

**Turkey: Economic Developments, Prospects, Opportunities, Challenges**  
**Gaziantep: Chamber of Industry, October 10, 2010**

OPEN:

- Thank you for coming. My name is Ulrich Zachau. I am the Country Director of the World Bank in Turkey.
- My talk today is about “Current Economic Developments”... but before that let me briefly introduce our institution, the World Bank, to give you an idea of how we try to understand Turkey and its economy.

Introduction to the Bank

- The WB is *both a development institution and a bank*. We can see this—that we both are a bank and promote development—in our owners, in our goals, and in what we do/our instruments.
- First, our owners. Our owners are the governments of 187 countries. So the World Bank is a publicly owned multilateral institution. And we are global.
- Second, our goals. Our objective is to help countries *improve the lives of their people* – this is what we mean by “development.” We do not make a profit. Any money we make on the loans we give back to the poorest countries in the form of development assistance.
- Third, our activities and instruments, what we do.
  - Like other banks, we lend money and we get repaid. We lend at a loss to poor countries and we lend at break-even to countries like Turkey.
  - We lend money for projects – energy, infrastructure, health, education, etc. We also lend money for government budgets, when governments are implementing good policies for improving living standards.
  - Like some banks, we also advise our clients—but we advise governments on economic and social policies, not private citizens on investments.

- Lastly, we also promote global public goods. For example, the World Bank advocates good policies on climate change and on international trade.
- In Turkey we do all these things...
  - During 2008-11, we are lending nearly 8 billion US dollars to the Turkish government and to Turkish firms, through credit lines with Turkish banks.
  - Here in Gaziantep, for example, 22 SMEs have received \$9.2 million of loans from our SME credit lines, through intermediary banks.
  - And on our advisory work, you will hear about some of it today.
  - Just to give you a couple of examples in addition to today's report on female labor force participation: we have completed or are completing joint work with the government on labor markets, on informality, on the investment climate, on developing corporate bond markets, on energy efficiency, on food safety, on saving and growth, on health, and so on.

### The Current Economic Situation

- **Now to today's topic: what are our views on the current economic situation?**
- Turkey suffered, as did other countries, from the impact of the recent global credit crisis. The economy shrank by 4.7% last year, quite a big hit.
  - To give you an idea, that meant that Turkey was ranked in the bottom 10 percent by growth in 2009.
  - Another statistic: unemployment in Turkey reached 16% in early 2009, and nearly 30% among youth, ages 15-24. That is very high by international comparison, and I'll come back to Turkish labor markets later.
- Why was Turkey hit by the crisis? We think there are three main reasons.
- First is that Turkey was already slowing down in 2008. Companies had invested a lot and built up stocks and confidence was already falling, so global events magnified a slowdown that was already happening.
- Second, Turkey happens to export a lot to the EU (about half its exports) and you all know that the EU was one of the centers of the credit crunch.

- Also, Turkey exports things like white goods (fridges and so on) and cars; these are not the things people buy in the middle of a recession!
- Lastly, Turkey borrows a lot from overseas to pay for its investments. In late 2008 this caused a lot of uncertainty in Turkey about whether some firms would face problems with their banks. In the end things were not as bad as some people, and some of us, had feared.
- Now the good news... Turkey has bounced back quickly. Turkey was growing again by the 2<sup>nd</sup> quarter of 2009.
  - Our economic team estimates that growth this year will be higher than 7% and could even reach 8% – in other words we're now above where we were before the crisis.
  - Unemployment has come back down. It's still 1.0% or 1.5% higher than before the crisis, and it's still quite high, but most of the rise that took place in 2008 and 2009 has disappeared.
- Why did Turkey bounce back so fast? The key reason is the structural reforms since 2002, in response to the 2001 crisis in Turkey, which was a crisis "made in Turkey" (unlike the last one, which was "made in America").
  - The financial system is now in good shape, banks have enough capital to lend (Turkish banks are actually among the best capitalized in Europe, with capital ratios of about 20% of their lending, on average).
  - Second, the government has built a track record of reducing its debt and managing the economy well. Between 2002 and now the national debt has about halved. Investors see Turkey as a well-run economy they are interested in putting their money into.
  - Third, Turkey's firms are also in good shape. The financial crisis has in a sense tested Turkey's private sector and it passed the test.
    - Those debts overseas proved to be manageable; Turkish firms' balance sheets are actually quite healthy.
    - And the strengths that made foreign banks and investors interested in Turkey before the crisis – its entrepreneurialism; its strategic location; the size of its domestic market – keep them interested today.

- What next?

## The Short Run

- In the short run, the “bounce-back” has now happened; **we are back to more normal-looking numbers** concerning output, growth, and employment... the economy cannot keep booming at 7%; **there are simply too many constraints**.
  - **One constraint is export growth**. In the first half of 2010 Turkey’s exports bounced back somewhat from their slump; they grew by 14% over the first half of 2009. But now they are much more sluggish. In the third quarter of 2010 Turkey’s exports fell by 6% on the second quarter.
    - By the way, **here in Gaziantep** exports are doing better, indeed last quarter, while Turkey’s fell by 6%, Gaziantep’s exports grew by 10% on the 2<sup>nd</sup> quarter: well done! Of course Gaziantep is exporting more goods to the east rather than the west; this may have helped.
    - The more Turkey can build on the success of places like Gaziantep, the more it can diversify and shield itself from economic volatility and risk.
  - **Another is the inventory cycle** . From the 4<sup>th</sup> quarter of 2008, when the extent of the global crisis began to reveal itself, Turkish firms rapidly ran down inventories, knocking up to 3 percentage points off GDP. In other words, destocking was responsible for a big chunk of the slowdown in Turkey. That process has also reversed itself. From the 3<sup>rd</sup> quarter of 2009, firms rapidly re-accumulated stocks of inventories. In the last year, that process has also been responsible for some 3% of GDP growth. But this process – which magnifies volatility and deepens the business cycle – has now essentially played itself out. The inventory cycle in Turkey normally lasts about 2 years; so based on these patterns it will soon now weaken growth rather than strengthen it.
  - **A third factor is the uncertainty that next year’s elections will likely bring**, as in most countries, and a wait-and-see approach by many investors.
- **What can Turkey do about these factors?** Not much... stick to its framework...
  - inflation targeting
  - an independent central bank

- a floating exchange rate
- medium-term fiscal planning – and prudent debt ratios.
- Turkey has been doing these things well for a number of years now. So there's always a danger they are taken for granted... they should not be.
- Turkey deserves a great deal of credit, after years of having failed to put in place this kind of – we could call it “macroeconomic infrastructure” – and it remains crucial that this be protected as Turkey moves onto a more advanced and ambitious reform agenda.
- Let's think about that longer-term agenda... We've seen since 2001 that even when things are going well Turkey still faces some challenges...
  - For example, unemployment has rarely dipped below 10 percent, even in the “good times” – by which I mean periods of high growth.
  - And before the recession hit, energy supply was threatening to become a constraining factor on the Turkish economy; and could soon be again.

### The Link between the Short Term and the Long Run

- Those two facts give us clues about Turkey's key long-term challenges: one, the competitiveness of its labor force; two, the long-run sustainability (environmental, financial, and social) of its economic growth process.
- **Let's start with labor - jobs.** There are ***two dimensions*** to making Turkish labor more competitive. ***One*** is bringing *more* people into the labor force.
  - Turkey, along with Mexico, has the most restrictive laws governing flexible labor contracts (like part time and short term work) and hiring and firing. These restrictions stop firms from hiring and then training and retaining new workers, especially young workers and female workers.
  - **By the way, women's participation in the labor force is a particular issue here in Gaziantep.** The female labor force participation rate in Turkey as a whole in 2009 was 26%; here in the region covering Gaziantep, Adiyaman and Kilis, female participation is only just over half that, at 14%. (Although it has been rising... in 2005 it was 8%, the lowest in the country).

- The **second dimension is education**... not just school-level education but what happened before and after.
  - In the short-run, the World Bank is working with the government (Işkur) on making vocational training more effective at getting people into jobs.
  - For the long term, what happens in the first few years of education is critical for increasing the achievement and employability of young Turkish workers. So we're also working with the government on early childhood education.
  - Almost everybody in **Gaziantep** goes to primary school. However, despite recent progress enrollment in preschool and secondary education are still below the national average (24% versus 39% in preschool education; 53% versus 65% in secondary education).
  
- The second key challenge for Turkey in the long run that I would like to mention is **rebalancing its energy use so it can meet energy demand in a way that is physically feasible and secure, is clean, and is affordable**.
  - So Turkey can make itself more **environmentally sustainable**: moving away from carbon-intensive technologies that Turkey has to import towards less carbon-intensive technologies in which Turkey has an advantage, like geothermal, wind, and solar energy.
  - And so that the **financing of energy also becomes more sustainable**: that means relying less on importing hydrocarbon sources of energy and leaning more towards sources of energy that Turkey has natural advantages in, like wind, geothermal, and solar.
  - Here in Turkey, because Turkey still depends so much on traditional, carbon-heavy energy imports, these two things go together: making energy production and use cleaner and making it more secure and affordable in the long run. This is not true everywhere, but it's true in Turkey.

- **Clean and efficient energy is also an issue specifically for Gaziantep.** The World Bank has chosen Gaziantep as a pilot for the rapid stocktaking of the energy efficiency of cities. This is only the second such city pilot worldwide and it will be done in collaboration among the city of Gaziantep, Ilier Bank, and the World Bank. This pilot will look at various public sector activities, including transportation, buildings, public lighting, water and wastewater services, power and heating, and solid waste. And it will compare the energy efficiency of Gaziantep with a range of cities globally, and provide options for areas that the city government can focus on to improve the overall sustainability of the city.

## Conclusion

- Let me recap with **three main messages...**
- **First: The economy is on a sound footing.** Fundamentals are strong. Let's always keep in mind the progress that Turkey has made! The challenge now is not to let things be taken for granted, to maintain these achievements.
- **Second:** in the short run, let's not expect miracles. There are global factors which will make it unlikely that Turkey will maintain a very high pace of growth in the coming year or so. Moderate growth is fine under these circumstances (e.g., our estimates of growth this coming year are in the 3% to 4% range).
- **Third:** Turkey faces some big long-term challenges, which have huge long-run effects but also have more immediate implications too...
  - The most important challenges here are in education (improving quality);
  - skills (focusing on youth unemployment);
  - and making regulations more flexible to allow firms to employ all workers.
- These challenges are not only important in the long run for Turkey, for its productivity and competitiveness, but also in the short run, to maintain reform momentum on the many policy areas I have described.
- Thank you.