6. CHALLENGES FOR REGIONAL DEVELOPMENT POLICY

83. The policy and institutional framework for regional development plays an important role in contributing to a more equal sharing of the benefits of high growth. By strengthening the policy framework and the institutional structure of regional development Turkey could address the issue of wide regional discrepancies.

84. Regional disparities in Turkey are large and persistent. Turkey suffers of large regional development disparities: these are significantly larger than in EU15 countries, and at the high end of disparities prevailing in new EU members (Figure 16). As in much of the EU, regional income disparities in Turkey have stayed more or less constant over the last few years (Figure 16 b). Regional disparities run largely along the east-west axis. “Advanced” regions (those with an average income per capita higher than the 75 percent of the national average) include Marmara, Aegean, Mediterranean and Central Anatolia, while the remaining three regions, Eastern Anatolia, Southeastern Anatolia and Black Sea, are classified as “lagging”.

![Figure 16: Variability of Regional GDP Per Capita in Turkey and Selected EU Countries](image)

Source: Eurostat and Turkstat

85. This is a cause of concern for three reasons. First, disparities in regional economic development are reflected in disparities in household income, with relatively high concentrations of poverty in the East. Second, the absence of economic growth in the East could spur additional migration to the large cities of the West, contributing to urban congestion. Third, the absence of growth in the East may reflect a bias in the allocation of investment capital, suggesting that the East harbors unexploited investment opportunities which could benefit Turkey as a whole, thus a contributing factor to overall income convergence.
Factors Underlying Regional Disparities and the Challenge

86. Overall, there is no clear evidence of convergence in per capita income across regions in Turkey over 1980-2000. While disparities among individual provinces appear to have decreased, disparities between the lagging region as a whole and the advanced region as a whole have increased or remained constant. Absolute convergence is found only in the productivity of labor. Conditional convergence (which measures convergence after taking differences in initial conditions into account) is found in one study. The studies also find that regional inequality tends to increase when the national economy is growing rapidly.

87. Differences in labor productivity are the key determinants of regional disparities as they account for 88 percent of differences in per capita regional incomes. Differences in unit effort (average hours per employee) and activity rates follow, each with a contribution a little over 20 percent. Employment rates are actually higher in lagging regions, probably due to hidden unemployment in agriculture, and therefore contribute negatively to income disparities (-33 percent).

88. Variations in labor productivity reflect the predominance of low productivity agriculture in the East. The findings of a decomposition analysis are largely explained by wide differences in the economic structure of the lagging and advanced regions, i.e., the composition of output and employment. In the lagging region, agriculture accounts for almost 30 percent of GDP and 60 percent of employment. Even discounting a likely high hidden unemployment in agriculture, this represents a significant difference from the advanced regions, in which the figures are respectively 12 percent and 27 percent. Agriculture is at the same time the least productive source of employment in the lagging region. This is partly due to strong climatic disadvantages. More specifically, agricultural productivity in the East is about one third of the level prevailing in the West. The gap is somewhat less pronounced in services (39 percent), and industry (45 percent).

89. Raising the level of output per capita in lagging regions even half-way to the levels currently enjoyed by advanced regions, would be a momentous task. The scale of the task can be illustrated by analyzing the conditions under which the per capita GDP gap prevailing in 2000 could be cut in half by the year 2013 (the end year of the current national development plan); that is, per capita GDP in lagging regions be increased from 50 percent to 75 percent of per capita income in advanced regions. At the “baseline” employment rate (55 percent) in lagging regions, a 7 percent annual rate of productivity growth would be required to cut in half per capita income disparities by the end of the current national development plan, assuming the labor force remains in situ. This
is significantly higher than the average annual rate of productivity growth in Turkey as a whole over the period 1991-2003. Slower rates of productivity growth would need to be compensated by fairly large increases in rates of employment (Figure 17). For example, if productivity grows at 4 percent per year, the end-of-period employment rate would need to increase to 80 percent to reduce the gap by half.

Options for Strengthening Regional Policies

90. **A meaningful reduction of income disparities will probably require a significant change in the economic structure of lagging regions.** Bridging the existing productivity gaps between advanced and lagging regions will require a significant reduction in the employment and GDP shares of agriculture, and reallocation of resources to non-farm rural development activities in rural areas, and to industry and services in urban areas.

91. **Empirical analysis conducted in this study points to some key factors affecting long-term regional income disparities:**

- There is strong evidence that human capital matters for regional growth. The regions with higher schooling rates (i.e. quantity of human capital accumulation) tend to grow significantly faster than other regions.

- While the size of the public investment in a region does not impact its growth performance, its composition does. The results point to two findings, although they should be interpreted with caution: (i) public investment skewed towards social spending has a positive association with regional growth performance, while, (ii) public investment skewed towards the primary sector has a negative association with regional growth performance.

- Similarly, the role of incentives in generating regional growth is found to be insignificant—a finding consistent with the finding of limited cost-effectiveness of regional development incentives in generating new jobs discussed earlier as well as the international literature on state aid. The reasons might be the possible short-term duration of the impacts (firms may leave the lagging regions once the incentive expires), the absence of any broader impact on the regional economy (if benefiting firms operate as industrial enclaves) and the tendency of such firms to be highly capital intensive and therefore generate little employment.

92. **Large integrated infrastructure programs have also had limited results.** Starting with South East Anatolia Project (GAP) in the 1960s, during subsequent planning periods, several regional development plans were designed and (partly) implemented. Arguably, regional plans have had the merit of focusing planning efforts on relatively large geographical areas, spanning far beyond the jurisdictions of individual provinces, and attempting to address their common development challenges. The original model has been constrained by a focus on a limited number of sectors and a fairly centralized governance structure. The gradual transformation of GAP into a multi-sector, dual-management (national and local) project signals a change in the underlying development model, which is confirmed by the more integrated approach followed by more recent plans (for example, Eastern Anatolia Project (DAP),
Eastern Black Sea Regional Development Plan (DOKAP)). The future viability of the regional plan model is open to question though, on account of the limited administrative capacity of local executing agencies, of the prevailing governance structure (which appears still fairly centralized), and of funding uncertainties.

93. **The Government is now experimenting with regional development agencies.** The Law on the Establishment, Co-ordination and Duties of DAs at NUTS II level (entered into force in February 2006) sanctions, for the first time in Turkish history, the institutionalization of a regional level of governance. In purely administrative terms, the rationale for the establishment of DAs is the creation of structures legally entitled to manage EU-cofinanced development programs spanning the jurisdictions of multiple provinces, thereby replacing—but only after a yet unspecified “transition process”—the temporary system used at present, which is based on Service Unions.7 As of end-2007, only two DAs were actually established, and the secondary legislation required for their full functioning is still in the process of being formulated. In May 2007, the Council of State issued an injunction on the implementation of the regulation on the working principles of DAs and also referred the case to the Constitutional Court on the basis that some articles of the Law no.5449 are unconstitutional. While the Court’s decision, rendered in November 2007, annulled certain provisions affecting the appointment of staff and tax exemptions, it left the remainder of the law intact. The authorities are now free to establish new DAs and permit the existing agencies to fully operate.

94. **The Government is also considering a “growth poles” strategy.** Within the 9th National Development Plan, the Government has indicated its intention to focus development efforts, within less developed regions, on “centres with high growth potential” – an approach unofficially labelled as the “growth poles strategy.” The rationale is to support the development of urban areas that could divert migration from eastern rural areas, away from the conventional destinations in Western Turkey (in particular Istanbul and Izmir). Official documents indicate that the strategy will focus on 12 poles, accounting for some 20 percent of total 2001 population, and with per capita income of 66 percent of the national average in 2001.

95. **The international literature suggests that, in a market economy such as Turkey’s, the location of labor and capital is largely determined by private economic forces.** Therefore, it is important to recognize market forces as the primary determinant of the location of economic activity in government’s efforts to influence the location of economic activity. The literature—and Turkey’s own experience—also suggests that some of the traditional instruments used by governments to influence the location of economic growth are not particularly effective. Firm-specific investment incentives have a mixed track record. The evidence suggests that such incentives can affect investors’ location decisions, if the incentives are large enough. But they do not guarantee that the resulting investments will have broader multiplier effects on the regional economy or that the investors will remain once the incentives expire.

7 Service unions, established by the Local Authority Unions Law (amended in 2005) consist of an association of provincial and municipal administrations for the joint provision of services over multiple jurisdictions, hence they can be used as management structures for the implementation of regional development programs.
96. There are nevertheless key roles for the public sector in regional development.

- The first is the provision of education. Education, by enhancing skills, productivity, and adaptability, is conducive to long-term economic growth. Other things being equal, this suggests that investment in education is an effective means of stimulating growth in poorer regions. It should be recognized that education can also increase the propensity of people to move. Nevertheless, the development of a critical mass of educated workers in the larger urban areas of the East could improve this area’s attractiveness to investors.

- Governments also play a key role in the provision of infrastructure. Building macro-level infrastructure—power and telecommunications lines, highways, railroads, port and airport facilities—in depressed regions is a time-honored approach to regional development. Although much of the existing literature and the analysis carried out under this CEM do not provide any evidence that physical infrastructure stimulates regional growth, some recent studies argue that under certain conditions public infrastructure investments contribute significantly to productivity growth. The right sort of infrastructure investment can provide a necessary if not sufficient condition for economic growth. What is important is to identify such investments that would exhibit comparatively high economic rates of return.

- Another key role for government is to coordinate and facilitate the development proposals of private investor and public entities. The design and implementation of successful policies to accompany the transformation of lagging regions cuts across sectors and levels of government. The establishment of partnerships among public and private stakeholders alike is needed, to orient and govern this process. This process needs to aim at bridging the gap between knowledge on the constraints to, and opportunities for, regional development (typically more available locally); and the funds required to finance public investments (often provided centrally).

97. Under the existing institutional structure of the Turkish public sector, it would be difficult to take charge of the third role above. Turkish public sector is highly centralized, with most spending decisions taken by ministries headquartered in Ankara. Local governments have relatively few functional responsibilities and limited bargaining power. At the same time, national sectoral ministries tend to operate in sectoral stovepipes, without considering the wider economic development implications of their actions or possible synergies with other sectors.

98. The current planning system offers a place to start. Turkey has a system of multi-level development planning spanning different levels of government and aimed at different objectives. The 9th National Development Plan stipulates that an overarching regional development strategy will be prepared at the national level. While SPO has primary responsibility for regional plans, there are a number of other planning instruments, at other territorial levels, that affect regional development outcomes. At lower levels of jurisdictions, Provincial Development and Provincial Territorial Plans (and more recently, strategic planning for Special Provincial Administrations and larger Municipalities) are intended to guide the selection of projects at a more micro level.

---

The proposed DAs could also provide a venue and mechanism for inter-sectoral and central-local coordination. Such a role, for example, is played by regional DAs in England. The private sector (represented both in the DAs' Development Council and Executive Board) could provide an important input through its knowledge of where the market development opportunities are, what are the constraints to seizing them, and what are the priority public investments that would help removing those constraints. However, how large a role DAs should play in regional development is still an open question. Current legislation limits the authority of the DAs. The preparation of regional development strategies are envisaged to be led by SPO. The financial power of DAs is also limited. With an estimated average annual budget of some €19 million per agency, DAs will have only a small financial role in regional development. The effectiveness of DAs will instead crucially depend on the active participation of local stakeholders and the technical/administrative capacity of their staff. These assets may be in short supply in some of the regions with limited traditions of public participatory processes and insufficient experience in decentralized management of development programs.