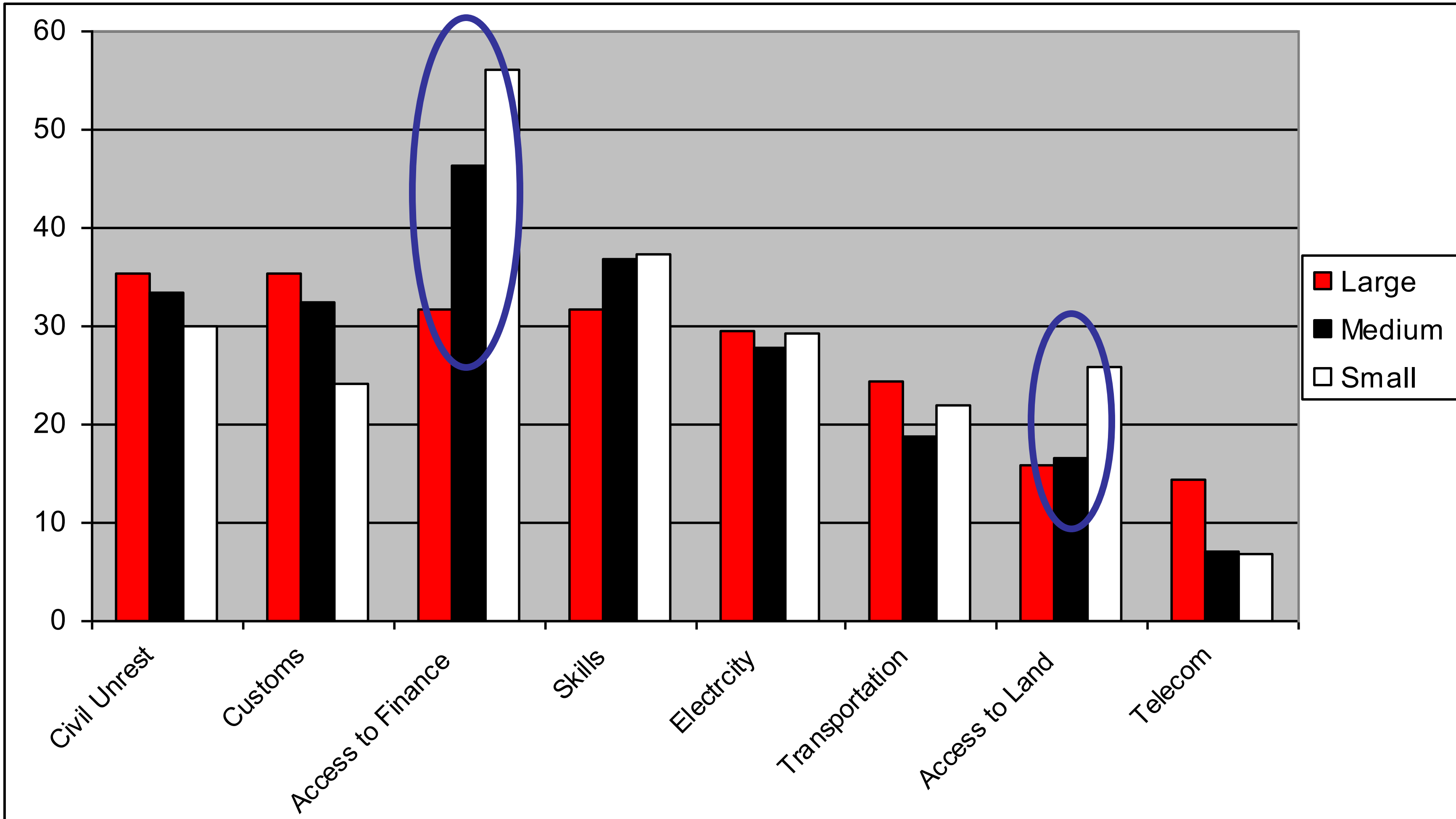
What does an ICA provide? (2)



What does an ICA provide? (3)



What does an ICA provide? (4)



Binding Constraints and Action Plans

- Binding Constraint in **Pakistan**: Low labor productivity, higher wages
  - ➔ Committee on Reforms in Regulatory Legal and Policy Environment introduced labor market reforms
- Binding Constraint in **Moldova**: Over-regulation, excess inspections, large agency fees and compliance costs
  - ➔ New Inter-Ministerial Commission for Deregulation Action Plan prioritizes curtailing inspections and agency fees, simplifying licensing and reporting requirements
- Binding Constraint in **Bangladesh**: erratic and poor quality of electricity supply
  - ➔ WB financed Power Sector Development Technical Assistance Project ($15.5 million)

Potential Ideas for Turkey's ICA

- Implications for Industrial Policy
- Setting the priorities (not limited to):
  - ➔ Would regional Incentives / Subsidies work?
  - ➔ What would be the performance gains be if the energy costs were the same as in China?
  - ➔ What are the root causes of lack of access to finance? Is access to finance a problem for SMEs only or is it a problem for large companies as well?
  - ➔ Are exporters more productive than non-exporters? if yes why?
  - ➔ Does innovative capabilities depend directly on R&D activities? Or are they embedded in other characteristics of firms (exporting, licensing, education of managers etc)?

Limitations of the Survey

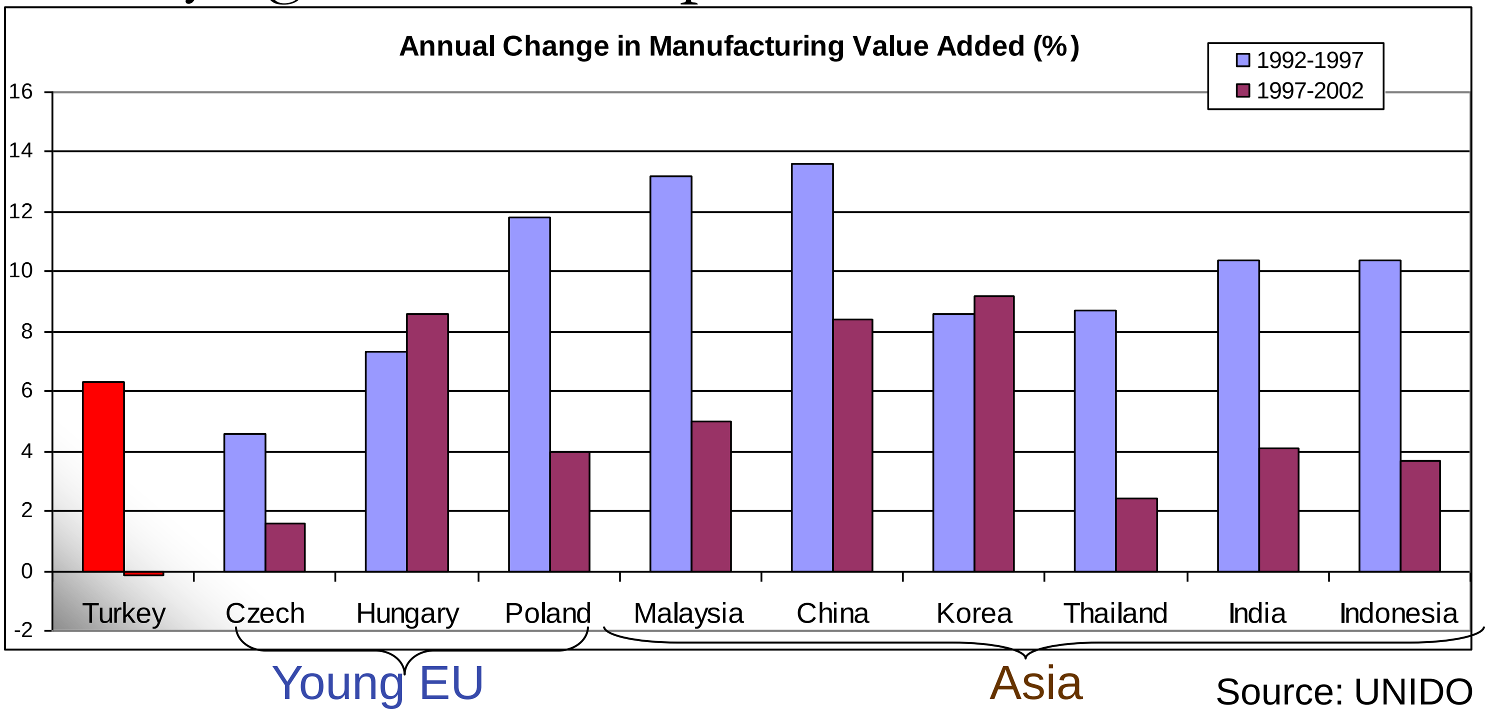
- Data provides only a snapshot of the economy:
  - ➔ Dynamic Analysis in background papers
    - Informality
    - FDI
    - Innovation
    - Red Tape
  - ➔ Conducting biannual ICA surveys (Indonesia)
  - ➔ Dynamic Analysis will be captured with accompanying projects:
    - Computable General Equilibrium Model

Dynamic Analysis matters…

- Dynamic Transformation of the Turkish Economy
  - ➔ Sectoral transition
    - Which sectors will become the engines of growth?
    - From traditional towards modern doing business (i.e.)retail
  - ➔ From informal to formal
    - Effect of informality on competition, public finance, and productivity?
  - ➔ Sectoral and Corporate Restructuring
    - End of the dynastic family businesses?
    - Increasing importance of economies of scale and scope
  - ➔ Creative destruction & Transformation
    - Competition ➔ easier entry & exit

Challenges

- Intensifying Global Competition



Source: UNIDO

- Sustainability of transformation?
- Adopting EU standards (costly in the short term). Solution:
  - ➔ Infrastructure and public sector reforms (decreasing costs)
  - ➔ Corporate Governance (institutionalization)

Long term Goals

- Innovative Policy Responses

  e.g. textile sector in TR: EREZ in Palestine; mom&pop shops in retail

  ➔Technically correct

  ➔Administratively implementable

  ➔Politically feasible

- Policy Dialogue

  ➔ A dialogue instrument between business community and government

    - Public-private partnership is crucial for policy success

  ➔ Capacity building for policy formulation at TOBB

  ➔ Continuation of the YOIKK initiative

  ➔ Cooperation with and between different government agencies

Questions and Answers

Further questions and comments? Please send them to emre.deliveli@epri.org.tr

If you would like to join the ICA Turkey mailing list, please send an e-mail to senem@tepav.org.tr