



The Economic Policy Research Foundation of Turkey

***38th meeting of the EU-Turkey
Joint Consultative Committee (JCC)***

***SMEs-Trade development and investment
environment opportunities between the EU and
Turkey***

***April 8, 2019
Brussels***

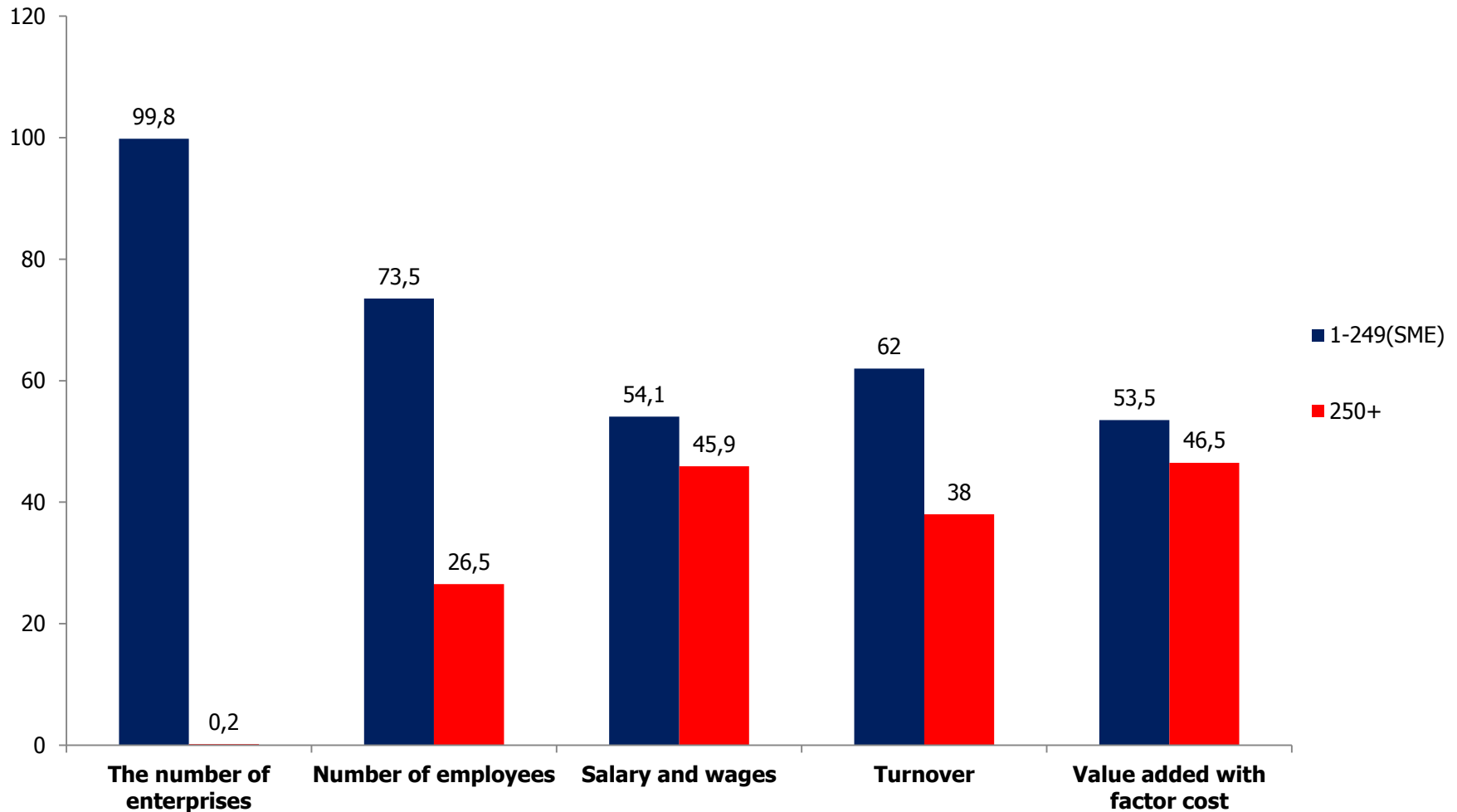
SMEs matter...

- SMEs are the main pillar of nearly all national economies in the world.
- They generate more than a half of jobs and income as well as value added.
- SMEs contribute to economic growth and innovation.
- They are increasingly integrated in **global value chains**, and form a working ecosystem with larger enterprises.
- They are engaged in and deeply affected by the **trading** and **investment environment** (i.e. doing business and trade protectionism).

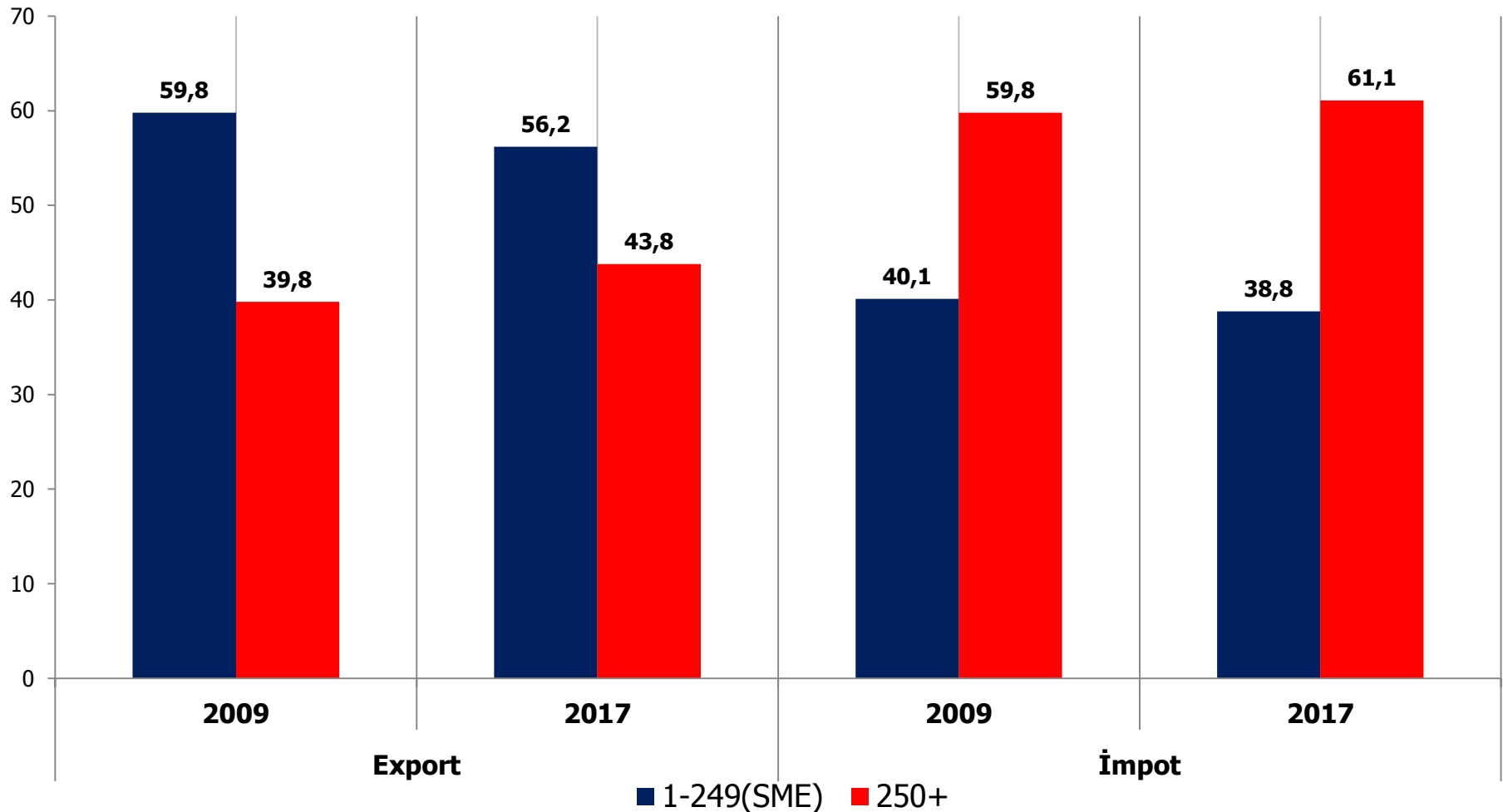
Challenges for the SMEs

- Limited access to finance
- Lower R&D, low intensity of technology use
- Limited internationalization and global supply chain (GVC) integration
- Regulatory environment
- Market access problems
- Limited skilled labor and productivity

SMEs in Turkey's economy, 2014-2016



Share of SMEs in foreign trade in TR, 2015 (TÜİK)



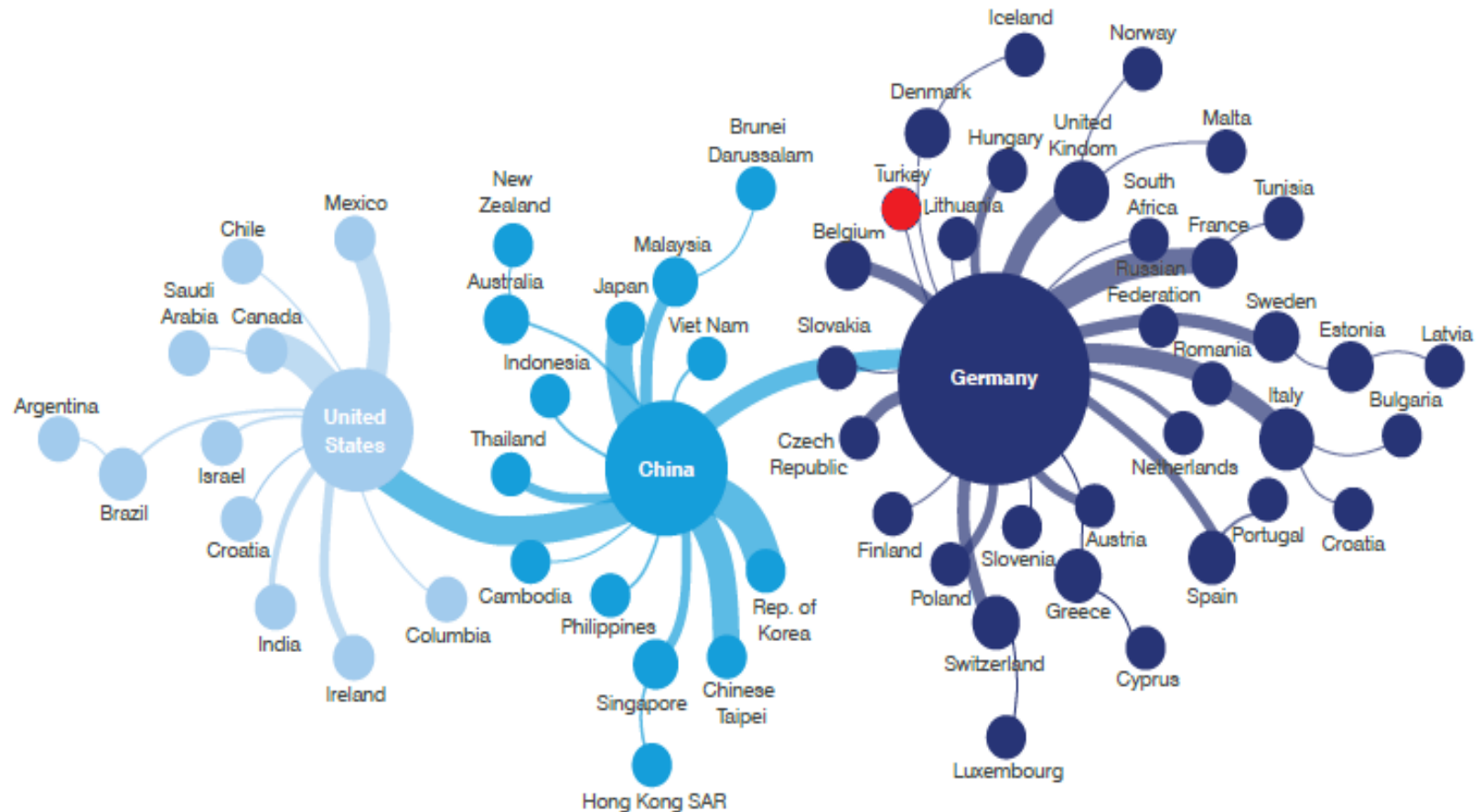
Why GVC participation is essential

- Trade, and **Global Value Chain (GVCs)** create opportunities for SMEs:
 - to absorb spillovers of technology, managerial knowledge
 - to innovate
 - to enhance productivity
- welfare gains from **SME internationalization.**

OECD (2018), Fostering greater SME participation in a globally integrated economy.

TR SMEs mostly integrated to regional (European) VCs

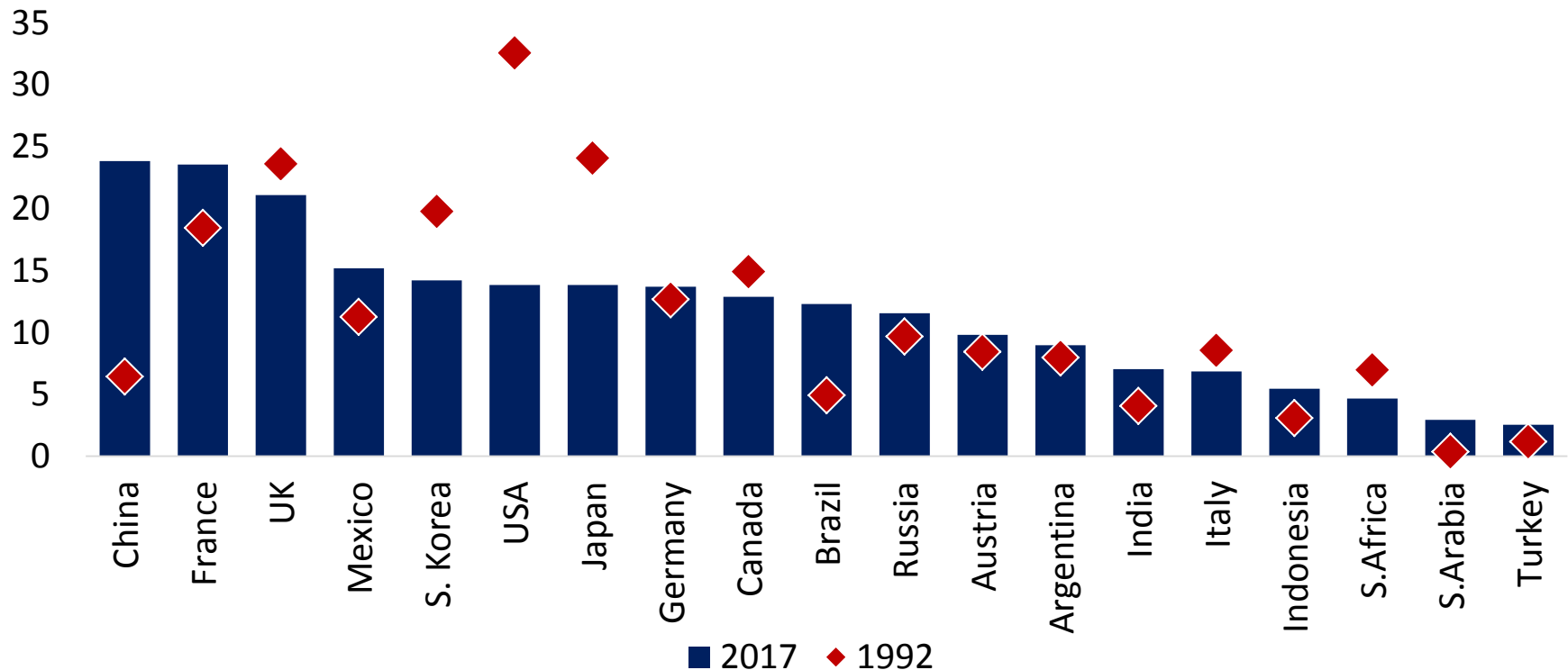
FIGURE 2 Network analysis demonstrates the regional nature of value chains



Note: The lines between countries represent the bilateral share of trade in parts and components, with thicker lines representing greater shares.
Source: Santoni, Gianluca, and Daria Taglioni (2015).

TR needs to increase high-tech exports

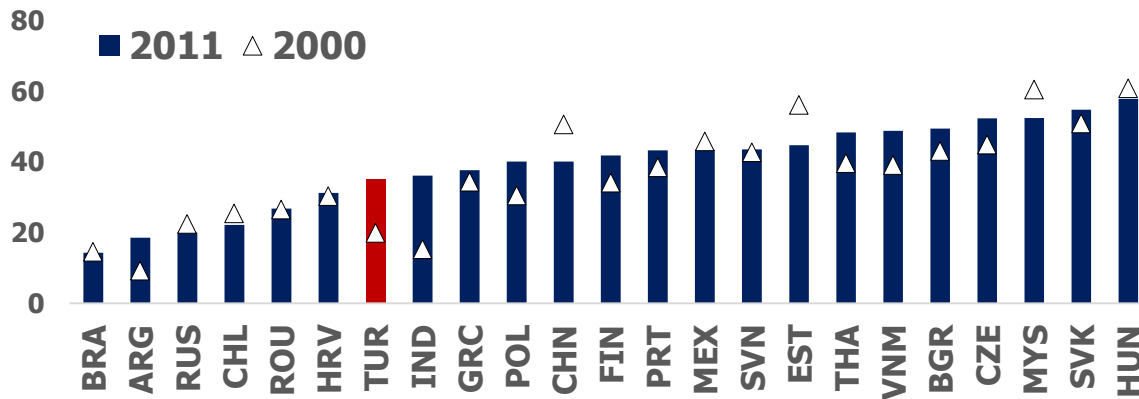
High-technology exports in G20 countries, as a share of manufactured exports, %, 1992 & 2017



Source: World Bank

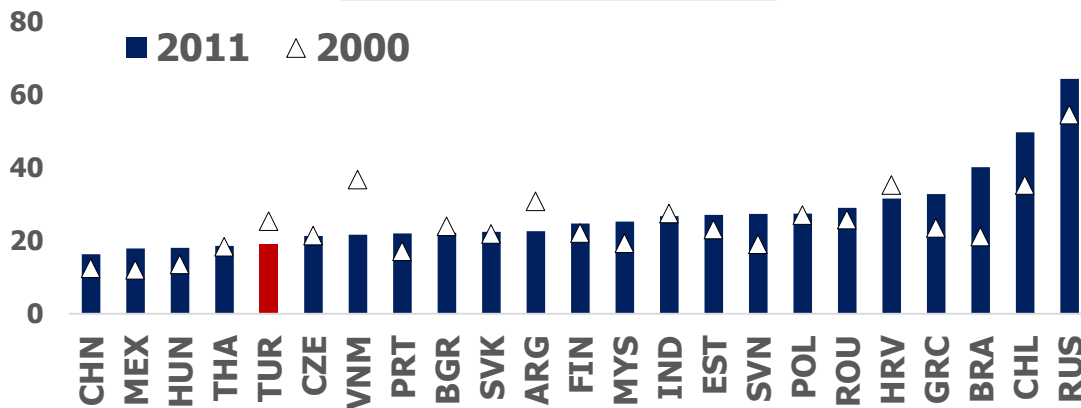
Forward linkage signifying GVC participation declined in TR, while backward risen

Backward participation



Backward participation
measures import content of a country's export

Forward participation



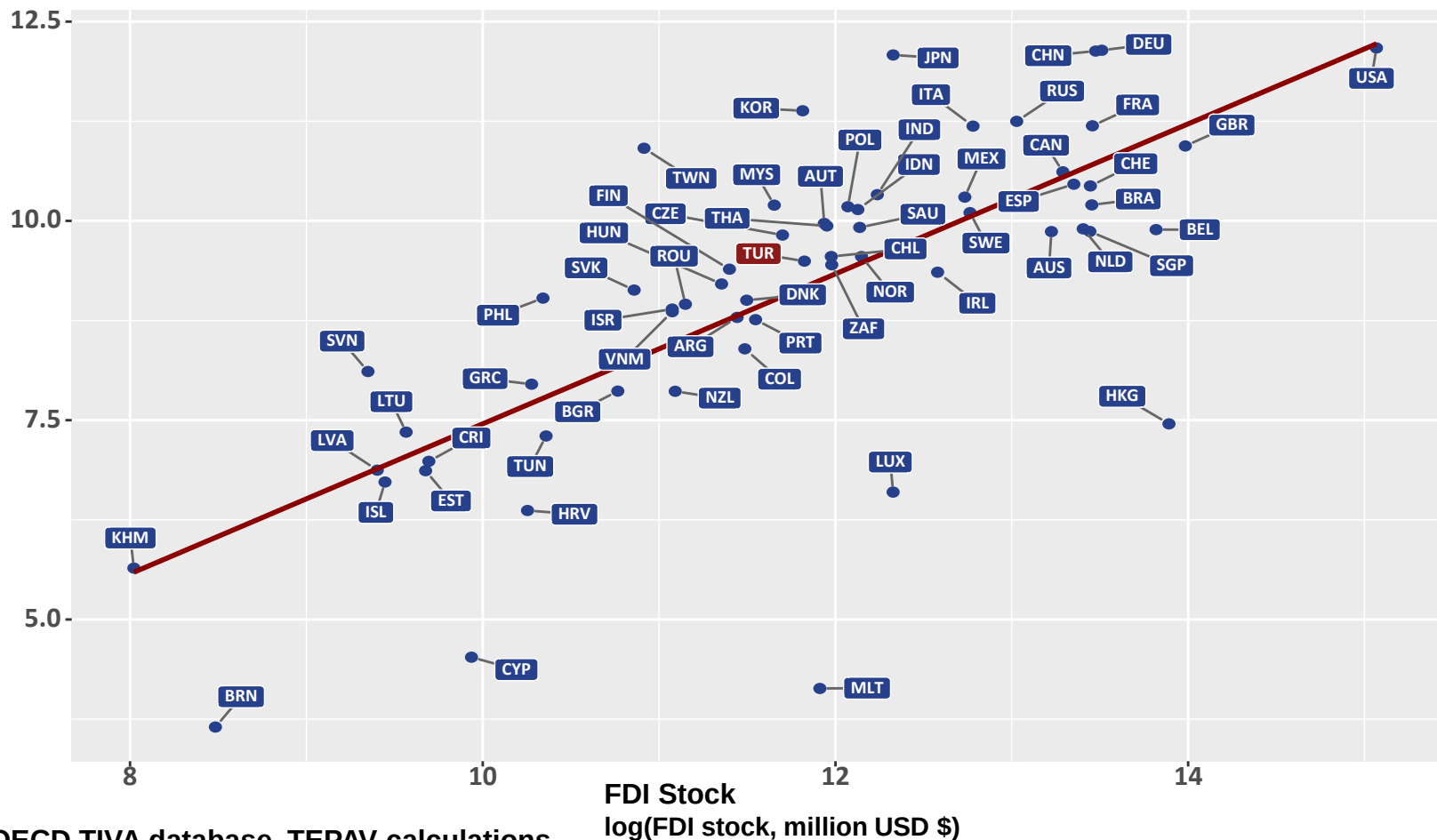
Forward participation
measures domestic value added embodied in foreign countries' exports

FDI facilitates GVC integration (forward linkages)

Forward participation in exports and FDI Stocks

Forward Link: Contribution of Local Economies to GVC

Log (Embodied local domestic value in foreign exports, million USD \$)



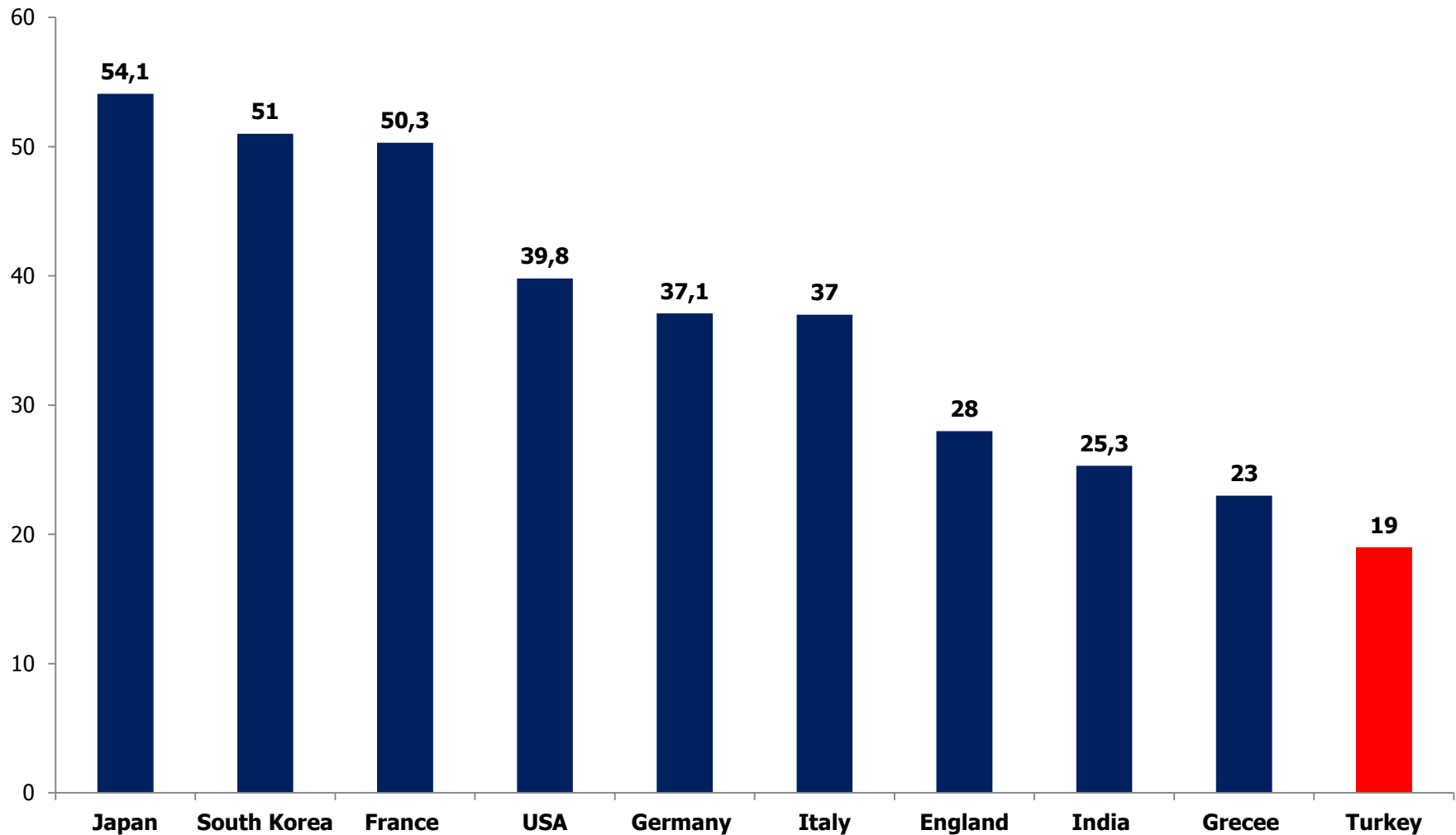
SME integration to GVCs: Turkey

- Several important factors to boost SME competitiveness and GVC integration:
 - to improve **access to finance**
 - to cope with the **digital transformation**
 - to live in better regulatory environment and the **rule of law**
 - to better integrate into the trading system, and to boost **trade capacity**.

Access to finance

- Strengthen financial market infrastructure for SMEs
 - G20/OECD High Level Principles on SME financing
 - impact assessment on financial regulation about SME lending, insolvency rules...
- Facilitate access to financial instruments
 - Boosting financial literacy of SMEs
- Enhance digital financial inclusion
 - Boosting SMEs for digital finance, electronic invoicing...

Financial inclusion: Shares of the Credit provided to SMEs in Selected Countries, (2016)



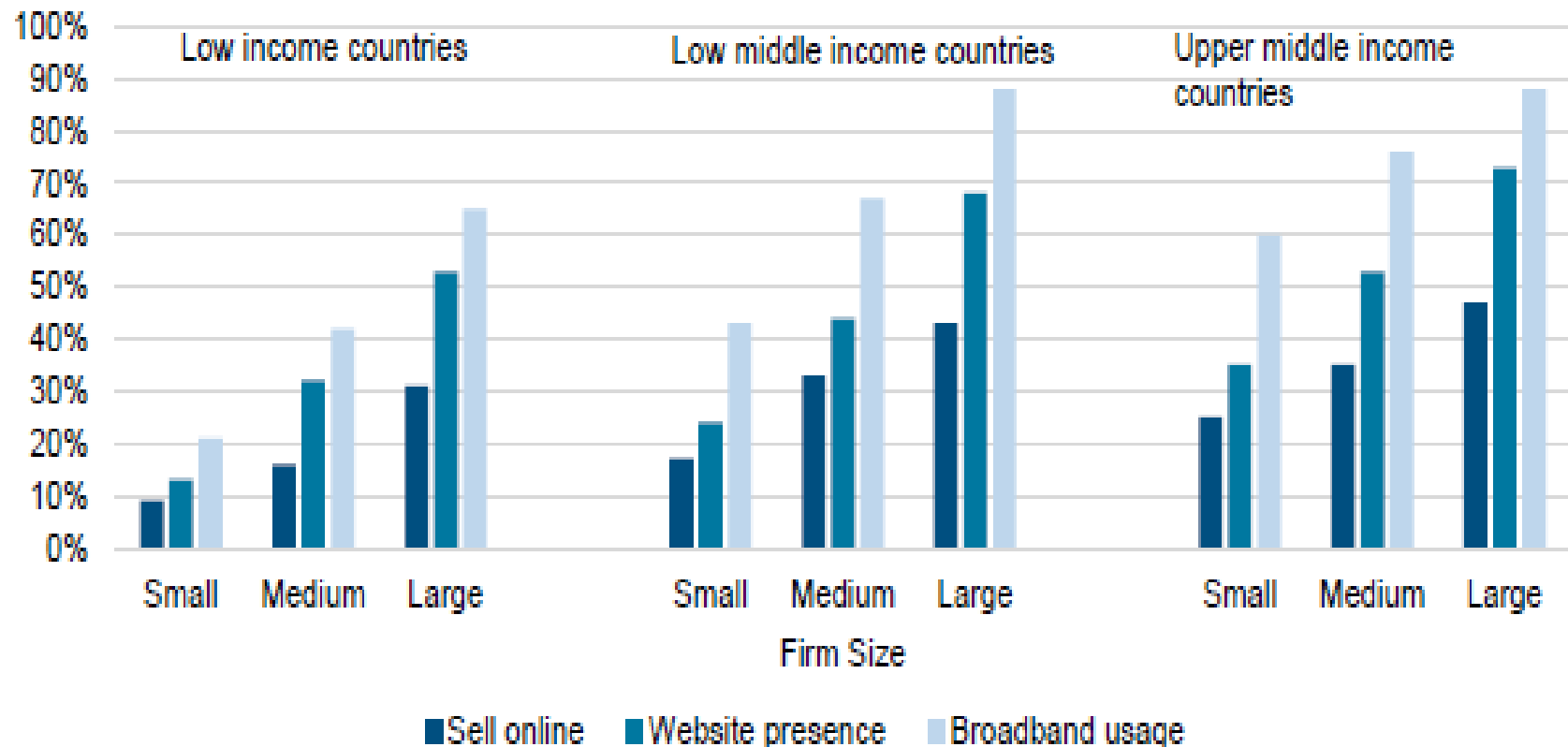
Source: EIB Information Bulletin, 2017

Digitalization and SMEs

Potential Benefits of Digitalization for SMEs:

- **Greater access to markets:** E-Commerce and the Internet ***lower costs for transaction*** while reducing the need for physical infrastructure/presence in foreign market
- **More access to financing:** new opportunities for SMEs to obtain funding.
- **Greater access to technology and applications:** Through cloud services (improved ICT) SMEs can access a wide range of technologies and applications.

SMEs use internet less intensively



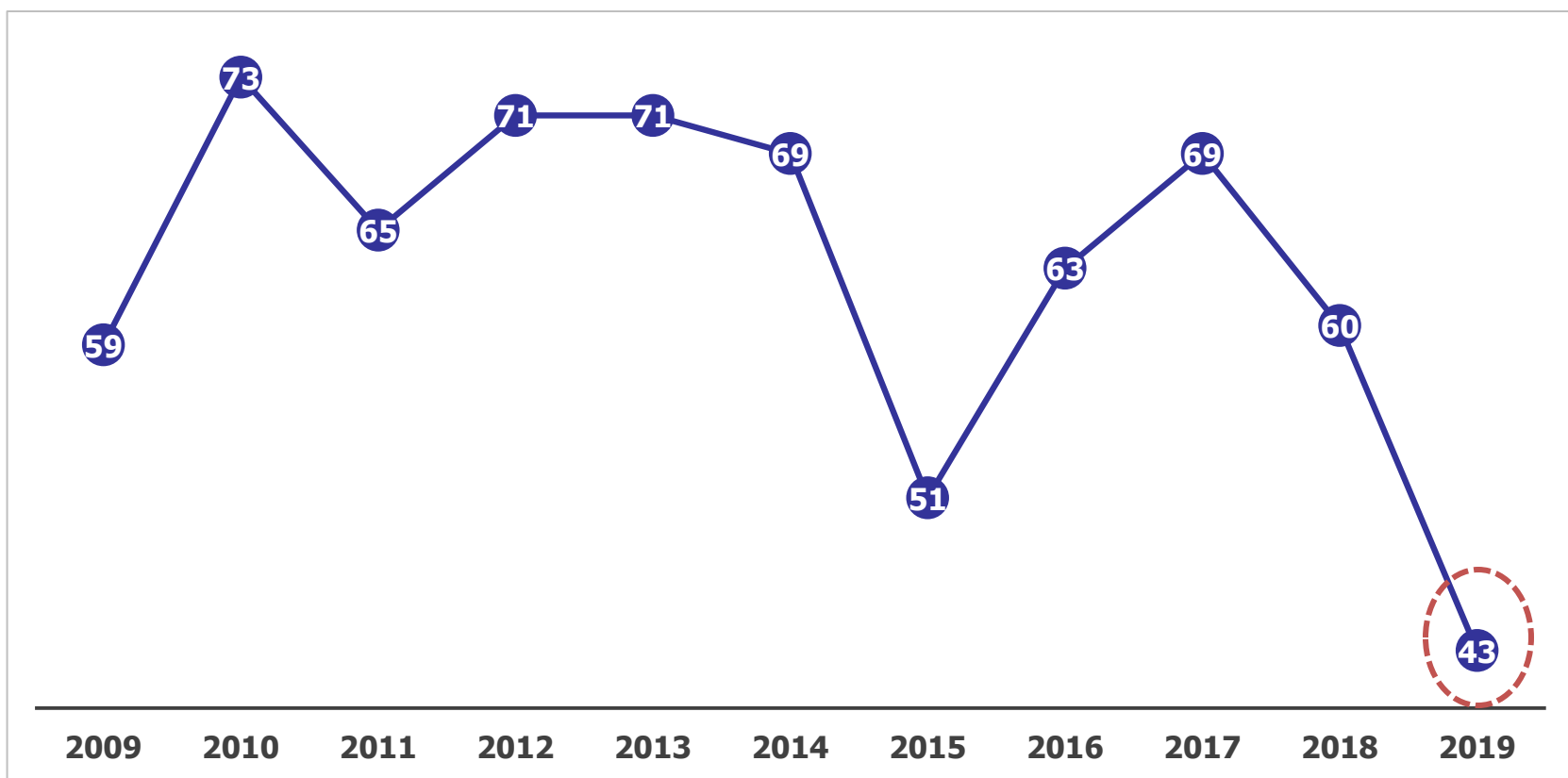
Source: Source: Hussain, based on World Bank Enterprise Surveys (2015), accessed March 29, 2017, <http://pubdocs.worldbank.org/en/38551451931382135/Fia1-6.csv>.

Regulatory environment and the rule of law

- *GVCs need FDI which needs good investment environment:*
- *Doing Business* in Turkey
- *Rule of Law* index
- *World Governance Indicators*
-

Turkey ranked 60-70 for years

Doing Business Index, World ranking, 2009-2019



Best performance achieved by Turkey in the last decade, 2019

Action Plan by 107 articles

**COORDINATION COUNCIL FOR THE IMPROVEMENT OF INVESTMENT ENVIRONMENT (YOİKK)
2017-2018 ACTION PLAN TABLE BY INDICATORS**

MINISTRY/INDICATOR	Starting business	Construct ion permits	Getting electricity	Registering property	Paying taxes	Trading accross borders	Getting credit	Enforcing contracts	Resolving insolvency	STK	TOTAL
JUSTICE							2	4	10	-	16
SCIENCE, INDUSTRY AND TECHNOLOGY										3	3
LABOUR AND SOCIAL SECURITY	1	2			1					6	10
ENVIRONMENT AND URBAN AFFAIRS		8		6						-	14
ECONOMY										2	2
ENERGY AND NATURAL RESOURCES			2							2	4
FOOD, AGRICULTURE AND LIVESTOCK										1	1
CUSTOMS AND TRADE	7					8	2			5	22
HOME AFFAIRS		9	1		1					-	11
DEVELOPMENT										1	1
FINANCE	2	1			6			1		6	16
TRANSPORT. AND COMMUNICATION						3				1	4
TREASURY							1			1	2
TBB Risk C.							1			-	1
TOTAL*	10	20	3	6	8	11	6	5	10	28	107

Getting better in Doing Business index

	DB 2018	DB 2019	Change
Starting a business	80	78	+2
Dealing with construction permits	96	59	+37
Getting electricity	55	60	-5
Registering property	46	39	+7
Getting credit	77	32	+45
Protecting minority investors	20	26	-6
Paying taxes	88	80	+8
Trading accross borders	71	42	+29
Enforcing contracts	30	19	+11
Resolving insolvency	139	109	+30
Overall ranking	60	43	+17

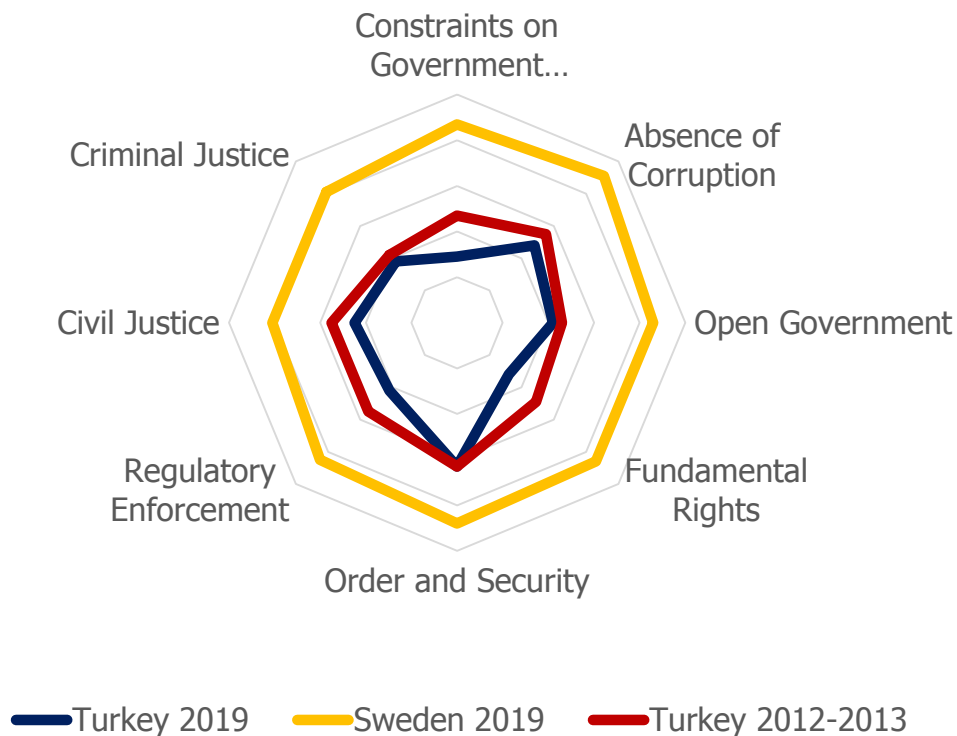
Turkey is among the 10 most improved economy in DB

Rule of Law

- High tech FDI is needed to bring positive spillovers for productivity, technology.
- For Turkish SMEs to integrate into GVCs.
- but this is possible by means of **more stability.**

Needs to improve in **Rule of Law index**

Turkey's Rule of Law Index indicators, 2012 & 2019



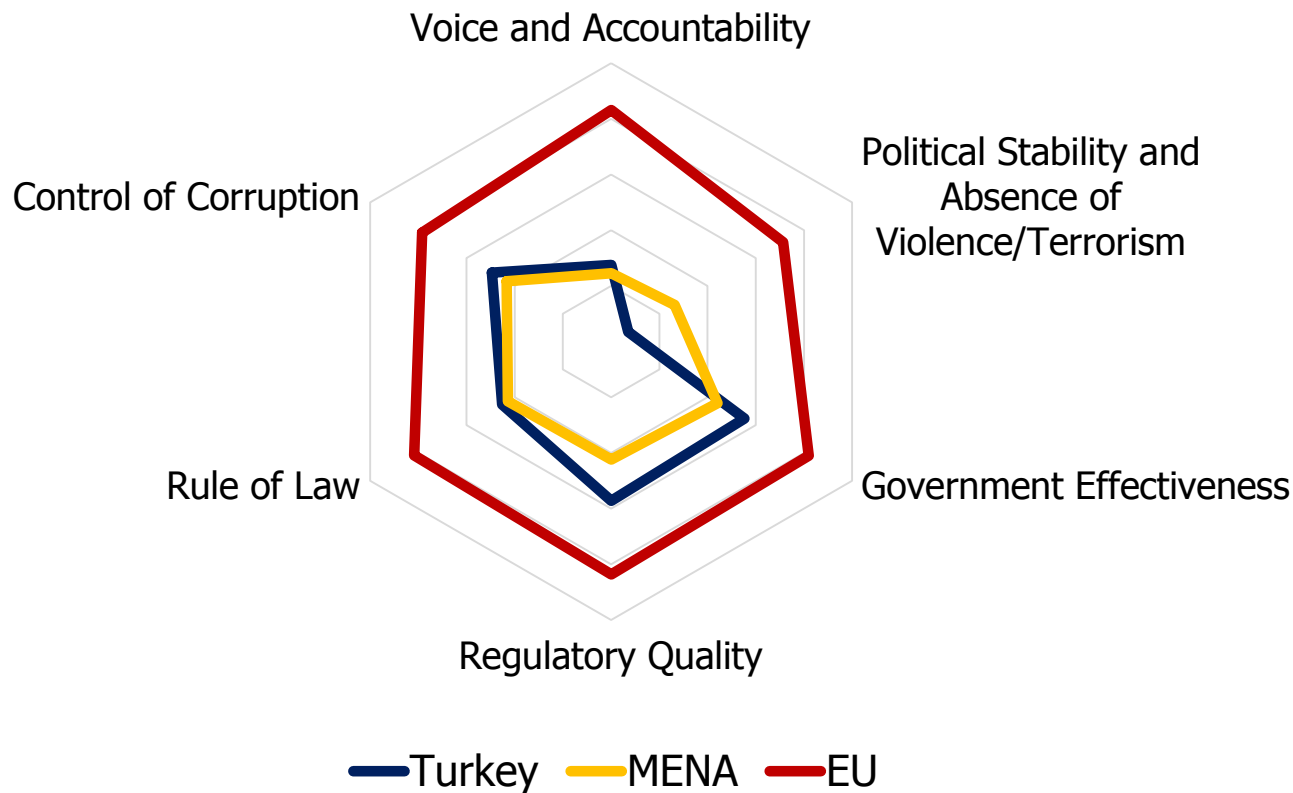
WJP Rule Of Law Index Factors	Ranking, 2019
Constraints on Government Powers	123/126
Absence of Corruption	57/126
Open Government	94/126
Fundamental Rights	122/126
Order and Security	96/126
Regulatory Enforcement	106/126
Civil Justice	96/126
Criminal Justice	85/126

Source: World Justice Project, TEPAV calculations (unweighted average)

Note: Outer side represents higher score

Turkey needs to decide where it stands

WB World Governance Indicators, percentile rankings of EU-28, MENA and Turkey, 2017



Source: World Governance Indicators, TEPAV calculations (unweighted average)

Note: Outer side represents higher score

SMEs and trade barriers

- Barriers to SMEs access to global markets:
 - (i) limited information about the working of the foreign markets, **difficulties in accessing export distribution channels**;
 - (ii) costly **product standards** and certification procedures,
 - (iii) burdensome **customs regulations/procedures**;
 - (iv) poor **access to finance** and slow payment mechanisms.

WTO World Trade Report, 2016

SMEs voice in CU process

- Deeper regional integration is a blueprint for SME success...
- More attention to the specific needs of SMEs in the customs union.

→ Specific SME-friendly chapter

- Database listing all regulatory requirements for compliance
- trade facilitation (how to reform cumbersome procedures)-TFA
- Elimination of unnecessary hurdles and simplify RoO
- capacity building in digital trade and e-commerce (Alibaba/Kompass)
- SME committee to follow up implementation

→ Deepening CU into agriculture and trade in services

- to promote productivity in services and agricultural enterprises
- Service trade restrictions represent 10-20 % of tariff equivalence
- to reduce farm prices that can minimize labour costs in urban areas (working mostly in SMEs)

Opportunities are mutual for EU and TR SMEs:

if trading framework between the EU and TR is enhanced

EU SMEs

- *Dairy products*
- *Processed foods*
- *Fruit and vegetables*
- *Basic chemicals and plastics*
(value chain integration for intermediate products)
- *Auto, machinery and electrical equipment*
- *Business and professional services- and trade services*
(wholesale and retailing)

Turkey's SMEs

- *Processed foods*
- *Fruit and vegetables*
- *Textile, clothing and footwear*
(also to third markets)
- *Trade, construction and transport services,*
recreational services, logistics

Customs Union and SMEs

- Opening negotiations for an upgraded CU can help European and Turkish SMEs to benefit mutually as well as in third country markets.
- CU is a technical issue, which should not be politicized.

The EU *acquis* directly relevant to SMEs

Chapter not closed/not yet opened

- Public procurement
- Company law
- Intellectual property law
- Competition
- Information society & media
- Food security, veterinary & phytosanitary policy
- Taxation
- Social policy and employm.
- Enterprise and industrial p.
- Regional policy...
- Environment
- Consumer & health protection

Chapter subject to political blockage

- Free movement of goods (CE marking)
- Financial services
- Agriculture and rural development
- Customs union
- Freedom to provide services
- Education & culture
- Energy

Conclusions

- **Need for a new approach to internationalize SMEs and their linkage with the GVCs**
- **Strong and credible program with a new SME-driven narrative**
 - Turkey transformed itself from low-tech to mid-tech industrial country through EU engagement
 - Now is the time for the next jump (especially for its SMEs)
- **Choosing priorities is a good starting point**
 - Customs Union is an area of opportunity (should not be politicized)
 - Building digital capacity, integration with EU digital single market
 - financial inclusion and level-playing field for SMEs