

17. **The Central Bank has announced its goal to bring inflation down to 4 percent in the period 2008-2010.** In 2006, inflation had reversed its downward trend of the previous years and risen back to about 10 percent. In 2007, CPI inflation fell again to 8.39 percent—but inflation stayed well above the Central Bank’s 4 percent target and the upper uncertainty band of 6 percent. Nevertheless, the core CPI index – excluding energy, unprocessed food, alcoholic beverages, tobacco products and gold – remained around 6 percent during 2007. In the first months of 2008, possible increases in food and energy prices may lead to a temporary increase in annual CPI inflation. The annual CPI inflation is projected to fall to about 5 percent in end-2008.

## II. TURKEY’S VISION AND KEY DEVELOPMENT CHALLENGES

### Box 1: Government Program

The development program of the Turkish Government is set out in three key documents that outline Turkey’s overarching development goals, the medium-term reform agenda, and specific actions and responsibilities within the Government.

***Ninth Development Plan 2007-2013:*** The Turkish General National Assembly approved this plan in 2006 and it has become Law No. 877. This framework provides a long-term perspective and represents unity in objectives by the public sector and civil society. It aims for an enhanced quality of life through an inclusive development process.

***Government Action Plan:*** Separate short and medium-term plans translate the broader objectives of the Ninth Development Plan into specific operational actions for line ministries’ and Government agencies’ responsibilities. The Government issued a Quarterly Action Plan for the fourth quarter of 2007 and an Annual Program for 2008.

***Program for Harmonization with EU Aquis:*** This is a detailed plan outlining the specific actions needed to be implemented to fulfill the 35 chapters for EU accession.

18. **The Government’s Ninth Development Plan for 2007-13 sets out a vision of Turkey with stable growth, a more equitable income distribution, and increased global competitiveness, as the country transforms into an information society and completes EU harmonization.** The development priorities embedded in the Plan are clustered around improved competitiveness and employment, equitable human and social development, and efficient provision of high-quality public services, with emphasis on the reduction of regional differences. The agenda for EU accession is a major cross-cutting theme. The following is a selection of Government action areas that are particularly relevant to the cooperation with the WBG.

#### ***A. Improved Competitiveness and Employment Opportunities***

19. **Government policies aim to achieve sustained rapid growth and improved living standards through increased competitiveness and the creation of employment opportunities.** Maintaining sound macroeconomic policies, improving the investment climate, enhancing the flexibility of the labor market, upgrading the skills of the labor force, increasing access to investment capital, promoting the generation of knowledge and innovation, modernizing Turkey’s infrastructure and developing conditions for non-

agricultural rural activities are critical ingredients of the Government's multi-year reform program.

20. **Creating jobs is a central priority.** Despite strong growth, the employment rate is low, especially among women, and unemployment is high, especially among youth. In 2006, only 48 percent of the working age population had a job or were looking for a job; 26.1 percent of Turkish women were employed (EU averages were 64 percent and 56 percent, respectively). Current youth unemployment is 18.7 percent, almost twice as high as the overall unemployment rate of about 10 percent.<sup>10</sup> International experience has shown that the most important element to reduce poverty on a sustainable basis is the creation of good jobs that is productive jobs in safe environments that generate sufficient income to raise a family.

21. **Creation of more and better jobs in Turkey is closely related to continued private sector growth.** Strong private sector growth in Turkey in turn depends on: (i) an improved investment climate; (ii) a better functioning labor market and improved skills; (iii) enhanced financial stability and access to finance; and (iv) improved firms' technological progress and increased use of quality standards; and (v) adequate and affordable electricity supply.

22. **Reduced informality, lowered barriers to entry, operation and exit of firms, and continued strong privatization are key ingredients of a better investment climate.** In order to streamline the legal, regulatory and administrative framework of the investment climate in Turkey "Reform Program for the Improvement of the Investment Climate of Turkey" is underway. Recently, Turkey has attracted record levels of foreign direct investment which is a sign of the improving investment climate in the country. However, there are continuing problems that should be resolved during the upcoming period. A large portion of GNP (with estimates varying between 35 to 55 percent) is produced by the informal sector, and social security contributions are only paid by about 47 percent of the active labor force. Taxation is the main driver of informality, which decreases productivity, growth and employment. The Government recently reduced the corporate income tax from 30 to 20 percent and implemented tax reforms to improve collection efficiency and reduce firms' compliance costs. Further reforms are needed to spread the tax burden to all firms, reduce compliance costs and minimize labor tax rates. While starting a new business does not take much time, its cost is high. Obtaining a license also takes longer than in comparator countries, and the fees are also high. Finally, exiting the market takes longer and yields lower recovery rates than in comparator countries. Continued strong privatization will also support a better investment environment.

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<sup>10</sup> Available regional data reveal no particular difference in terms of change in employment and unemployment across regions. It is also not clear that lagging regions have higher unemployment rates. For example, unemployment is significantly above the country average in Istanbul despite the low participation rate, while unemployment is almost half the average in the less developed regions of the Black Sea and North-East Anatolia. Employment rates are higher in lagging regions probably because of informal employment in agriculture.

**23. Reforming the labor market and improving the quality of labor skills are essential for job-creating growth.** Turkish labor regulations are inflexible. Payroll taxes and compulsory non-wage costs are high, and the employment protection legislation is restrictive. Key measures to reform the labor market include increasing the flexibility of labor regulations, extending unemployment insurance coverage, easing restrictive employment protection rules, and reducing payroll taxes and other labor-related costs. Improving labor skills is also essential and the Government's Development Plan includes a number of programs and policies which would link skill-building activities, including vocational and technical training, to the development of core, demand-determined competencies. Despite successful results of recent education reforms, challenges remain, including low enrollment in secondary and tertiary education, low students' proficiency in problem solving (math, reading and science) and limited training provided by Turkish firms. Raising educational achievement, aligning the contents of education with the needs of the labor market, and increasing training provided to workers by firms are all critical for improving the skills of the labor force.

**24. Strengthening financial sector stability and improving access to finance are needed for private sector growth.** The financial system has substantially recovered from the 2001 crisis. Credit has grown rapidly, numerous foreign banks have entered through acquisitions or partnerships, Initial Public Offerings (IPOs) for two large state banks have been successful, and a new Banking Law in 2005 is facilitating strengthened regulation and supervision. Strengthening the supervisory framework and completing the privatization of the three large state banks remains a key medium-term goal. Enhancing access to medium and long term finance for firms and individuals remains an important priority for strengthening private sector competitiveness and growth. Financial intermediaries in Turkey are constrained in their access to medium term funds, and are mostly funded by deposits and up to 1 or 2 year borrowing. In order to manage the liquidity and interest rate risks associated with medium and long term lending, financial intermediaries (banks and leasing companies in particular) need better access to medium term funding, for instance as provided by medium and long term credit lines. Complementary reforms to strengthen the underpinnings of the credit market include improving the movable collateral regime, the collection and sharing of firms' credit information, enforcing the bankruptcy law, improving the quality of accounting and auditing among firms, and strengthening corporate governance. Streamlining the taxation regime to level the playing field between financial intermediaries could help improve efficiency in the Turkish financial sector.

**25. Technological progress and the increased use of the Internet and quality standards enhance firms' competitiveness.** Turkey almost doubled R&D expenditures in the past decade, but R&D, financed by private firms and productive innovation are still limited. The level of technology absorption is moderate. Increasing productive innovation and technology adoption at the firm level requires reviewing the existing legislation, improving protection of intellectual property rights, reviewing fiscal incentives for R&D and assessing the results of existing innovation and technology adoption programs. Increasing firms' access to—and productive use of—the Internet

requires continuing liberalization of the telecom sector, improving telecom regulation, implementing universal access fund schemes, improving IT skills of the labor force and use of the internet by Government agencies. As for the use of quality standards, increasing the number of certified firms requires improving the National Quality System, including standardization, accreditation services and metrology, as well as providing training, consultancy services and matching grants for quality certifications to firms.

**26. Continued restructuring of agriculture and off-farm rural development are necessary for improving competitiveness and creating jobs in rural areas.**

Agriculture accounts for 9.2 percent of GNP and 27.3 percent of employment. While employment in agriculture is still high, it has been declining during the last two decades with the resultant rural-urban migration. A particular challenge in the years ahead will be to balance agricultural and rural development and the respective policies and institutional and implementation arrangements against the backdrop of on-going changes in the Common Agricultural Policy (CAP). Support to entrepreneurial activities in the services and industry sectors will continue gaining in importance, with priority on financing of essential institutional and infrastructure investments rather than income support as such. To take maximum advantage of EU pre-accession funds for agriculture and rural development, several complementary actions are underway. A Rural Development Strategy has been prepared, and an Instrument for Pre-Accession for Rural Development (IPARD) plan is in preparation, which, among other things outlines the establishment of a Rural Development Paying Agency, and which proposes to strengthen participatory management processes

**27. Infrastructure services are an important driver of growth.** The importance of these services reflects both internal demand and Turkey's geopolitical position – as a link between Europe, Asia and the Middle East. Although Turkey is relatively well-endowed with infrastructure compared to other emerging economies, it falls short of OECD and EU standards. Businesses are burdened by costly backbone infrastructure services of insufficient quality. The dominant transport mode – road -- suffers from localized congestion and deteriorating road quality. While daunting, this combination suggests that much can be gained through more efficient, user-financed, operations. The largest transformational challenge is moving from monopolistic state entities providing services toward the mix of private and state that characterizes efficient higher income economies. In key infrastructure service areas, Turkey has already introduced or made substantial progress in designing the changes to legal and regulatory structures needed to meet EU acquis requirements.

**28. Energy supply security is a crucial concern for Turkey.** As a result of rapidly growing demand generated by strong growth and rising social standards, electricity supply shortages have begun to emerge and Turkey faces a potentially serious supply crisis that could have significant macroeconomic implications. Efforts to improve efficiency and improve demand management are yet to have a significant impact and need to be enhanced. Levels of private sector investments have not been sufficient to ensure that supply keeps pace with demand growth, and options for significant imports being available are also limited in the near term. There is thus a need for increasing investments in domestic generation and transmission capacity. This will entail a range of

measures to encourage greater private sector investment in additional generation capacity. Public sector investments will be required to augment transmission capacity and, at least in the short-term, also in generation to meet the shortfall between the required level of investments and the investment expected to be realized from the private sector.

29. **The Government is updating its national energy strategy**, with a view to meeting Turkey's growing energy demand in an efficient and sustainable manner. The strategy will be consistent with the Ninth Development Plan's objective of ensuring security of energy supply while keeping adverse environmental effects at a minimum level. While Turkey's carbon emissions are still below those of several comparable countries, especially on a per capita basis, emissions have been increasing substantially, along with high economic growth over the last decade. The energy sector has contributed most to this increase in emissions, and as Turkey's energy demand and energy use are expected to continue growing rapidly, energy efficiency and environmental and climate change considerations will be of increasing importance. The strategy will likely include a wide range of measures to: increase energy efficiency and improve demand management; revise end-user tariffs, reduce electricity losses, improve collections (particularly from municipalities) and resolve inter-enterprise arrears to improve the financial viability of the sector and thereby improve the incentives for private investment; emphasize renewable energy development; increase the reliability and efficiency of existing generation through investments in rehabilitation (including environmental upgrades); privatize the distribution network and selected existing generation plants; improve the functioning of the wholesale market; and introduce a capacity mechanism. Similarly, continued investments would be required in the gas sector to ensure the adequate gas supply to meet residential, industrial and power generation needs.

### ***B. Equitable Human and Social Development***

30. **Human and social development constitutes a key objective of the Government's program.** Turkey has successfully reduced poverty and inequality in the past years but social indicators lag behind comparator countries. The Government plans call for the implementation of social security reform, including the introduction of universal health insurance, modernization of the education system to improve its quality and relevance, the restructuring of the health sector and a reduction in social disparities, all leading to reduced poverty rates and inequality levels.

31. **Improving income inequality and promoting social inclusion is core to Turkey's social policy plans.** Turkey's income inequality is comparable to other middle income countries but it remains well above levels in the EU. Turkey's income concentration had a Gini coefficient (measuring inequality) of 38 in 2005, compared with 25-30 for most EU countries. Nonetheless, inequality has been reduced considerably since 1994 (see Table 3 below). The Government's Development Plan specifically calls for improving the income distribution over the next years.

32. **Poverty has also declined and extreme poverty is low.** Poverty declined from 28 percent in 1994 to 17.81 percent in 2006, and extreme poverty was reduced to below 1 percent, according to Turkish statistics<sup>11</sup>. Important regional difference in welfare and poverty do persist, however. In 2001, the highest provincial GDP per capita was almost 11 times the lowest GDP per capita, reflecting substantial differences in income and in economic growth across provinces. In Turkey, there is a high degree of social solidarity such that poor people share resources with poorer neighbors, reducing the extent of extreme poverty. This informal coping mechanism, strongest in rural areas, was under considerable stress after the crisis of 2001 but appears to be working still, as qualitative fieldwork suggests.

**Table 3: Poverty and Inequality, 1994-2005**

	1994	2002	2003	2004	2005
<b>Poverty</b>	28.3	27.0	28.1	25.6	20.5
<b>Complete</b>	28.3	27.0	28.1	25.6	20.5
<b>Food</b>	2.9	1.4	1.3	1.3	0.9
<b>Inequality</b>					
<b>Gini (income)</b>	0.45	0.44	n.a.	0.40	0.38

Sources: 1994 & 2002, World Bank poverty assessments. 2003-2005, Turkstat.

33. **As an important poverty reduction measure, Turkey introduced, with Bank support, a conditional cash transfer (CCT) program in 2001.** Today, the program reaches 2.6 million children in poor households in a, by international standards, well-targeted manner. An impact evaluation has shown that the CCT program has improved nutrition and school attendance of beneficiary children, with important positive spill-over benefits in health, education, improved frequency of treatment for diarrhea, improved vaccination compliance and registration of marriages and births. Further, qualitative data suggests that the program has contributed to the empowerment of women who receive the CCT payments for their children.

34. **Implementation of the social security reform remains a key priority.** In 2006, Parliament passed a landmark reform, including parametric and institutional changes in the pension system and the introduction of universal health insurance. The pension reform is important for fiscal sustainability, the health reform is important for access, and both are important for equity. In December 2006, the Constitutional Court ruled that some of the provisions of the law should not be implemented, mostly those affecting civil servants and that such provisions be revised in accordance with the particular status of civil servants in the Constitution. In view of the Court decision, the Government decided to postpone the implementation of the law. The Government has confirmed its strong support for the reform and submitted revised legislation to Parliament in November 2007. The implementation is not expected to begin until July 2008, leaving time for any further

<sup>11</sup> Poverty is defined in the 2005 Joint Poverty Assessment as the consumption level required to meet necessary food and non-food needs. Reflecting local conditions and a local line, extreme poverty is measured by consumption below the cost of food. Other poverty estimates such as US\$1 per day poverty depend on the purchasing power parity used, but are also low.

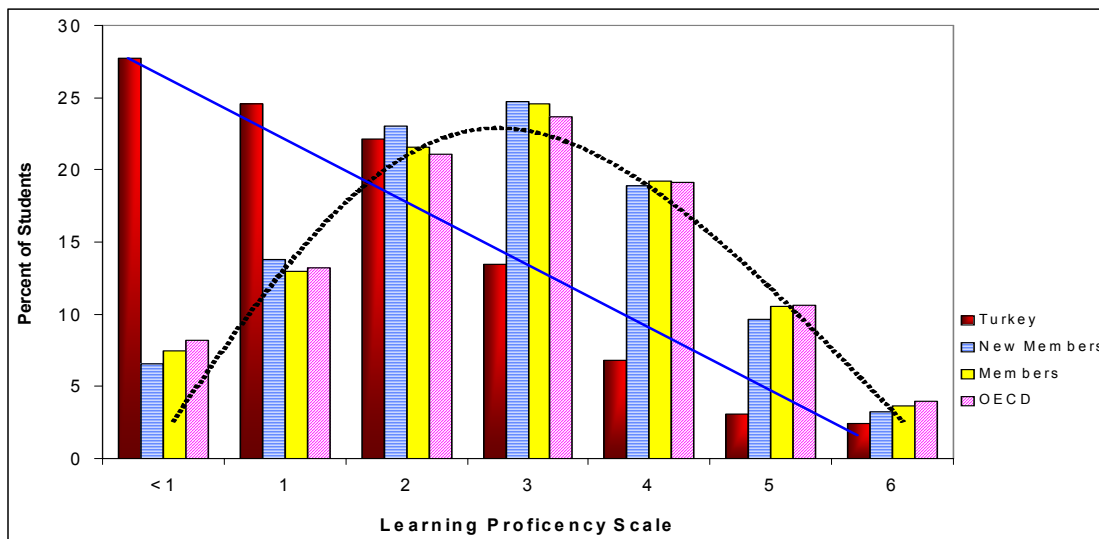
constitutional challenges to be resolved. While the long term financial balance will be unaffected, the short and medium term deficits are expected to rise somewhat due to the revision required by the Constitutional Court. Nevertheless, savings from the reform are expected to be substantial.

**35. Low levels of education translate into a workforce with skill deficiencies and present significant constraints on operations and job growth in the private sector.** The Turkish workforce has lower levels of education than nearly all comparator countries (such as Bulgaria, Chile or Poland with approximately similar income levels). Almost 60 percent of the Turkish workforce has less than ten years of education. In addition, and as the Government spells out in its Development Plan, no system currently exists that would offer new labor market entrants and current workers to build their job-relevant competencies in a flexible, modular manner.

**36. Enhanced quality and relevance of education are critical for Turkey's future.** While enrollment in basic education has increased by almost 1.8 million since 1997 reform, the gross enrollment rate for 2005/2006 stood at 96.34 percent with the net enrolment rate likely to be lower due to repetition and coverage, showing that still an important fraction of school-age children remain outside the primary school system, many of them girls, or live in rural areas and/or are poor. In addition, the availability of early childhood development and preschool programs are quite limited in Turkey. Secondary education attainment is low by international standards. Figure 1 below shows that in Turkey, the learning proficiency level ('1' being the lowest proficiency, '6' being the highest) of 15 year olds is significantly below the levels of the OECD and the new member states of the EU). The *Assessment Programme for International Student Assessment* (PISA) results in 2006 show the same results (as well as the same average ranking for Turkey, being second-to-last among all OECD member countries). In 2006, 44.7 percent of Turkish youth between the ages of 20 and 24 had a secondary diploma compared with 74.8 percent for the EU15 countries. For girls the comparable rate in Turkey stands at 38.9 percent. The rates also vary significantly by geographic region, with much lower rates of enrollment and attainment in the eastern provinces. Even if students have secondary education, skill levels are low by international standards, as illustrated in the graph below.

**37. Higher education reform is a high priority.** The gross higher education enrollment rate in Turkey was 30 percent in 2004 compared with an average of 70 percent in Western Europe and North America. The current entrance examination system diverts resources from more productive learning, and increases inequality between the rich and poor.

**Figure 1: Distribution of 15 Yr. Old Students by Proficiency Level, Turkey, EU & OECD**



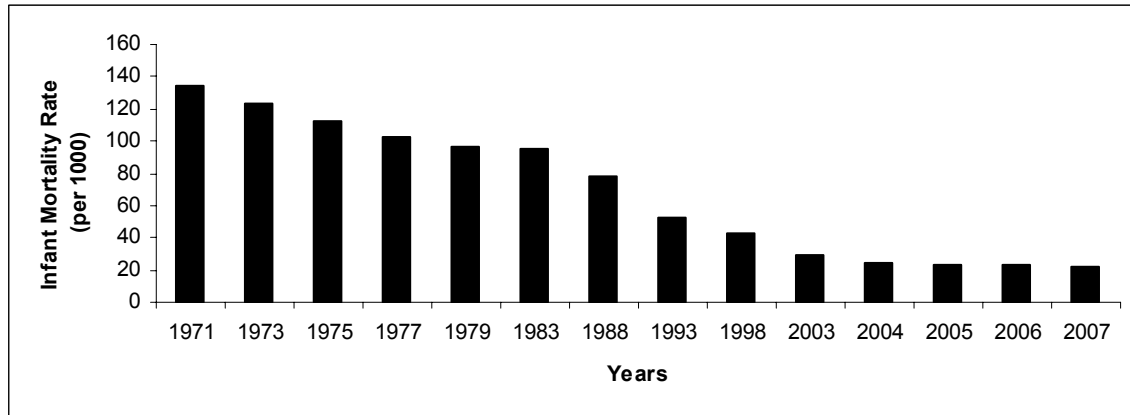
Source: Program of International Student Assessment-PISA 2004

38. **Significant improvement in health outcomes has been achieved over the past years.** The Government has a strong vision and commitment to health sector modernization, and a well-formulated health reform strategy. The focus of the Government's strategy is on improving health outcomes while simultaneously controlling rising health expenditures. Implementation is a challenge with reforms taking years to implement, particularly with respect to passing laws. Despite these challenges, much has been achieved in expanding health services, especially for rural and vulnerable populations (e.g., rapid expansion of family medicine, mobile health teams in rural areas and coverage of outpatient services and pharmaceuticals for low-income families). For example, the infant mortality rate dropped from 53/1000 in 1989-1993 to 29/1000 live births for 1999-2003 period and is expected to have further declined. Similarly, the under five mortality rate declined from 52/1000 live births (1994-1998) to 37/1000 live births in 1999-2003."

39. **Further improvement in aggregate health outcomes will involve addressing geographic, urban/rural and income-based disparities.** Currently, significant geographic, urban/rural and income disparities in health outcomes driven by access barriers for the poor and vulnerable and lower levels of knowledge about seeking care exist. For example, the maternal mortality rate stood at 28.5 per hundred thousand live births in 2005, varying from a low 7.4 in western Anatolia to 68.3 at the East Black Sea and North East Anatolia. Also, despite the notable improvements, infant- and under-five mortality rates targeted by the fourth and fifth MDGs, respectively, are high in Turkey compared to other MICs and they are among the highest in Europe. Life expectancy at birth in 2006 was 69.1 years for males and 74.0 years for females, still about seven years below the OECD average. With the population pyramid changing in the coming decades, so will the burden of disease, placing added importance on reforming the health care delivery model which would need to include a review of both quantity and specialization of health personnel. Also, there is a need to continue focusing on the equity of spending by better targeting public spending on poor and vulnerable and with more resources on

preventive and primary health care services and making sure poor are covered for life-threatening illnesses.

**Figure 2: Changes in Infant Mortality Rates in Turkey Between 1970 and 2007**



**Source:** \* Trends in Fertility and Mortality in Turkey US-NRC and SPO Five Years Development Plan Estimations  
 1983 Turkish Population and Health Survey 1979-1982 period estimation.  
 1988 Turkish Population and Health Survey  
 1993, 1998, 2003 Turkish Population and Health Survey  
 2004, 2005, 2006, 2007 TURKSTAT estimations

40. **Promoting social inclusion is a major element of meeting the Copenhagen criteria and thus for the EU accession negotiation process.** Turkey has made notable progress in strengthening the social safety-net towards the disadvantaged and vulnerable, primarily through the introduction of a conditional cash transfer program that effectively – and with notable impact – reaches 2.6 million children in poor households. Main priorities in the years ahead would include: (i) building on the conditional cash transfer program, further strengthening of social safety net; (ii) rethinking the income support strategy for the poor and vulnerable in the context of providing a springboard for gainful employment; (iii) taking initiatives aiming at youth inclusion; and (iv) providing continuous support to female employment, reducing the pay gap and in general integrating women as full equal partners in society; (v) improving the monitoring and evaluation of social services and then expanding cost-effective services to underserved population groups.

**C. Efficient Provision of High Quality Public Services**

41. **The Government’s program puts great emphasis on improving the efficiency and quality of public services.** Improving the quality and management of public expenditures, strengthening public sector governance, putting into practice the e-government, reducing regional disparities, improving local delivery of public services, and strengthening environmental protection, and emergency preparedness and disaster risk mitigation are among the key priorities. Strengthening regulation and pricing public services in accordance with economic criteria will be important to achieve these objectives.

42. **Continuing improvements in the composition and quality of public spending will greatly help Turkey meet its development challenges and foster sustained growth.** Fiscal consolidation so far has relied heavily on revenues. Future efforts on the expenditure side will be important to increase the sustainability of fiscal adjustment and help support economic growth in particular by containing current expenditures so that sufficient fiscal room is left for financing productive public investments. Sustained investments will be needed in education, in infrastructure for less-developed regions, in the energy sector, in areas where alignment with the EU *acquis* entails a cost (e.g., environment), and where significant co-financing is needed for absorbing pre-accession funds (e.g., rural development). Moreover, a high level of public sector primary budget surplus will need to be maintained in order to accelerate the reduction of public debt in proportion to GDP and forestall pressures on the external current account. To this end, reducing state aid and implementing the social security reform will be important. Although short-term fiscal gains from the social security reform are not expected to be large, creating fiscal room in the medium-term, especially for lowering high payroll taxes, as well as sustainability of fiscal balances will heavily depend on its implementation.

43. **Trade-offs in expenditure allocations will be important as will expenditure reforms aimed at efficiency gains.** Increased fiscal space could be sought possibly by reducing spending in functional areas where it appears to be oversized in international comparison and by implementing reforms that improve efficiency and help contain costs in areas where expenditure pressures are being felt—such as health care and pensions. Horizontal reforms, focused on the modernization of civil service pay and employment and the careful formulation of the investment program, would also help contain pressures on the wage bill and investment spending across functional areas. The Government recognizes the importance of ensuring appropriate allocations for operation and maintenance of public capital on accelerated decay of capital goods may unduly burden the investment program in the future. A framework conducive to a greater role of the private sector in the financing, development and operation of infrastructure should be created—requiring a predictable policy and regulatory environment, together with careful design of Government commitments to private operators to minimize the risk of contingent liabilities.

44. **Addressing the unfinished agenda in public financial management reform represents a major challenge.** Far-reaching public financial management reforms have improved budget coverage, formulation, execution, accounting, auditing, and procurement, providing a new legal framework for modern public expenditure management and accountability. The main challenge ahead is the implementation of the reform agenda throughout the entire general Government, including extra budgetary funds and revolving funds. The key areas that require further attention are: (i) enabling a fully functioning internal audit structure; (ii) enactment of the Turkish Court of Accounts legislation, and (iii) bringing the remaining extra budgetary funds and revolving funds under the public financial management and control structures.<sup>12</sup> Effective leadership and

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<sup>12</sup> The Government is expected to restructure the revolving funds by mid 2008 as envisaged in the Public Financial Management and Control Law (PFMC), seems challenging. The Government has initiated a draft

coordination among agencies would be required for the effective implementation of the overall public financial management reform agenda.

45. **Continued improvement in governance remains a priority.** Recent governance indicators reflect improving trends, including reduced corruption. Surveys of firms and households suggest that corruption levels in Turkey are not unlike those in many EU countries. Reforms undertaken to meet the EU's political criteria (democratic institutions, rule of law) for accession talks are starting to have an impact. The legal framework against corruption has been strengthened with specific provisions in the new Criminal Code, new legislation on public procurement and civil service ethics, and the ratification of major international conventions<sup>13</sup>. New legislation on access to information and on the press has helped increase transparency. More streamlined procedures for tax administration, customs and business licensing have also reduced opportunities for corruption. As a result, between 2002 and 2005, Turkey's performance improved according to several surveys of the business community. The European Bank for Reconstruction and Development (EBRD)-World Bank Business Environment and Enterprise Performance Surveys (BEEPS)<sup>14</sup> indicate improvements in many areas vulnerable to corruption (including business licensing, tax administration, customs and the courts) and reductions in overall bribe frequency and the perception of state capture<sup>15</sup>. The BEEPS also show a higher level of confidence in the legal system in Turkey than in the EU8 countries. Doing Business ranks Turkey higher than the EU8 average in starting a business and registering property, but much worse in dealing with licenses, employing workers, and closing a business.

46. **Public sector governance is a key priority for Turkey in the medium term.** The Ninth Development Plan of the Government for the 2007-2013 period identified "increasing quality and effectiveness of public services" as one of the 5 development axes. Priorities under this axes include among others restructuring of the public administration, human resources management and judicial reform. The public sector governance and judicial reform agendas are of crucial importance for a strong investment climate conducive to growth and job creation, and thus for meeting Turkey's long-term development challenges. Turkey would also benefit from a strong public administration that is more apt to implement the EU *Acquis*. Similarly the justice sector will play a critical role in adapting to EU requirements and standards. Improving public sector governance encompasses a broad agenda, underpinning many of the short-term and

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restructuring plan for Ministry of Health revolving funds and announced in its Annual Program for 2008 that revolving funds would be restructured by mid-2008. Depending on the restructuring alternative, bringing the revolving funds under the public financial management and control structure may not be necessary.

<sup>13</sup> Turkey's accession to the Council of Europe's anti-corruption monitoring mechanism – the Group of States Against Corruption (GRECO) – and its peer review processes have strengthened governance and anti-corruption.

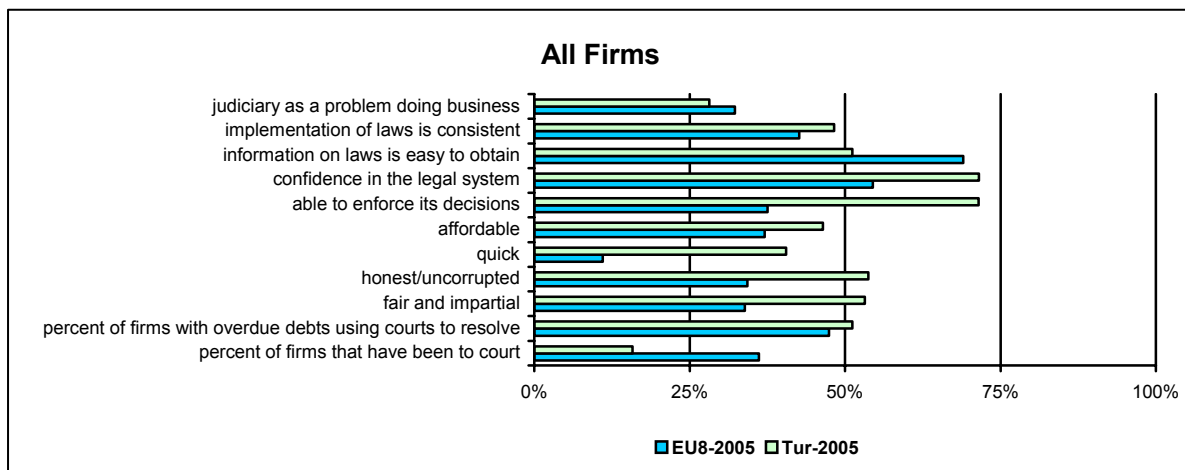
<sup>14</sup> [www.worldbank.org/eca/governance](http://www.worldbank.org/eca/governance) has more information on the BEEPS.

<sup>15</sup> The World Economic Forum's survey of business executives similarly finds reductions in the frequency of bribery related to tax, exports-imports, courts, procurement, and the diversion of funds for personal use.

medium-term priorities in the Accession Partnership with Turkey adopted by the EU Council in January 2006.<sup>16</sup> Some key challenges, for example, include:

- Strengthening institutions implementing anti-corruption policy and coordination among them—a prerequisite for further improving the investment climate;
- Promoting judicial reform—to ensure consistent interpretation of legal provisions and strengthen the efficiency of procedures;
- Reforming public administration and civil service, to improve efficiency, accountability, and transparency—a key “horizontal” requirement for the effective implementation of the EU acquis;
- Strengthening the independence and effective functioning of regulatory bodies—for example, in key network industries such as public procurement—and establishing new ones when needed (for example, for monitoring of state aid); and
- Ensuring effective, transparent, and participatory local administration—a key for improving the quality of public services; for effective implementation of regional development policies and rural development and the absorption of EU pre-accession funds.

**Figure 3: Legal and Judicial Issues**



EU8 countries include Estonia, Latvia, Lithuania, Poland, Hungary, the Czech Republic, Slovakia and Slovenia (Source: BEEPS 2005)

47. **The reduction of regional differences is also part of the Government’s medium-term agenda.** Income disparity both across regions and provinces in Turkey is considerable. In order to support regional development and facilitate the use of EU funds for this purpose, the Government has begun to set up regional development agencies. These would play a planning and coordination role, supporting implementation of regional plans and programs. As of October 2007, only two regional development

<sup>16</sup> 2006/35/EC: Council Decision of 23 January 2006 on the principles, priorities and conditions contained in the Accession Partnership with Turkey  
[http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=en&numdoc=32006D0035&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=en&numdoc=32006D0035&model=guichett)

agencies (RDAs) have been established in regions of Izmir and Adana/ Mersin. They are not functioning yet because the secondary legislation required is under formulation. The establishment of new RDAs needs a resolution of a Constitutional Court challenge. Other remaining challenges include: (i) designing and implementing a national strategy for regional development, (ii) managing the EU funds for regional development, and (iii) building capacity at the regional development agencies.

**48. Advancing decentralization will have a major impact on the efficiency and quality of public services at the local level.** Local governments account for only about 10 percent of government expenditures. The Government has embarked on a gradual process of decentralization. The authorities are aware of the importance of successful decentralization, of improvements in the technical capacity of local administrations and in local accountability, and of the matching of expenditure responsibilities and revenues. The targeting of intergovernmental transfers is also a key issue, given the wide disparities in tax bases among Turkey's 3,225 municipalities and 81 provinces. Finally, the Government is concerned about the current mechanism used to finance capital investments in smaller municipalities.

**49. The Government's objective is to position administrations to deliver the public services for which they have comparative advantages and create the framework that will promote efficient and sustainable service delivery.** To this end, the Government's program includes: (i) improved system of intergovernmental transfers; and (ii) fundamental reforms in the legal and financial structure of Iller Bank, the public financial institution for financing municipal development. In addition, administrations would need to disengage from such activities that could be better provided by the private sector. In addition local administrations would focus on those core public services—water supply and wastewater, solid waste management, and land use planning and development—where the private sector is unlikely to engage, at least in the medium term. However, over time implementing pricing policies that will enable service providers to recover the full cost of regulated services will be likely to stimulate private sector interest but will require transparent procedures of contracting and regulating the services of private providers.

**50. Developing municipal infrastructure is key to improved local service delivery.** Infrastructure investment needs at the local level are significant for water supply, sanitation, air pollution reduction, solid waste management, secondary roads and other related municipal services. Migration from rural to urban areas has further increased the pressure on municipalities to provide safe and reliable municipal services. Migration has also created social, economic and environmental problems, and added to the complexity of urban planning in Turkey. Municipalities and their utilities have depended on the central government to subsidize sector investment and operations, but such subsidies must be linked to higher coverage and better quality of service. The poor credit record of municipalities and the lack of availability of long-term funds have prevented most municipalities to access private capital for investments, except for the largest metropolitan municipalities. Allocation of public and private funds for maintenance and new investments at the municipal level, greater use of public-private partnerships (PPPs) to operate publicly owned systems (with appropriate fiscal

monitoring and risk management) and improvement of governance at the municipal and central government levels are key objectives.

51. **A particular challenge in the provision of public services is Turkey's vulnerability to natural disasters, especially earthquakes and wildfires due to severe droughts.** After the devastating 1999 Marmara earthquake, consecutive governments have shifted attention from post-disaster recovery to hazard risk management. Some progress has been made through the introduction of a decentralized emergency management model and the establishment of a single central coordination agency (Turkish Emergency Management Agency (TEMAD)). However, institutional restructuring has been slow and incomplete. The difficulty of consolidating responsibilities for disaster risk management, currently fragmented and spread between a number of agencies, hampers progress in this area. While some progress has been made in strengthening the enforcement of building codes and adherence to seismically safe construction practices, this remain a long-term agenda which requires not only regulatory changes, but more importantly, good governance and better public awareness and determination of authorities to enforce better compliance with legal requirements and technical standards. There is also progress to be made in integrating disaster risk management in the overall development and planning agenda.

52. **Enhancing environmental standards and compliance mechanisms is part of Turkey's program to meet EU Accession criteria.** The EU is taking the lead in supporting this effort. Complying with the EU environmental directives will be a major challenge for Turkey, and will require significant investments over a long period in water treatment, solid and hazardous waste management, industrial pollution control, nature protection, and water resources management. The environmental acquis provides an opportunity for greater public participation in environmental assessment and for transparency regarding environmental information and decision making. The process of planning for the EU negotiations are expected to give Government and the business community an opportunity to work together to identify and address the main barriers to adopting cleaner technologies. Finally, appropriate management of the environment is also fundamental to the Government's poverty reduction efforts, as it helps break a vicious circle of poverty, environmental degradation, and rural to urban migration. In some rural areas, over-use and degradation of natural resources appears to be the only way for the poor to survive. Around 65 percent of Turkey's agricultural land is suffering from 'severe' or 'very severe' erosion, covering around 45 million ha. In many of these areas, rural poverty and a degraded environment forces people to migrate to urban areas, further stressing urban physical and environmental infrastructure. In poor urban areas a degraded environment contributes to ill health and social exclusion.