



Main Report

MEMBER COUNTRY PARTNERSHIP STRATEGY

OF THE IDB GROUP

FOR

TURKEY

2010-2013G / 1431-1434H

Rajab 1431H

June 2010G

CURRENCY

Currency Unit = Yeni Turk Lirasi (YTL)—New Turkish Lira
 US\$1.00=YTL 1.59 (Exchange Rate as of June 1, 2010)

FISCAL YEAR (TURKEY)

January 1-December 31

ABBREVIATIONS and ACRONYMS:

BOT	: Build Operate Transfer
BRSA	: Banking, Regulation and Supervision Agency
COMCEC	: OIC Standing Committee on Economic and Commercial Cooperation
CPI	: Consumer Price Index
EU	: European Union
FDI	: Foreign Direct Investment
GDP	: Gross Domestic Product
GFCF	: Gross Fixed Capital Formation
GNS	: Gross National Savings
IBRD	: International Bank for Reconstruction and Development
ICA	: Investment Climate Assessment
ICD	: Islamic Corporation for the Development of the Private Sector
ICIEC	: Islamic Corporation for the Insurance of Investment and Export Credit
IDB	: Islamic Development Bank
IDB GROUP	: IDB, ICIEC, IRTI, ICD, ITFC
IRTI	: Islamic Research and Training Institute
ISMEP	: Istanbul Seismic Risk Mitigation Project
ITAP	: IDB Group Investment Promotion Technical Assistance Program
ITFC	: International Islamic Trade Finance Corporation
JDP	: Justice and Development Party
L/C	: Letter of Credit
LDMC	: Least Developed Member Country
MC	: Member Country
MDB/MDI	: Multilateral Development Banks/Institutions
MoU	: Memorandum of Understanding
MTP	: Medium Term Program
NDP	: Ninth Development Plan
OECD	: Organization for Economic Co-operation and Development
OIC	: Organization of the Islamic Conference
PISA	: Program for International Student Assessment
PMU	: Project Management Unit
PPP	: Public Private Partnership
R&D	: Research and Development
SME	: Small and Medium Enterprise
SPV	: Special Purpose Vehicle (Entity)
TCDD	: Turkish State Railways
TEPAV	: Economic Policy Research Foundation of Turkey
TIKA	: Turkish International Cooperation and Development Agency
TOBB	: Union of Chambers and Commodity Exchanges of Turkey
TURKSTAT	: Turkish Statistical Institute

Member Country Partnership Strategy (MCPS) for Turkey

Table of Contents:

Executive Summary	
I.	Introduction _____ 1 Purpose, objective and key aspects of process for preparing MCPS
II.	Country Context, Recent Economic Trends and Challenges _____ 2 A. Socio-political-historical context B. Recent economic trends and challenges C. Structural weaknesses versus strong economic performance in the 2001-2008 period D. Key constraints to economic growth and employment in the medium term
III.	Turkey's vision, development challenges and priorities _____ 13 A. Ninth Development Plan (NDP) 2007-2013 a. Increased competitiveness b. Increasing employment c. Strengthening Human Development and Social Solidarity d. Regional Development e. Increased quality and effectiveness of public services B. Medium Term Program (MTP) 2010-2012—mid-term adjustment of priorities in wake of global crisis C. Risks to Government strategy
IV.	Elements of IDB Group Partnership Strategy _____ 16 A. Past interventions by the IDB Group to Turkey B. Lessons learned from past IDB Group interventions in Turkey C. Other Development Partners D. Strategic Framework for aligning NDP objectives with IDB Group Vision E. Areas for Future Engagement by IDB Group i. <u>Supporting growth through Infrastructure Development</u> a. Energy b. Transport c. Disaster Management

	<ul style="list-style-type: none"> d. <i>Financing infrastructure projects through public-private partnerships</i> ii. <u><i>Enhancing Human Development through Education</i></u> <ul style="list-style-type: none"> a. <i>Improving the quality of education through pre-school education</i> b. <i>Vocational Training</i> iii. <u><i>Raising Employment through Private Sector Development</i></u> <ul style="list-style-type: none"> a. <i>Addressing barriers to growth of SMEs</i> b. <i>ITFC & ICIEC Role in Trade Finance and Insurance</i> c. <i>Development and diversification of financing instruments including Islamic Finance & IRTI Role</i> iv. <u><i>Reverse Linkage-Support Turkey can provide to other Member Countries</i></u> 	
	F. Indicative MCPS Program and Potential Areas of Collaboration with Other Development Partners	
	G. Items for Future Dialog and Next Steps	
V.	Risks and Uncertainties	41
VI.	Conclusion and Way Forward	43

Annex:

- 1- Strategy of the Ninth Development Plan
- 2- Strategic Framework for Turkey MCPS
- 3- Results Matrix
4. Turkey's Profile at a glance-Key Facts and Figures (including Map)

MCPS Task Team Members

Country Department (Coordinator):

Director	Rami M. Saeed Ahmad
Division Manager	Hikmat Aliyev
Lead Economist	Irfan Aleem
Country Manager for Turkey	Bahadir Yadikar
Young Professionals	Ahsanul Kibria Ali M. Khan

IDB Group Entities and Departments:

Entity/Department	Representatives
ICIEC/ITAP	Bessem Soua Khalid Khalafalla
ICD	Himmatilla Boriev Kazi Hussain
ITFC	Ayhan Karaca Harun Celik Ahmet Gundogdu
IRTI	Mehmet Fehmi Eken
The Chief Economist Complex	Nosratollah Nafar
Group Strategic Planning Department	Intikhab Alam
Treasury Department	Mohammad Saeedullah
Group Risk Management Department	Ariful Alam Chowdhury
Islamic Financial Services Industry Department	Wasim Ahmed Abdulwahab
Infrastructure Department	Farid Khan (Energy) Belkacem Ouzrourou (Transportation) Nizar Zaied (Urban Development) M. Hasan Mahmud (PPP)
Human Development Department	Mohamed Ali Taure (ST&TC) Makha Ndao (Education) Sadiq Mohammed Tayeb (Health)

Executive Summary

Preparation of the Member Country Partnership Strategy (MCPS) is a key priority under the IDB Group Reform agenda and represents a paradigm shift in the way IDB Group will be conducting its core business of developmental lending and support. The MCPS will form the foundation of the Bank's future dialog with MCs. It will set out the IDB Group's diagnosis of the member country's development situation and a selective program of planned Bank Group support tailored to the country's development objectives and the Group's development expertise and resources as well as the activities of the other development partners.

The MCPS process is designed to enable the IDB Group to form a partnership with the MCs consistent with the development priorities of MCs and the IDB Group 1440H Vision and strategic thrusts. This alignment between MCs and IDB Group priorities is ensured through a participatory consultation process with the MCs, international development partners and other stakeholders through identification of demand-driven, efficient and timely interventions (including Islamic Banking and Financial Services) consistent with IDB Group's comparative advantage/niche to enhance development impact and regional economic integration of MCs.

The IDB Group has undertaken the MCPS process for Turkey as a pilot initiative. The rationale for starting with Turkey include its importance as the largest economy in the OIC, a rising regional power strategically situated between east and west, the strong interest demonstrated by the Turkish Government, the availability of detailed economic data, and its importance for diversifying IDB's portfolio as well as enhancing the partnership with the IDB Group. Moreover, the lessons learned during this process would benefit the preparation of MCPSs for other MCs.

This MCPS is anchored on the priorities of Turkey's Ninth Development Plan 2007-2013 and takes as a starting point an economy that is turning around and performing better than expected in the wake of the global crisis because of the measures implemented by the Government in its Medium Term Program (2010-2012). These measures—including a fiscal stimulus, monetary easing, and enhancing availability of credit—helped the economy emerge from recession in the second quarter of 2009, and returned to growth by the fourth quarter of the year in which it grew at an annualized rate of around 6%. Growth momentum has continued into 2010, underpinned by strong domestic demand, better export performance and continuing effects of Government stimulus.

The prospects for achieving the 7% economic growth target of the NDP, however, hinge on how key sectors of the economy, especially the labor-intensive industries like textile and clothing that were the engine of growth in the 2001-2007 period, invest and restore their competitiveness in the face of structural challenges facing the economy. The latter include raising private savings, further development of human capital to provide needed skills, overcoming infrastructural bottlenecks, absence of long-term finance, and constraints to SME growth. The traditional industries, dominated by SMES, traditionally accounted for a large share

of employment and exports. These industries have lost their competitiveness in both domestic and international markets and their ability to adjust has profound implications for employment and growth, and for attracting foreign investment into the real sector in coming years.

This MCPS is a partnership based on four pillars—Supporting Growth (through Infrastructure Development); Enhancing Human Development (through Education), Raising Employment (by Private Sector Development), and (iv) "Reverse Linkage" (in the form of support Turkey can provide other MCs) – supported by a financing envelope of US\$ 2.0 billion for the 2010-2013 period, and arrangements for cooperation. Two IDB Group missions, including representatives from ITFC, ICD, ICIEC and concerned departments, visited Turkey during January and March 2010 to hold discussions on the MCPS with the Government, other development partners, the private sector and civil society. The missions, led by the President of the IDB Group for the policy dialog part, received an overwhelmingly positive response from the Government and resulted in the signing of a Memorandum of Understanding (MOU) indicating commitment of IDB Group to the process. The strategic framework (Annex 2) illustrates the essence of the MCPS process.

A unique feature of this MCPS is the emphasis on “reverse linkage” to capitalize on Turkey's experience in areas where it has accumulated a high level of expertise. The eventual outcome of these interventions would also lead to a resource transfer much larger than the amount of funding provided by IDB Group through technical cooperation and grants under this framework.

The Government has indicated that its main interest is in seeking financing for large projects and programs which is consistent with IDB Group's objective to scale-up. While a sizable financial envelope for IDB Group interventions, in 2010 – 2013, is planned for this MCPS, the actual financing amounts, however, will be determined in the programming phase taking account of country needs, Government priorities and growth scenarios for the Turkish economy.

During consultation with development partners, following areas were identified as possible areas of cooperation: (i) Vocational and pre-school education and disaster management with World Bank; (ii) Transport and energy with European Investment Bank; (iii) Public private partnerships with European Bank for Reconstruction and Development (EBRD). IDB Group will share final MCPS document with the “Coordination Group¹” to explore areas for cooperation.

The four key expected outcomes from the Turkey MCPS process include the following: (i) Government ownership of the planned multi-year program tailored to the NDP objectives. (ii) Harmonization of IDB Group's program with that of other development partners in Turkey (iii) A focus on impact and results by engaging Government in a strategic dialog to address key constraints that it is facing in achieving its development goals, and (iv) Leveraging internal IDB Group synergies through consultations and focus on niche areas.

¹ The Coordination Group consists of (i) Abu Dhabi Fund for Development; (ii) Kuwait Fund for Arab Economic Development; (iii) OPEC Fund for International Development; (iv) Saudi Fund for Development

I. INTRODUCTION

1. **The preparation of the Member Country Partnership Strategy (MCPS) for Member Countries (MCs) is a key priority under the implementation of the IDB Group reform agenda.** The MCPS, which will form the foundation of the Bank's future dialog with MCs, will set out the Bank's diagnosis of the country's development situation and a selective program of planned Bank Group support tailored to the country's development objectives, the Group's competitive advantage and the activities of the other development partners.

2. **The design of the MCPS process embodies the unique value added which IDB Group could provide to MCs in a strategic partnership to align MC priorities with the priorities identified in the 1440H vision.** This alignment of MC and IDB Group priorities calls for a process of consultations, internally and externally with the client and other development partners, on IDB Group's comparative advantage and niche, which are as important as the final MCPS document. The knowledge generated through these consultations will be a great asset in changing mindsets and the way MCs perceive IDB Group.

3. **The MCPS for Turkey is part of the first set of MCPSs that IDB Group is launching.** The rationale for starting with Turkey include its importance as the largest economy in the OIC, a rising regional power located strategically between the east and west, the strong interest shown by the Turkish Government, the availability of good information on Turkey and its importance for diversifying IDB Group's portfolio. Moreover, the lessons learned during this process will benefit the preparation of MCPS for other member countries.

4. **This Report seeks to achieve several objectives.** First, it introduces the country situation and key economic and development challenges faced by Turkey. Second, it outlines as a starting point Turkey's development vision, strategy, and its priorities in the medium-term. Third, it records the consensus on key elements of the Turkey-IDB Group partnership: lessons learned from past IDB Group interventions in Turkey, a strategic framework for aligning Turkey's goals with the IDB Group Vision, areas for future engagement taking account of the activities of other development partners and lessons of experience, and the proposed scale of financing. Lastly, it assesses implementation risks in the four key expected outcomes of the MCPS process—Turkey's ownership of the proposed interventions, alignment and harmonization of the program with other development partners, impact and results, and leveraging of internal IDB Group synergies--and measures to mitigate these risks.

II. COUNTRY CONTEXT, RECENT ECONOMIC TRENDS AND CHALLENGES

A. SOCIO-POLITICAL-HISTORICAL CONTEXT

5. **Turkey, with a population of 73 million, is located strategically at the confluence of the Mediterranean, Aegean and Black Seas.** In 2008, Turkey ranked as the 17th largest economy in the world with a nominal GDP of US\$734.9 billion. Turkey, with a GDP per capita of US\$9,942 (in current US\$) in 2008, is a high middle-income country with country rating from all major ratings agencies: Moody's Ba2; S&P BB; Fitch BB+. Over 70% of its people live in urban areas. Agriculture accounts for some 9% of its GDP, industry for 26%, and services for 65%. Textile & apparels and automotive are the leading export sectors.

6. **Turkey is the only IDB member country represented in the OECD, and is a candidate for the European Union (EU) membership.** The accession negotiations to the European Union started at the end of 2005 after Turkey had complied with Copenhagen political criteria (for strengthening democracy and rule of law and implemented reforms in the area of human rights, expression of ideas, and freedom of speech) and Copenhagen Economic Criteria (existence of a market economy and ability to cope with EU competitive pressures). Accession negotiations are ongoing with 10 out of 35 chapters of European Legislation now complete and prospects for EU accession remains a significant anchor for political and economic reforms in Turkey. Turkey initiated a customs union with the EU in 1996 and harmonized legislation related to business activities in areas including customs, standards and business start-up documentation.

7. **After a decade of unstable coalitions in 1990s, a single party Government, the Justice and Development Party (JDP), has been ruling since November 2002.** The JDP has secured a majority in the Grand National Assembly in 2007 elections. Next elections are scheduled for July 2011. Most of the executive powers are concentrated in the Cabinet of Ministers.

B. RECENT ECONOMIC TRENDS AND CHALLENGES

8. **Turkey made remarkable progress in economic management between 2002 and 2007 greatly improving macroeconomic stability and facilitating strong economic growth.** In the wake of the 2001 economic crises, the Government implemented tight fiscal and monetary policies-- including a decline in the budget deficit from 12.8% of GDP in 2001 to 1.6% in 2007-- and enacted financial sector reforms to improve macroeconomic stability and strengthen the banking sector. A dynamic external environment complemented these reforms, by boosting exports, and attracting foreign capital. The impact of these reforms is visible in the impressive achievements attained over 2002-2007. Economic growth accelerated to an average rate of about 7% per annum while the rate of inflation fell (annual increase in CPI) from 68.5% in 2001 to 8.4% in 2007. During this period, exports grew at an impressive rate of 9% per annum in real terms, gross fixed investment increased from around 16% to over 21%, public debt declined from

over 74.1% of GDP in 2001 to 39.5% in 2007. Total external debt, public and private, also fell from 80% of GDP in 2001 to less than 40% in 2007.

9. **Turkey complemented sound macroeconomic policies in 2002-2007 with structural reforms to reduce the role of the state and improving the business environment for private investment.** Privatization was encouraged and the Government implemented policy reforms to improve the business environment. This helped to shift the composition of exports from low-value added to higher- value added products in line with the country's policy of industrialization and increasing global competitiveness. This transformation along with an improved business environment led to high private investment and consumption in both the industrial and services sectors, which underpinned high growth rates. Foreign direct investment also went up sharply.

10. **In the wake of strong economic growth, poverty has declined.** Extreme poverty - measured by food poverty and income per person per day less than 2.15 US\$ per day- is almost nonexistent in Turkey. However, inequality - measured by the Gini coefficient - remains relatively high—the coefficient for Turkey is around 40, compared with 25-30 for most EU countries.(see Table 1 below)

Table 1: Poverty and Inequality Indicators

Methods	Poverty Headcount (%)						
	2002	2003	2004	2005	2006	2007	2008
Food Poverty	1.35	1.29	1.29	0.87	0.74	0.48	0.54
Complete Poverty (food+ non-food)	26.96	28.12	25.6	20.5	17.8	17.79	17.11
Below 1 US \$ per capita per day	0.2	0.01	0.02	0.01	0.00	0.00	0.00
Below 2.15 US \$ per capita per day	3.04	2.39	2.49	1.55	1.41	0.63	0.47
Gini Coefficient	0.43 ^a	-	-	0.43 ^a	0.43 ^b	0.41 ^b	-

Source: Turkstat , ^aWorld Development Indicators, ^bTurkstat

11. **2008-Present: Despite the prudent macroeconomic management policies during 2002-2007, the 2008 global financial crises triggered a major downturn in the real economy.** There was a significant drop in exports, accompanied by difficulty in accessing foreign financing: the large inflows, which peaked in the second quarter of 2008 at around 35 % of exports, not only disappeared, but also replaced by the end of 2008 by sizable net outflows. The ensuing increasing uncertainty in-turn led to a delay in investment and consumptions decisions. The impact was a substantive contraction in the economy equivalent to 4.7% of GDP, adding to unemployment, which reached 14.0% in 2009 compared to an average of 10% in recent years. The fiscal deficit increased to 5.5% in 2009, leading to a rise in public debt from 39.5% of GDP in 2007 to 47.3% in 2009. However, inflation remained subdued and on a downward path allowing the central bank to lower its key interest rate to below 10%--a record low since 2000.

12. **The Government has taken significant measures to alleviate the impact of the crisis, and the economy appears to be turning around and performing better than expected.** The Government took several measures, including a fiscal stimulus, monetary easing, and enhancing

availability of credit and the economy has performed better than expected in emerging out of the crises. It came out of recession in the second quarter of 2009, and returned to growth by the fourth quarter of the year in which it grew at an annualized rate of around 6%. Growth momentum has continued into 2010, underpinned by strong domestic demand--private consumption grew by 4.7% in the fourth quarter of 2009 supported by recovering exports and tax incentives, together with a surge in Government spending of 17.9% in the same period provided additional stimulus. GDP is expected to grow by 6% in 2010.

13. **Exports, which fell by around 23% in 2009, and confidence are recovering but so are concerns about inflation.** Exports grew by 6.4% in the fourth quarter of 2009 but so did imports, which rose by 10.5% in the same period and 28.3% in February of 2010. As a result, the current account deficit was 33.8% higher in February 2010 compared to a year earlier. The recovery is becoming more broad based with consumer and investor confidence improving, unemployment stabilizing (at 14.5% in February 2010 compared with 16.1% in mid 2009), foreign inflows recovering, and industrial output rising. However, concerns about inflation, which has been on an upward trend since the last quarter of 2009, are rising with the CPI for May 2010 9.1% higher than a year earlier. Also strong indicators of growth in the first quarter of 2010 reflect expansion from a low base and numbers are likely to decrease in the second half of 2010.

C. STRUCTURAL WEAKNESSES VERSUS STRONG ECONOMIC PERFORMANCE IN 2002-2008

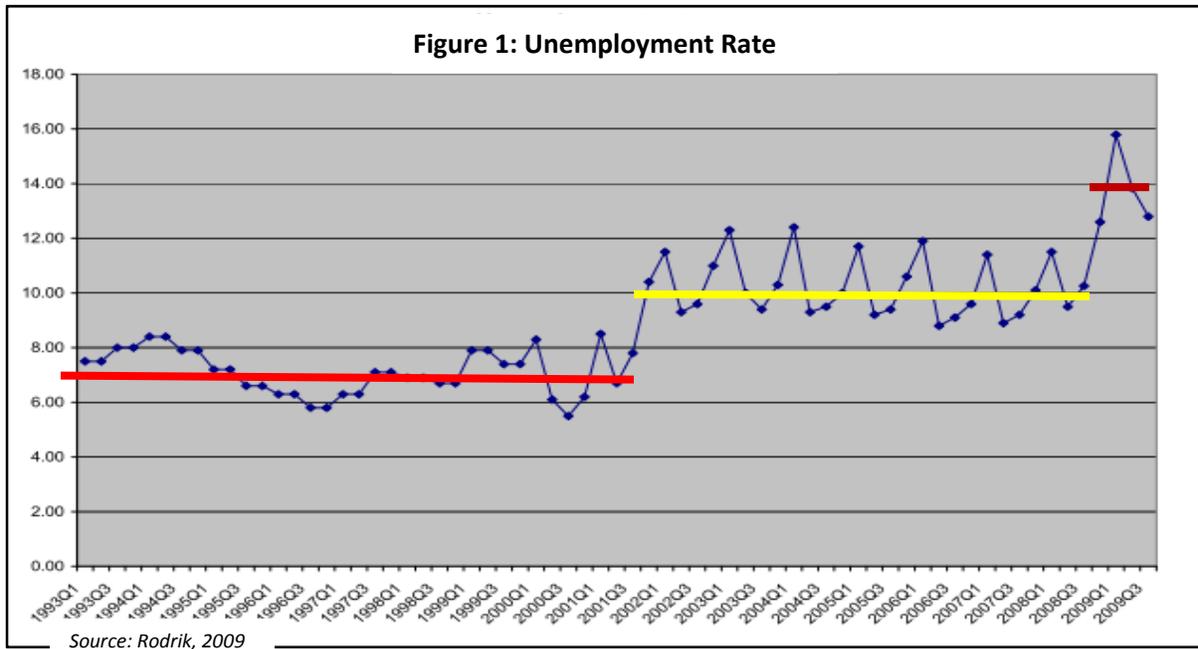
14. Underlying the performance of the economy over 2002-2008 are structural vulnerabilities that will pose challenges to growth and employment in the years ahead. There are several trends observed during 2002-2008, which raise concerns about the apparent strength of the economy in this period: (i) underutilization of human resources, (ii) relatively low levels of investment, (iii) low educational attainment relative to comparator OECD countries, and (iv) a sub optimal composition of foreign direct investment (FDI).²

i. Underutilization of Human Resources

15. *Despite the relatively strong average growth performance, the impact on employment remained limited:* the average annual increase in employment over the period from 2002 to 2007 was merely 0.4%, while the unemployment rate averaged around 10%. A review of the rate of unemployment since 1992 shows a worrying tendency for the unemployment of country to ratchet upwards. From an average of 7% during 1990s, it climbed to a new range of 9-12% following the 2001 crises, and stood at about 10% before rising to 14% in 2009 following the onset of the global financial crisis.³ Particularly worrying in this context is the downward trend in the labor force participation rate, especially among women affected by Turkey's structural transformation--the workforce participation rate in 2010 was 48% compared to more than 60% for most EU countries-- and the high unemployment rate among the youth (about 24% in 2009).

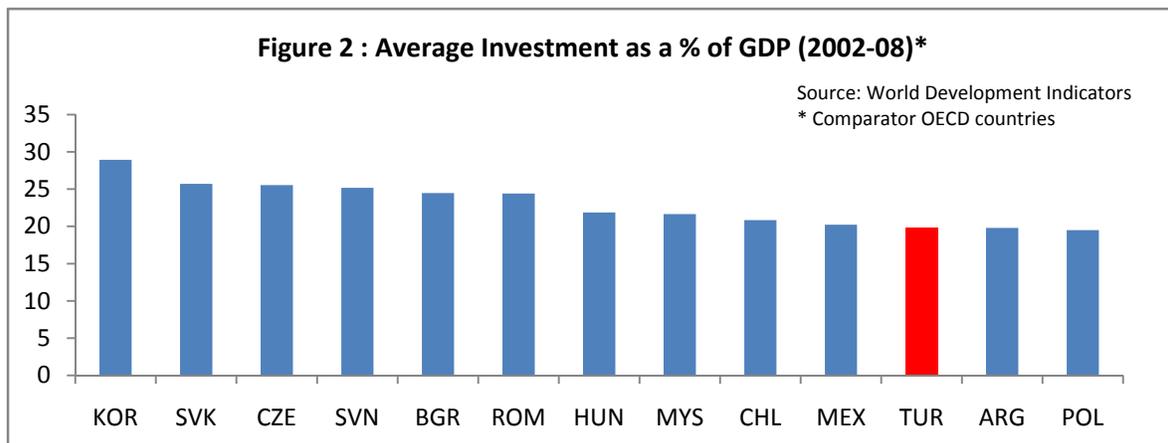
² Rigidities in labor market and the large share of informal economy are also considered significant issues.

³ A reduction in agriculture sector's share in GDP, from 12% to 9%, which currently employs 26% of the total work force, contributed to the slow increase in employment over 2001-2008.



ii. Relatively Low Levels of Investment

16. *Investment levels have remained low according to several measures.* Investment levels, which averaged 19.8% of GDP over 2002-2008, did not meet both the Ninth Development Plan target of 24% and the 28% level seen by some analysts as optimal level for Turkey⁴. Investment levels do not even fare well in comparison to other comparator countries—see graph.



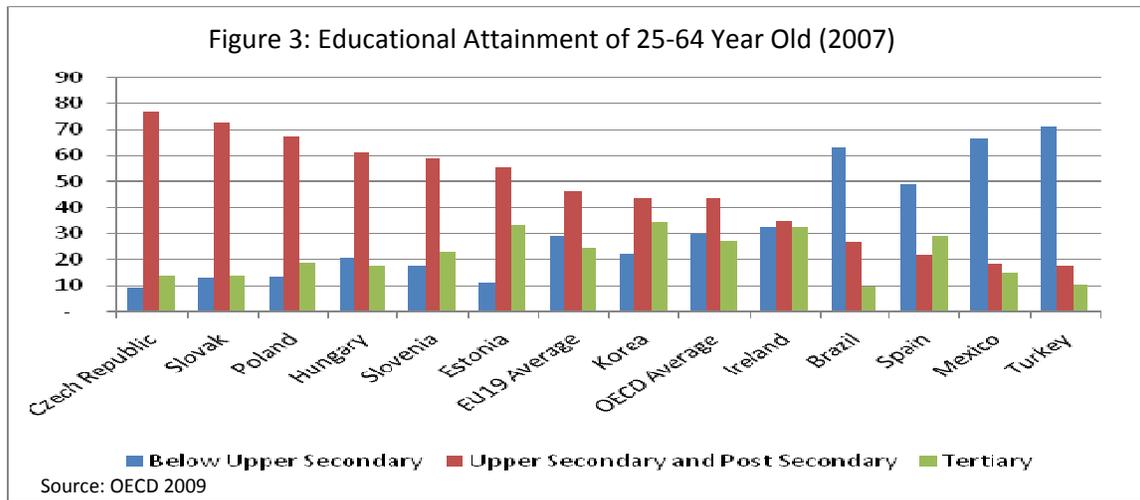
iii. Low Educational Attainment relative to comparator OECD countries

17. *While education attainment in Turkey is high relative to OIC countries, it is low relative to comparator OECD countries.* More than 70% of the working-age⁵ population had an education level of lower secondary or below, while less than 20% attained upper and post secondary education in 2005. This was low relative to the OECD average and comparator countries all of

⁴ Rodrik, Dani: The Turkish Economy After the Crisis (2009)

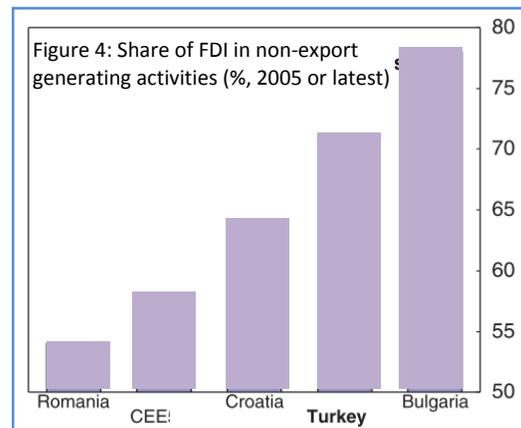
⁵ Taken as 25 to 64 year olds in the population for the cited study.

which have higher shares than Turkey of the working population with upper and post secondary population (see figure, source: OECD, 2009):

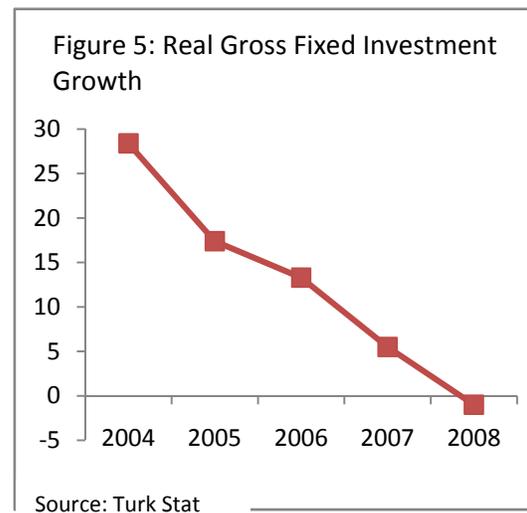


vi. Sub-optimal Composition of Foreign Direct Investment

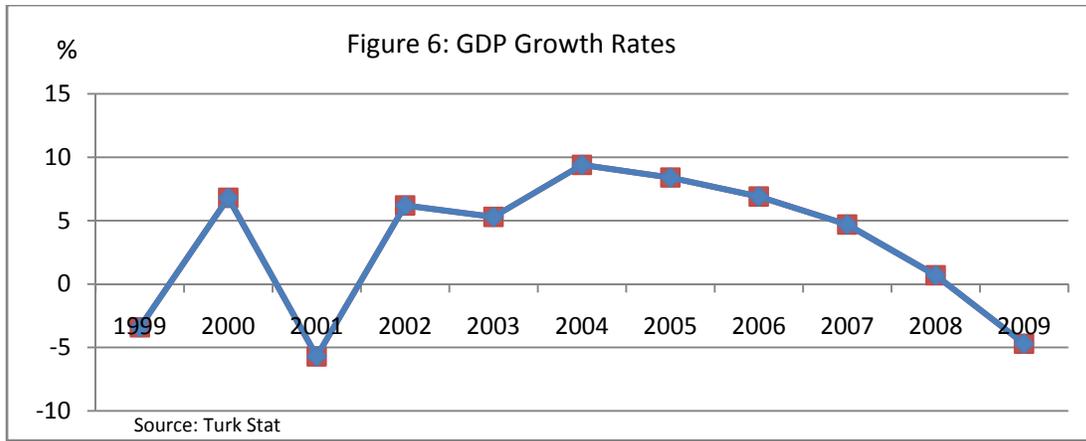
18. *Most of the foreign direct investment inflows appear to have gone into non-export generating activities.* In 2008, about 68.2 percent of foreign direct investment took place in non-tradable services sector (including banking, retail trade, energy and telecom) while only 25.7 percent went directly into manufacturing, which represents nearly 90% of the total exports.⁶



19. The steady decline in the rate of GDP growth and real investment growth in the 5 year period, 2004-2008, well before the onset of the global financial crisis is symptomatic of these underlying weaknesses--see figures 5 and 6.



⁶ It is also not clear if FDI funded services helped exports—e.g. electricity costs remain relatively high.



D. KEY CONSTRAINTS TO ECONOMIC GROWTH AND EMPLOYMENT IN THE MEDIUM TERM

20. Based on available evidence, an assessment of analysis of economic performance from different sources, and discussions with the Government and other development partners, the following developments of the economy help to understand the constraints to economic growth and employment facing the Turkish economy in the medium term.

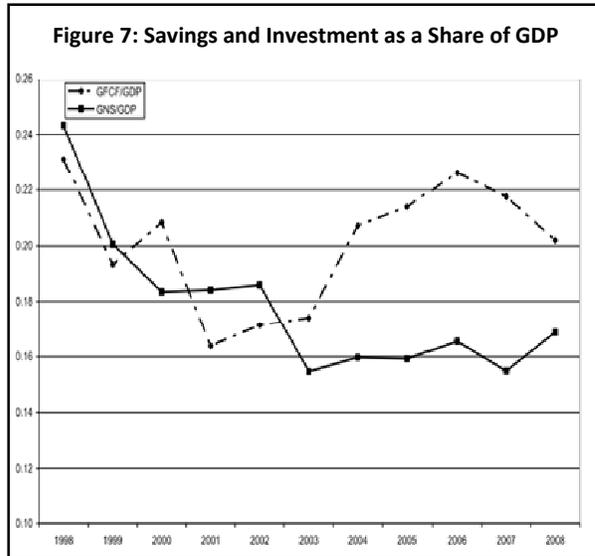
21. **The continuation of a downward trend in the national savings rate, at a time when the demand for investment was increasing, created a large savings-investment gap.** The gross national savings rate has been on a downward trend since the 1990s when the savings rate was over 24%.⁷ In the post 2001 crises period the savings rate continued to decline from an average of around 18.4% in 2001 to 15.5% in 2007⁸. Domestic investment on the other hand grew from around 16.5% of GDP to around 23% over the same period. The result was a widening gap between domestic savings and investment reaching nearly 6% in 2007. As a reflection of this widening gap, the economy has been subject to substantial current account deficits.

22. **Foreign capital inflows filled the gap between savings and investment and led to an appreciation of the Turkish Lira.** Foreign inflows, which peaked at 6% of GDP in 2006 when they exceeded US\$ 50 billion, were large by any standard.⁹ The rising demand for Turkish Lira led to the real appreciation of currency by 35% (from 2002 to 2008).

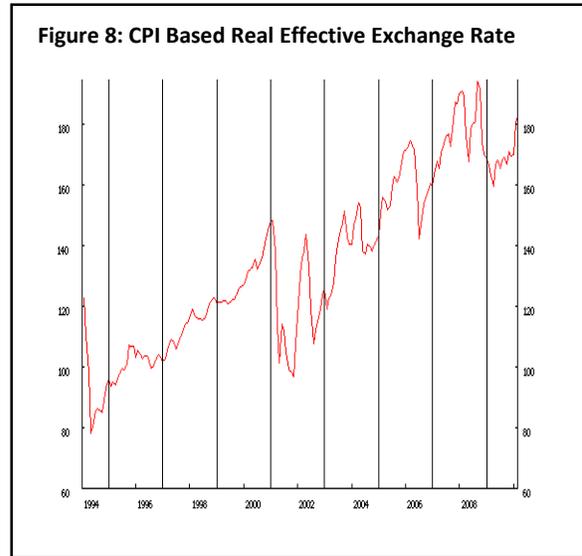
⁷ The decline and continuing weakness in the savings rate is alarming and attributable to a drop in private savings, which fell, from 25.3% of GDP in 2002 to around 9.8% in 2006 before reverting to 14.2% in 2007. Public savings over the same period went up from -6.2% of GDP in 2002 to 6.2% in 2006, before declining to 3.1% in 2007. The fall in private saving could be due to several factors, including new social security structures, macro-stabilization, increased public savings, credit expansion, and prospects of EU accession.

⁸ Low relative to comparator countries: Chile (29%), South Korea (30%), Malaysia (38%), and Poland (22%).

⁹ Note: Capital inflows exceeded the current account deficit in 2006 by about US\$ 10.7 billion leading to an equivalent build-up of reserves—a reflection of both demand and supply side factors.



Source: SPO (Rodrik, 2009)



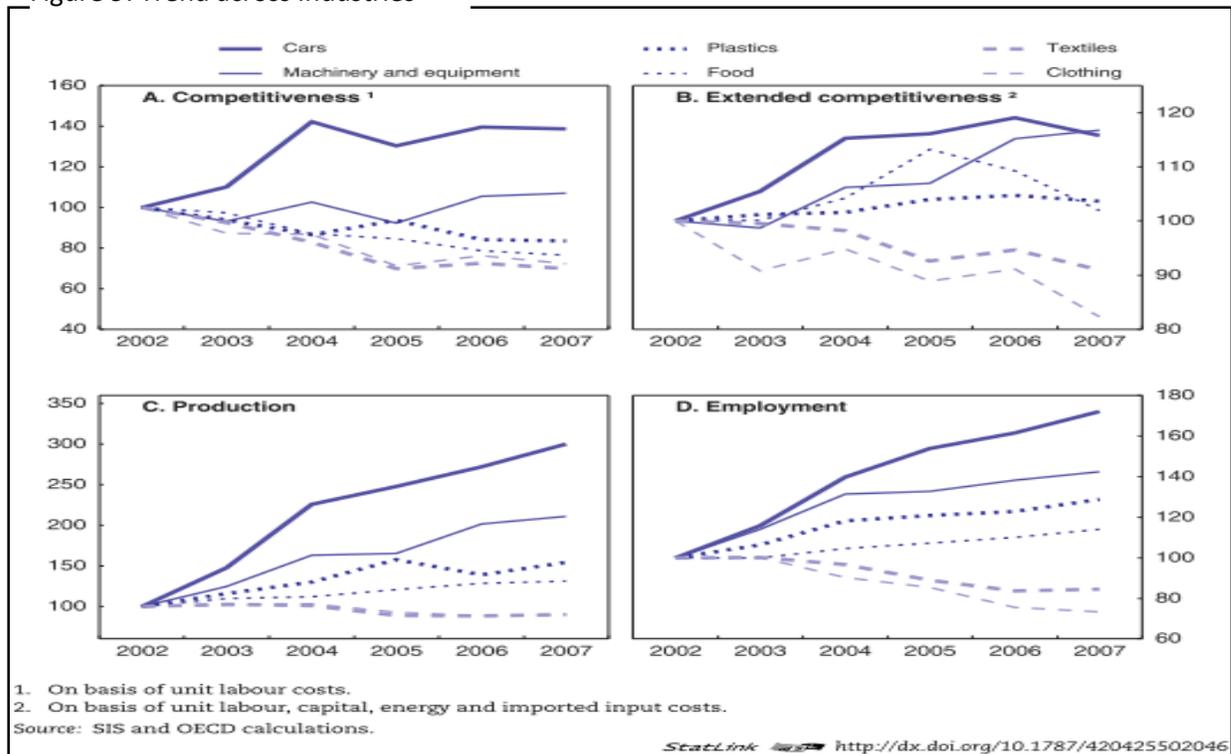
Source: Central Bank of Turkey (TL/FX)

23. **Along with the structural changes in the global economy, including increasing competition from low labor cost countries, this substantive appreciation of the exchange rate had an adverse impact on the labor-intensive traditional sector.** This sector, which includes activities like textile and clothing industries, has traditionally accounted for a large share of employment and exports. These industries have lost their competitiveness in both, domestic and international markets because of currency appreciation. However, other sectors, including the highly capital and import intensive sector benefitted from this.

24. **There is significant evidence of the loss of competitiveness by firms in the traditional sector in the 2002-2007 period.** According to Banking and Regulation Supervision Agency (BRSA) data, lending to SMEs, which account for 90% of the firms in traditional sector, peaked in 2007 and has since been declining in absolute terms: in January 2010 it was 15% below December 2007 level. The share of SMEs in bank lending has also been on a declining trend— from 27% of bank lending in December 2007 to 21% in January 2010. This decline is a structural phenomenon, which started before the recession took hold in 2009. The result of a survey of 1500 SMEs, financed by the EU, shows that the most significant constraint faced by most firms is too “few clients”, reflecting weak demand faced by the firms¹⁰. The report concluded that this was due to competitive pressures faced by small firms from international businesses and cross-border informal sector imports from neighboring countries. The falling competitiveness, output and employment by firms working in traditional sectors—textiles and clothing—during 2002-2007 is also observable in the following graphs, based on OECD calculations.

¹⁰ European Union, “Small enterprise Finance in Turkey: Summary Results from Field Surveys in 2005 and 2008 and Comparative Analysis. (2008)”

Figure 9: Trend across Industries

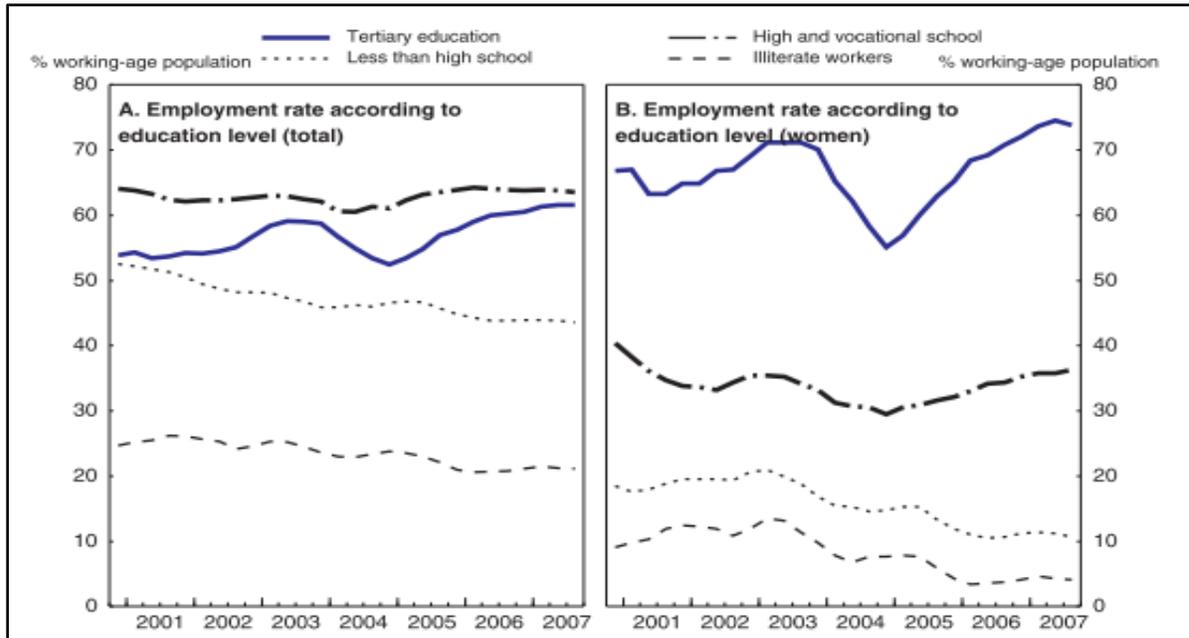


25. Given the above trends in the economy, especially the low and declining rate of savings, are unlikely to change in the short to medium term, the question is what can be done to help the traditional sector adjust and move up the value added chain and restore its competitiveness. This sector, which is dominated by SMEs, was the engine of growth in the post-2001 period. Hence, the answer to this question has profound implications for employment and growth, and for attracting foreign investment into the real sector in the coming years. There are several key constraints to this needed transformation:

26. **(I) Skills Mismatch:** *Both the quality and availability of the labour force do not meet the demand of a rapidly industrializing economy, constraining job growth.* The Investment Climate Assessment, 2007 (ICA 2007)¹¹, concluded that skill mismatch was one of the most important factors hindering investment growth in the country. A consistent increase in the unemployment of illiterate and less than high school graduates—forming the majority of Turkey’s workforce - demonstrates the existing mismatch of skills requirement in the market, which is in need of trained and educated workers as shown in the figure below. Skills mismatch problem seems to have two roots, (i) Relatively low quality of education compared to OECD and comparator countries, and (ii) Lack of vocational training in certain areas.

¹¹ While references in this document are to ICA 2007, the information is also consistent with the results of the Investment Climate Assessment Report, 2010, published on 28 May 2010.

Figure 10: Employment Rate According to Education Level



Source: OECD 2008

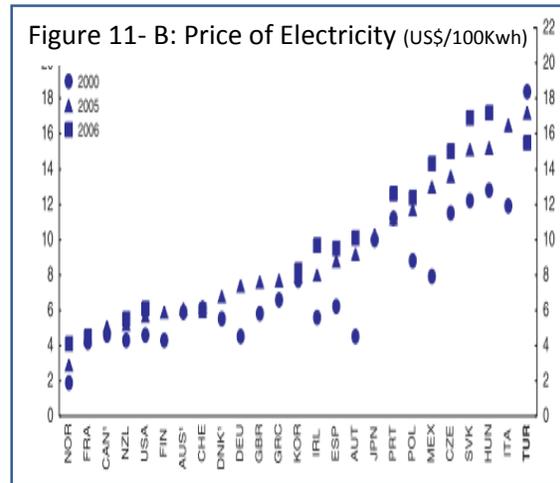
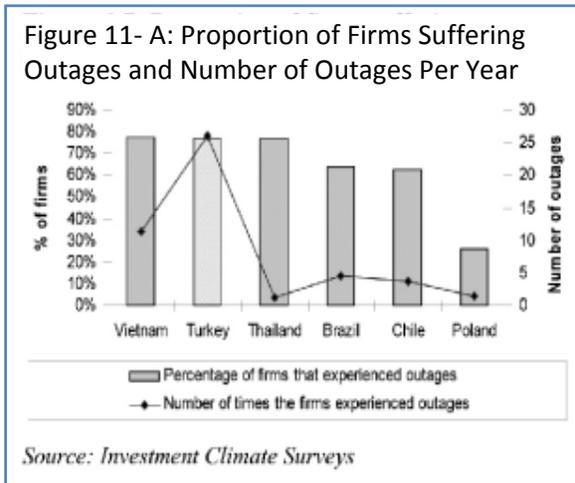
27. **(a) Relatively Low Quality of Education:** There is evidence that labor productivity and the quality of secondary schooling (as measured by the Program for International Student Assessment, PISA, and discussed below) is low in Turkey compared to almost all other OECD and comparator countries, with similar labor costs. Enhancing educational qualifications and generic thinking and learning skills of the young will contribute to increased labor productivity, competitiveness and employment growth.

28. **(b) Issues Related to Vocational Training:** The 2007 Investment Climate Assessment (ICA) identified labor skills as a key factor affecting the export competitiveness of Turkish firms and an important attribute when attracting FDI. ICA also revealed that labor skills and access to updated knowledge are two of the main obstacles to the growth of the business sector in Turkey. Study carried out by Economic Consultants from TEPAV shows that two generic skills are lacking: computer skills and proficiency in foreign languages. They also affect export competitiveness of Turkish firms and are an important attribute when attracting FDI. Few firms provide formal training to their workers and there is a need to link training with labor demand; ISKUR (Government employment agency) has been providing training and entrepreneurship programs and internships. In 2009, around 214,000 participants benefited from these programs.

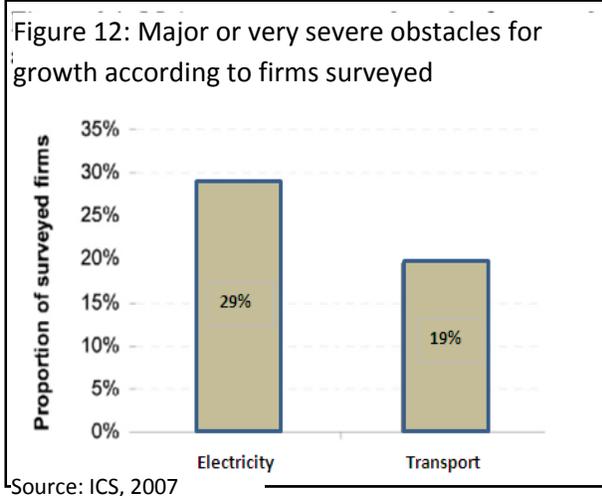
29. **(II) High cost and Lack of Access to Intermediate Inputs:** As revealed by the ICA 2007 (see figure below), high cost and lack of electricity security, and lack of access to transport are major bottlenecks reported by the industry.

a) High cost and lack of power security: High costs and deficiencies in electricity supply have significantly affected the operations of the industrial sector. According to ICA 2007 study, the

cost of electricity is high relative to OECD countries and Turkish firms, especially those in textile industry, suffer the most severe financial losses due to interruptions in electricity supply.

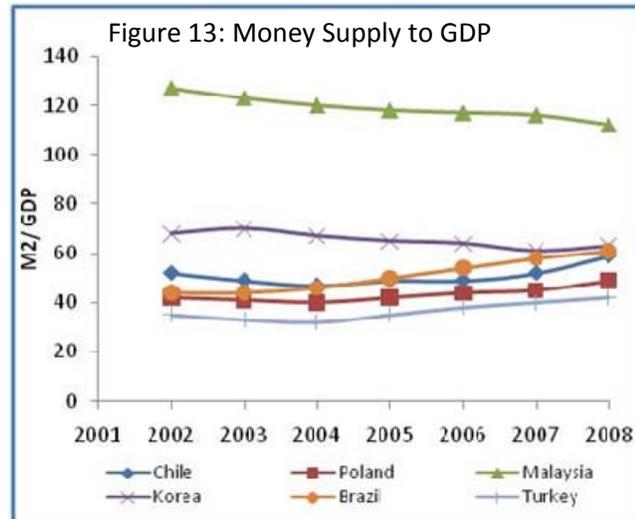


b) Quality and Access to Transport: ICA 2007 also identified lack of quality and lack of access to multimodal transport as a second major bottleneck. Despite rapid growth in demand for transport, public spending on transport is 1.7 % of GDP, compared to 6% in middle-income countries. Rail transport remains inadequate and roads are the major means of transport- this has led to an inefficient and unbalanced transport network. Despite improvement in roads, especially investment in dual carriageways, the quality of roads varies, localized congestion remains an issue, and routes can be indirect, adding to costs. More than a third of companies surveyed reported losing goods in transport within Turkey, a proportion almost three times higher than in European comparators.



30. **(III) Financial Sector Bottlenecks:** While the financial sector has been stabilized and significantly strengthened over the past several years through improvements in prudential regulations and supervision, more needs to be done to enhance its efficiency. There are three indications of this: (i) limited availability of long-term finance, (ii) sub-optimal allocation of resources- as reflected in high share of FDI in non-exporting activities, and (iii) limited mergers, acquisitions, and restructuring of SMEs-- a recognized role of the financial sector in developed markets—supporting firm growth and efficiency. Two factors seem to explain these issues: (a) Lack of depth of the financial system; and (b) Inadequacy of Financial Infrastructure.

31. (a) Lack of Depth of the Financial System: The depth of the financial system as measured by M2/GDP is a recognized measure of the level of development of financial markets and a significant predictor of the long-term economic growth¹². The M2/GDP ratio for Turkey is increasing but at around 40%, it is well below the levels of comparator countries—see graph.¹³ The relative shallowness of monetary depth is a reflection of several possible factors. These include receding but still present memories of past macro instability; crowding out of private investment by the high levels to which interest rates have been maintained until recently to finance fiscal deficits; and financial market inefficiencies in intermediating savings despite significant strengthening and modernization. The evidence that FDI has flowed largely to the non-tradable sector is a reflection of the latter.



Source: World Development Indicators

32. (b) Inadequacy in Financial Infrastructure: There are two main problems in financial infrastructure. First, is the absence of specific accounting standards for SMEs, which adversely affect their ability to prepare financial statement, and with their access to finance¹⁴. Second, is the absence of a centralized registry system for collaterals within the banking system, which raises risks of, lending to firms and SMEs in particular.

33. (IV) Constraints to SME Growth: SMEs which account for 77% of the total labor force employment and whose activities are concentrated in the traditional sector, face constraints to their expansion. The ICA 2007 study shows that Turkish firms do not grow as much as firms in comparator countries. Additional evidence that SMEs are not expanding, as already noted, is that lending to SMEs has been declining. Also, as noted before, this decline is a structural phenomenon, which emerged before the 2009 financial crises. Evidence, outlined in section IV below shows that ability of SMEs to compete and grow is constrained by the four key factors:

- a. Inadequate skills of workers, and entrepreneurs.
- b. Limited R&D and innovation, and lack of usage of quality certifications.
- c. Transparency issues
- d. Availability of long term finance

¹² Due to significant dollarization of the economy, M2Y/GDP is a better indicator of financial sector development. However, figures for this measure were not available for other comparator countries.

¹³ As per the new definition of Central Bank, M2/GDP in Turkey was 46% in 2008 and 51% in 2009.

¹⁴ The standards set by TASB are applicable for international firms and pose onerous demands on SME enterprises.

III. TURKEY'S VISION, DEVELOPMENT STRATEGY AND PRIORITIES

A. NINTH DEVELOPMENT PLAN (NDP) 2007-2013

34. **The NDP sets out a 21st century vision of Turkey where stable growth accompanies increased global competitiveness and a more equitable distribution of income, as the country transforms itself into an information society and completes EU harmonization.** Reflecting this vision, the structure of the NDP, as shown in the attached chart, reveals development priorities in the seven-year plan clustered around five strategic objectives, outlined below, with Private Sector Development and an agenda for EU accession as major cross-sector themes:

- i) *Increasing Competitiveness* The NDP outlines interventions to achieve sustained and rapid growth of 7 % per annum and improved living standards through increased competitiveness. The interventions include policies to maintain macroeconomic stability, and improve the business climate to raise investment levels to 24 % of GDP; of which public sector would contribute 6% of GDP totaling \$250 billion over the seven-year plan period or about \$37 billion a year on average. The reforms aim to strengthening of financial markets, support SME growth, enhance innovation and raise productivity by 2.3% per annum, modernize infrastructure and promote Turkey as a link between Europe, Asia and the Middle East.
- ii) *Increasing Employment* The reforms also includes measures to make labor market more responsive to demand, balancing security with flexibility, and enhancing skills to meet the needs of a modern industrialized economy. In the wake of labor market reforms, in combination with growth, NDP projects employment to grow at a rate of 2.7% per annum and help to reduce the unemployment rate to 7.7 percent by 2013.
- iii) *Strengthening Human Development and Social Solidarity* Turkey has been successful in reducing poverty and social indicators (e.g. on maternal mortality) are ahead of most OIC member countries but it lags behind OECD countries. To address these concerns the NDP calls for the implementation of measures to reform and improve the social security system including the plans to introduce a universal health insurance, modernization and reform of the education system to improve its quality and relevance, and the restructuring of the health sector to improve health outcomes and reduce social disparities.
- iv) *Ensuring Regional Development* through measures to reduce regional disparities by making regional development policy effective at the centre, increasing institutional capacity at local level, enhancing the contribution of regions to national development, competitiveness and employment, and maintaining a focus on rural development.
- v) *Increasing Quality and Effectiveness in Public Services* The NDP outlines measures to enhance the effective provision of public services through among other things enhancing fiscal space for productive public investments, rationalizing powers and responsibilities between central and local administrations, and preparedness for disaster risk mitigation.

B. MEDIUM-TERM PROGRAM (MTP) 2010-2012

35. **The Government published a Medium-Term Program (MTP) of action in late 2009 for 2010-2012¹⁵ outlining measures to restore post-crisis economic growth.** The MTP reflects changes to the level and composition of public expenditures in the wake of the global crisis with the aim of gradually reversing the deterioration in public finances, boost private sector activity, restore solid economic growth, and enhance employment opportunities. The reforms include:

- New fiscal rules—starting with 2011, fiscal management will be under pre-determined rules linking the actual fiscal deficit to a level compatible with a sustainable public debt structure taking account of the targeted long term public deficit and GDP growth rate.
- Measures to improve the efficiency of the Credit Guarantee Fund supported by the Treasury and to make it operational in order to enhance SME access to finance

36. **Reflecting the impact of the global crisis on Turkey, the MTP reiterates the existing goals of the NDP but lowers growth expectations**—the Government expects the recovery over the 2010 to 2012 period to be slow—the MTP projects GDP growth to rise from a negative 4.7% in 2009 to 3.5% in 2010, 4% in 2011 and only reaching 5% in 2012 see figure below. This compares with the 7% growth rate projected in the NDP. The macroeconomic projections contained in the 2010 Annual Program of public investment expenditures, prepared by the SPO in early 2010 is consistent with the projections in the MTP.

Table 2: GDP Growth Rate (Base Scenario)¹⁶

GDP Growth Rate	2009	2010	2011	2012
Base Scenario: Medium Term Program	-6.0% (MTP estimate) -4.7% (actual)	3.5%	4.5%	5.0%

37. **For the period 2010-2012, the MTP forecasts domestic demand to be the main source of growth.** The MTP projects domestic demand in 2010 to increase by 3.8% in real terms while targeting GDP to grow by 3.5% due to the negative 0.3% point contribution of net exports to growth. A projected growth in investments of 9.1% and of consumption by 2.5% supports the projected growth in domestic demand in 2010. This pattern of modestly rising domestic demand growth, fueled by rising consumption and investment growth, with negative contributions from net exports lowering the growth in GDP below the growth in domestic demand, repeats itself in 2011 and 2012. The MTP projects domestic demand to increase by 4.4% and 5.8% in 2011 and 2012 respectively to support GDP growth of 4% and 5%.

38. **A critical aspect of the reforms included as part of the MTP is fiscal consolidation, in particular the fiscal rule, to enhance public savings and stabilize the public debt to GDP ratio and to ensure the inflation continues on its downward path.** The MTP projects the fiscal deficit, which increased to 5.5% in 2009 following the crisis to decline to 2.1% by 2012 based on full

¹⁵ MTP for 2011-2013 is expected to be published in June 2010.

¹⁶ It is expected that growth forecasts will be revised upwards in MTP for 2011-2013.

implementation of the fiscal rules—a 3% improvement in public savings. On these assumptions, inflation continues on a downward path falling to 4.8% in 2012 from 6.5% in 2009 while the public debt to GDP ratio, which rose sharply in 2009 to 47.3 %, stabilizes at 48.8% in 2011 before declining in 2012.

C. RISKS AND UNCERTAINTIES IN THE GOVERNMENT’S STRATEGY

39. **There are several risks to the Government development strategy. First, the Government's emphasis on raising public savings is worthwhile and full implementation of the spirit of the fiscal rule will help to reduce the fiscal deficit, rein in the rise in the public-debt to GDP ratio and provide credibility and support for keeping inflation (and with it interest rates) on a declining trend.** This will be good for deepening financial markets and facilitating private sector investment in the long run. However, in the medium-term, a decline in the fiscal deficit (or public-sector dis-savings) by a 2-3% is not going to have a major impact in reducing the gap of the order of 10-12% between the national savings rate and desired investment levels of 24-28% as mentioned above. More emphasis should be placed to encourage private savings, if Turkey is to reduce its dependence on foreign savings, and to raise investment to desired levels.

40. **Second, given that it is not easy to raise the domestic savings rate significantly, at least in the medium-term, Turkey has to take steps to enhance the productivity of feasible investment, domestic and foreign, and reinstate foreign investment to levels achieved before the global crisis.** This calls for improving the business environment. While the NDP identifies many of the constraints in the business environment, it is all encompassing, and does not distinguish between key constraints and other reforms that may be useful but may not be a high priority. In particular, the Government would benefit from focusing its scarce resources, both in terms of time and financial resources, on critical measures that will help the private sector, and especially SMEs, to adjust more rapidly and move up the value-added chain to be competitive in the new global market place. This will help to attract investment and raise employment.

41. **On the upside, there are two uncertainties.** First, is the possibility that the global economy may recover faster than expected and which will help to buoy the Turkish economy through stronger export growth than envisaged in the MTP. Second, Turkey has a dynamic private sector and, with the right reforms in place, it may adjust at a faster pace to meet the competitive challenges than envisaged in the MTP. If these two factors come into play simultaneously, growth may recover at a faster pace than projected in the MTP even if does not reach the levels projected in the NDP. Table 3 (below) shows this higher growth scenario, taking account of the projections of private sector analysts and lessons from the recovery of the economy from the 2001 crisis.

Table 3: GDP Growth Rate (Higher Growth Scenario)

GDP Growth Rate	2009	2010	2011	2012
Higher Growth Scenario	-4.7%	6.5%	6.0%	6.0%

IV. ELEMENTS OF IDB GROUP PARTNERSHIP STRATEGY

A. PAST INTERVENTIONS BY THE IDB GROUP IN TURKEY

42. **IDB Group total financing approvals for Turkey has reached US\$4.6 billion.** Total cumulative approvals of IDB project finance and technical assistance operations for Turkey since inception now exceeds US\$ 1.1 billion. Since inception, IDB has approved 85 ordinary operations (net of cancellations) including special assistance. The transport sector has received the largest share of financing, around 34% of total approvals by value, while financial institutions, social services and industry received 22%, 18% and 15%, respectively. Distribution of the operations by mode wise has been balanced. Installment sale, leasing and istisna'a modes has each had a share around one fourth of the total approvals while other modes, mainly equity and loans, account for the remainder.

43. **Turkey has been one of the major beneficiaries of IDB Group's trade financing programs.** A cumulative total of US\$3.5 billion in (gross) trade finance operations has been approved for Turkey since the establishment of IDB. This figure represents about 10% of total gross trade financing approved by the IDB Group. Following the establishment of ITFC, the annual approval level for trade financing in favor of Turkish companies and banks rose from \$50 million to US\$200 million. Clients of ITFC are representing a wide range of sectors including food, agriculture, textile, automotive, petrochemicals, and electronics. The main financial institutional partners of ITFC in Turkey are Turk Exim bank and four Participation Banks.

44. **ICIEC has been supporting Turkish exports since inception of its operations.** The total amount of business insured by ICIEC for the exports from Turkey reached US\$ 674 million while business insured regarding the imports to Turkey amounted to US\$ 201 million. Regarding the investment insurance, ICIEC has not issued a policy so far, however, there are some applications received from Turkish investors about investments/projects in some of ICIEC member countries, which are under review, by ICIEC. Concerning investment promotion and capacity building activities, ITAP organized familiarization and capacity building programs in Turkey, in coordination with TOBB for the officials from other IDB Member Countries.

B. LESSONS LEARNED FROM PAST IDB GROUP INTERVENTIONS IN TURKEY

45. **IDB Group's interventions in the last decade could have been more effective in meeting Turkey's needs and enhancing IDB Group's image.** IDB Group projects, with a few exceptions in trade finance and transport, have been small relative to Turkey's needs, supported by funding seen as uncompetitive and characterized by the absence of a broader dialog on the country's development needs and priorities. There is a need to scale up projects, enhance the dialog with the Government and shift towards a programmatic approach to meet the country's needs over time. The competitiveness of IDB Group's financing terms and how IDB raises its finances, relative to other MDBs, were also raised as issues by the Government.

46. **Project implementation experience of IDB in Turkey in the past has been mixed.** About 20 % of all projects approved by the IDB Board of Executive Directors (18 out of 94, excluding special assistance) for Turkey were cancelled. At the same time, lines of financing with Turkish banks have not worked well mostly due to the cumbersome IDB line of financing procedures used in the past and lack of knowledge of IDB procedures in the banks executing the lines of financing. On the positive side, there is timely implementation of recently approved large scale railway and locomotive projects for TCDD, largely due to an effective PMU and accurate appraisal process. Streamlining project implementation arrangements and better explanation of procedures for IDB financing is critical to improve future project implementation.

47. **For future projects, the Bank needs to ensure beneficiaries' involvement in the projects at earliest stage** with the utmost care taken to provide orientation about new concepts and practices underlying project design and scope such as beneficiary driven participatory planning process, institution capacity building and service delivery approaches. In order to reduce implementation delays as experienced by a number of projects evaluated in Turkey, IDB shall strive to prepare more realistic implementation schedule and ensure quality of its due diligence process; and at the project implementation phase to ensure the beneficiaries' familiarity and knowledge of IDB rules and procedures. Close monitoring and supervision of the project, including the appointment of an IDB Field Representative are to be considered to facilitate smooth project implementation.

48. **Implementation of the trade finance operations in Turkey has moved relatively smoothly** because the approval process, legal documentation and implementation of the trade finance operations are much simpler than for project finance operations. However, the lack of local presence in Turkey makes it difficult for ITFC to assess company risk and monitor implementation, and ITFC's direct financing to the prime companies, which prefer unsecured borrowings, is limited. Even leading companies which have access to local and international financing on unsecured terms basis usually fail to qualify for ITFC and IDB Groups "clean financing" criteria. ITFC has signed service agreements with local banks and institutions as an attempt to overcome the difficulties caused by the lack of local presence. On the other hand, the disbursement mechanism for IDB/ITFC trade financing in Turkey was limited to L/Cs until 1428H, which was another bottleneck for effective implementation of the ITFC operations. In an attempt to improve implementation procedures, ITFC started to implement "Documentary Collection" as an alternative method of disbursement for Turkish companies since 1429H. Another issue faced by IDB/ITFC in Turkey with respect to the trade financing was the limitation on the source of supply by allowing only imported goods. However, most of trade finance clients of ITFC in Turkey have been requesting to benefit from financing for goods procured from domestic sources instead of imports. Therefore, ITFC has started to provide financing for purchasing from free trade zones within Turkey and lines which can be utilized for pre-export purposes.

49. **In addition, implementation of approved financing facilities and disbursements under the line of financing operations are, in general, higher compared to that for direct operations.**

Line of financing operations have also a higher developmental impact and are mostly used for supporting the SMEs, where in the case of the direct operations the beneficiaries are among the largest companies in the country, which on their own have access to alternative local and international finance resources.

50. **Although Turkey's economy is among the largest economies of ICIEC Member Countries, the volume of ICIEC operations in Turkey is still considered low.** This was mainly due to the shortage of marketing staff in ICIEC and lack of local presence. To increase the amount of business in Turkey, a considerable business development effort and a continuous physical presence in the field are required. Regarding the ITAP activities, the main lesson learned is that Turkey's experience in investment promotion can be replicated in member countries with the facilitation of ITAP.

C. OTHER DEVELOPMENT PARTNERS

51. **The World Bank Group** prepared its Country Partnership Strategy for Turkey (2008-2011) and adjusted it, following a mid-term review, to support the transition from the adverse impact of the global crisis to a return to sustainable growth. Total IBRD commitments over the 2008-11 period is USD7.7 billion (USD4.2 billion for Development Policy Loan). The main focus areas of the World Bank Group are energy, SME development and municipal services. IDB Group team had discussed with the World Bank Office in Ankara the Country Partnership Strategy experience of the World Bank Group in Turkey as well as potential cooperation areas, including vocational education.

52. There are four other major development partners: (i) **Council of Europe Development Bank**, focusing on social integration, environment and human capital with an allocation of EUR1.5 billion for 2008-11, (ii) **European Investment Bank**, focusing on private sector and infrastructure development with an allocation of EUR7 billion for 2008-10, (iii) **European Union**, focusing on pre accession programs with an allocation of EUR1.8 billion (mostly grant) for 2008-10, and (iv) **European Bank for Reconstruction and Development** operations in Turkey started in 2009 with a focus on SMEs, agribusiness, privatization, municipalities and energy efficiency. The financing envelope for 2010 is EUR600 million.

53. IDB Group team's discussions with the IMF Representative in Turkey revealed that IMF and Turkey had been discussing a possible stand-by agreement for the past year and recently concluded that Turkey does not need such support for the moment.

54. Currently IDB Group is not engaged in a partnerships/co-financing arrangement with other MDBs in Turkey. However, IDB Group has participated in the donor coordination meeting arranged by EU Commission in Turkey in March, 2010, and became a member of relevant working groups. IDB Group has also shared its priority areas with other development partners in order to explore the cooperation possibilities. This is critical for enhancing partnership and will be another advantage of the MCPS process.

D. STRATEGIC FRAMEWORK FOR ALIGNING NDP OBJECTIVES WITH IDB GROUP VISION

55. The MCPS and its underlying processes have two primary objectives.

First, is to outline GOVERNMENT's development vision and key priorities, provide a shared understanding and diagnosis of development issues, focusing on areas where IDB Group can realistically and selectively engage in partnership with other donors to help meet the goals of the NDP over the 2010-13 period, consistent with the IDB Group's 1440H Vision.

Second, is to focus on the "reverse linkage" to identify and agree upon on the support that Turkey can provide / share with other Member Countries through its unique experience and expertise in various socio-economic areas.

56. This unique two-way dialog and relationship, as illustrated in the attached Strategic Framework (Annex-2), outlines the proposed IDB Group interventions and the outcomes and intermediate results that IDB Group expects to influence. The proposed interventions were determined through a process of consultations—internally within IDB Group entities and externally with the Government, civil society and other development partners during the MCPS process. A key part of the Strategic Framework is a Results Matrix (or Framework) for monitoring progress in the implementation of MCPS across full range of interventions. The Results Matrix for Turkey, incorporating proposed interventions and expected outcomes in areas of future engagement during 2010-2013, as discussed in more detail below, is given in Annex - 3. The advantage of the MCPS process is the development of a shared strategy underlying IDB Group interventions will give the country ownership of, and provide incentive for, quality interventions that will have significant impact on the ground in harmony with other development partners.

E. AREAS FOR FUTURE ENGAGEMENT BY THE IDB GROUP

57. In the discussions that the MCPS task team had with the Government, the following areas for future engagement in Turkey by IDB Group in the 2010-2013 period were agreed: education, energy, transport, disaster management and private sector development as a cross cutting theme.

58. In addition to the above-mentioned areas, a unique feature of the Turkey MCPS is the inclusion of engagement in the form of “reverse linkage”, namely the support Turkey can provide other MCs by capitalizing on its experience in areas where it has developed a high level of expertise.

59. The above areas of engagement are consistent with the following criteria:

- I. Ownership: tailored to development objectives set out in Ninth Development Plan
- II. Alignment and harmonization: with other development partners

- III. *Impact and results*: interventions form a coherent strategy to address key constraints Turkey is facing in meeting its NDP goals as potential areas of highest pay-off
- IV. *Selectivity/catalyzing internal synergies* within and across IDB Group: Intervention on selective basis, within limits of IDB Group resources and consistent with the niche areas outlined in the 1440H vision where IDB Group has a comparative advantage.

60. In order to facilitate the alignment between IDB Group's goals and the NDP, the agreed areas of engagement were clustered around the following four pillars: (i) Supporting Growth (through Infrastructure Development); (ii) Enhancing Human Development (through Education); (iii) Raising Employment (by SME expansion/Private Sector Development), and (iv) Reverse Linkage. These areas directly support the goals of the NDP as specifically outlined in the Strategic Framework and more specifically in Results Matrix. It is to be noted that these pillars reflect overlapping goals. Thus, while, educational sector interventions will predominantly support the NDP goal of strengthening human development it will also have an impact on economic growth.

PILLAR 1: Supporting Growth through Infrastructure Development:

61. **The main driver of economic growth under the NDP is increased competitiveness.** As noted in Section II above, infrastructural bottlenecks represent a key constraint to achieving this goal. The following selected areas of intervention, clustered under this pillar, support this NDP goal: energy, transport, disaster management, and public-private partnerships to facilitate infrastructure development.

a. Energy

62. **Turkey is a net importer of energy and meets less than one-third of its energy consumption from domestic sources of energy, mostly coal.** Imported energy, mostly in the form of gas and oil, meets the remaining two-thirds of energy needs. Power generation constitutes 42.7% of all primary energy consumption followed by households and services (20.4%), transport (19.4%) and industry (13.1%). Agriculture constitutes only 4.4% of primary energy consumption. Turkey's fuel mix in power generation has changed substantially over the years with imported natural gas expanding rapidly in comparison to more economical domestic coal and hydro-electric (see table below). Consequently, the electricity tariff structure is especially vulnerable to the volatility of international gas prices.

Table 4: Breakdown of Electricity Generation by Primary Resources (%)

	1985	1990	1995	2000	2005	2007	2008	2009
Natural Gas and Multi-fuel	0.2	17.7	19.5	37.2	44.6	48,6	48.4	48.6
Domestic Coal	43.9	35.1	32.5	30.6	20.2	21.7	22.7	21.8
Imported Coal	0.0	0.0	0.0	0.0	6.3	6,2	6.3	6.6
Liquid Fuels	20.7	6.9	6.7	7.5	4.3	4,3	5.4	3.5
Hydro and other Renewables	35.2	40.2	41.2	24.7	24.6	19.2	17.3	19.5

Source: World Energy Council Turkish National Committee (2003); TEİAŞ

63. **Electricity Tariffs are relatively high with reference to comparator OECD countries,** owing to the dominant share of expensive natural gas in power generation. High tariffs are of concern to the business community as per Turkey Investment Climate Assessment undertaken by World Bank (2007).

64. **New legislation has reduced the role of the government in energy markets and strengthened market mechanisms.** The Electricity Market Law passed in 2001 marks the end of long-term, government guaranteed purchase contracts for the private sector and the Energy Market Regulatory Authority has been issuing licenses to auto producers, and independent power producers (IPPs) without power purchase guarantees from the government. The Government, however, continues to support Renewable Energy (RE) power plants through guaranteed Feed-in-Tariffs¹⁷ (FiTs) for the first ten years of operation.

65. **Ensuring investment in power generation to keep pace with demand is an important issue for energy security.** Turkey's annual power consumption is expected to grow at a rate of 6-7 percent per year in the period 2009-18, making Turkey one of the fastest growing power markets in the world. Various projection scenarios built by the state, indicate that firm generation margin will be depleted by as early as 2014. Therefore, there is a need for sustained investment in the electricity sector in order to ensure security of supply. For the medium and long-term supply security, it is crucial that licensed and under-construction power plants are commissioned as planned. Turkey is depending on the private sector investments for this purpose but the global economic crisis has led to a decline in foreign direct investment in Turkey, and lack of access to long-term finance within Turkey are likely to impact investments negatively. In the long run the availability of long term finance from foreign and local sources will be critical to enable Turkey to develop its energy sector. In the interim, Government needs to ensure the availability of long-term financing windows with appropriate borrowings and guarantees.

66. **There is also a vital need to optimize fuel-mix to reduce reliance on expensive imported natural gas for production of electricity.** Surveying the fuel-mix of Norway, Canada, France and USA, countries with some of the lowest electricity tariffs in the world, indicate that they all rely on the cheaper fuels e.g. Norway uses cheap hydropower to produce 98.2% of its electricity, Canada and France use a mix of Hydropower, Nuclear and Coal to generate 90.3% and 93.3% of their electricity, respectively. USA uses coal, the most economical fossil fuel, to produce 48.7% of its electricity. Therefore, in order to achieve the twin objective of the reducing generation costs as well to decrease its dependence on imported fossil fuels which make it vulnerable to price increases and supply interruptions, the Government of Turkey needs to encourage development of indigenous and more economical coal power plants as well as economically viable renewable energy generation facilities, i.e. hydropower and wind. It is also worth mentioning that the Government is already exploring the possibilities to construct nuclear power plants.

¹⁷ Feed-in-Tariff (FiT): A guaranteed purchase price offered by the Government to encourage private investment to develop indigenous Renewable Energy Resources.

67. **To complement an increase in supply, Turkey needs to manage demand by implementing measures to increase energy efficiency.** Significant potential for energy efficiency investments exists for households and energy intensive industries, e.g. iron and steel, cement, ceramics, textiles, paper etc., through better insulation, switch-over to new process technologies, as well as replacement of energy inefficient equipment (including electric motors, compressors, pumps). Utilization of excess heat for co-generation also can be another source of energy efficiency. While, exact benefits, in the absence of tangible Energy Efficiency projects, need to be further studied in coordination with the Government of Turkey and related private entities, it is worth noting that significant barriers need to be overcome for successful implementation of energy efficiency projects, including inadequate awareness of the benefits of energy efficiency and perceived high technical and financial risks of such projects.

68. **The government's main objective is to supply energy required for economic and social development in a continuous and secure manner at minimum cost.** The Government's updated energy strategy and Turkey's Ninth Development Plan (2007-13) both aim at ensuring security of energy supply, while keeping environmental effects at a minimum acceptable level. The state will promote a balanced resource diversification on the basis of primary energy resources including development of indigenous Renewable Energy Resources as well as promoting Energy Efficiency projects/programs. The Government also plans to complete liberalization of the power sector to facilitate the development of a market-based system to supply power at least cost. In this context, it needs to ensure that feed-in tariffs for renewable energy projects adequately balance the objectives of lowering costs and reducing Turkey's dependence on imported fuels, and adequate measures and incentives are in place to promote consumer awareness for the potentials of using power more efficiently.

69. **Renewable Energy (RE) & Energy Efficiency have been identified as priority areas for IDB Group's interventions in Turkey's energy sector in the 2010-2013 period.** By developing strategic partnerships with local financial intermediaries as well as concerned State entities, IDB Group will consider providing an estimated US\$ 500-700 million to develop the country's RE infrastructure (including RE and energy efficiency transmission lines). Sector studies will also be conducted to identify suitable energy efficiency projects for Bank's financing, explore the possibilities of developing local technologies for hydro and wind generation equipment and enhance energy efficiency incentive systems.

b. Transport

70. **Turkey has a strategic location and great potential for the economic integration of Europe with Asia and Middle East** through trade linkages. Expanding the coverage of and modernizing the existing transport infrastructure for all modes are critical to meet the increasing transport demand, reduce costs to industry and help Turkey's goal to become a competitive transport corridor. IDB's cross-country transport project implementation experience can ensure the strengthening of the connections with countries in Caucasus, Central Asia and Middle East.

71. **Turkey has a competitive road transport system with a dynamic logistics industry** and well maintained road networks especially along the East-West corridors. However, railways operate on an obsolete infrastructure due to lack of adequate investments in the sector in the second half of the 20th century. A comprehensive study for intermodal strategy to combine railways with roads and ports is an option to complement an already completed study on Turkey's transport corridors in 2008 with EU support. Implementation of the BOT model in passenger terminals of the airports and entrance of new private companies into the airline sector have improved the provision of air transport services and increased the number of passengers. Privatization of the ports has been continued and had positive impacts on the capacity and efficiency of the ports.

72. **Passenger and freight transport are, however, excessively dependent in the road network in Turkey.** According to 2009 data nearly 91% of goods are transported by highways while road transport covers approximately 90% of all passenger transport in Turkey which causes traffic congestion, environmental problems, higher oil imports and border crossing problems. Concentration of passenger and freight traffic in road transport is a result of the inadequate and relatively low quality physical infrastructure for railways and maritime transport as well as lack of integration of different transport modes.

73. **The main objective of the Government in the transportation sector is creation of a balanced and efficient transportation infrastructure through investments especially in railways, maritime and logistics centers.** Main priorities for the road transport system are upgrading existing network, improving traffic safety, and construction of new highways under PPP model. Main priorities for railway sector are increasing the share of railways in freight transport significantly through investments in railway infrastructure, development of intermodal options and logistics centers, enabling private sector train operations by restructuring the railway sectors, and construction of high speed passenger trains between major cities. The Government is also planning to promote maritime freight transport through construction of new hub ports and increasing efficiency of the existing ones through privatization and establishment of new regular maritime links within "short sea shipping" and motorways of the sea" concepts.

74. **Developing a balanced transport system through increasing the share of railways and maritime transport and improving intermodal options is essential to address the constraints in the transport sector.** Increasing the participation of private sector will be instrumental in enhancing the efficiency of the transport system in Turkey. However, the Government needs to invest in road transport network to address immediate challenges, multilateral development partners could complement the Government's efforts through long term interventions in the railways and ports guided by sector studies. IDB is already implementing two projects in the railway sector (i) Railway Tracks (US\$ 154 m.) and (ii) Electric Locomotives (US\$ 220 m).

75. **The following priority areas will be considered for IDB interventions in the transport sector for 2010-2013 with a tentative financing amount of US\$ 500-700 million:** (1) Expansion

and modernization (electrification, signalization, rehabilitation) of the railway network, especially the routes connecting Turkey to Syria, Iraq and Iran; (2) Construction of a major hub-port and integration of ports to other transport modes; (3) Construction of logistics centers and their integration to other transport modes; (4) Expansion of highway network under public private partnership model; (5) Expansion of in-city transport networks.

c. Disaster Management

76. **Turkey has embarked on a proactive approach for disaster management, specifically in the area of earthquake risk mitigation.** Experts see a high probability for a big earthquake in Istanbul within the coming two decades. The 1999 Marmara earthquake proved that a significant portion of Government buildings were not strong enough to withstand a major earthquake. Since Istanbul is the economic center of the country, a disaster in Istanbul would paralyze the country. **Major IFIs are working with the Government for a US\$2 billion disaster management program called Istanbul Seismic Risk Mitigation Project (ISMEP) which is** a significant attempt to implement essential principles of comprehensive disaster management. ISMEP Project consists of three (3) components: (i) Enhancing emergency preparedness; (ii) Seismic risk mitigation for priority public facilities; (iii) Enforcement of building code.

77. **The efforts of the Government are very important from the perspective of switching from post-disaster activities to pre-disaster preparations.** The Government has requested IDB's contribution to the efforts of the Government for strengthening and reconstructing the public buildings in Istanbul. Since the ISMEP management has built a substantial capacity, IDB may also learn from this experience and promote proactive disaster management approach in other MCs especially along with the assistance to the Government for reconstruction activities in Istanbul. Taking into consideration the activities of other development partners, IDB intervention could especially focus on reconstruction of vocational schools and hospitals in Istanbul.

d. Financing infrastructure projects through public-private partnerships

78. **Turkey has considerable experience and significant potential in public private partnership (PPP) projects.** During the 1980's, certain PPP models, such as BOT and BO, became prominent in increasing the role of the private sector in the Turkish economy. Several pieces of legislation were enacted, including (a) Build – Operate - Transfer, (b) Build - Operate, (c) Build - Rent - Transfer, and (d) Transfer of operation rights. Most of the PPP projects implemented in Turkey are in the energy sector and airport terminal building & operating projects. To ease the burden on public budget, ensure efficiency and benefit from the experience of private sector,, Government has now shifted from public funding of infrastructure projects to the private sector with a view to developing the provision of basic public services such as electricity and telecommunications.

79. **The challenges facing Turkey in PPP are evolving.** First, Turkey's, average size of PPP projects has significantly increased over time requiring financing not only from Turkish banks but

also from international financial institutions and export credit agencies. Second, several constraints have emerged during the implementation of existing BOT/Privatization projects. These include risk distribution between public and private sector entities, institutional arrangements for selecting and managing PPPs, and lack of standardization in procedures including contracts and bidding process. Third, the regulators, sponsors and local Turkish banks are not familiar with the methods and opportunities to use Islamic Finance along with conventional finance and ECA backed finance in PPP projects. Therefore, there is a need to make all relevant stakeholders aware of the potential of Islamic finance and its applicability in PPP project finance including in raising funds through issuance of Sukuks.

80. **Government is trying to address these challenges.** To address the issue of harmonization of project document and to ensure prudent risk allocation between public sector and private sector, a new framework law for PPP model is being drafted. IDB Group could extend Islamic Finance solutions to non-sovereign guaranteed PPP projects in energy and transport sectors. IDB can also arrange a workshop or seminar in Turkey to make aware of the all the stake holders of infrastructure finance (Government authorities, project sponsor and lenders) on the methods to use Islamic Finance in project financing and also share IDB's experience in this area.

PILLAR 2: Enhancing Human Development through Education:

81. **Enhancing the educational system in Turkey is a key instrument in the NDP for strengthening human development in order to achieve Turkey's 21st century vision.**

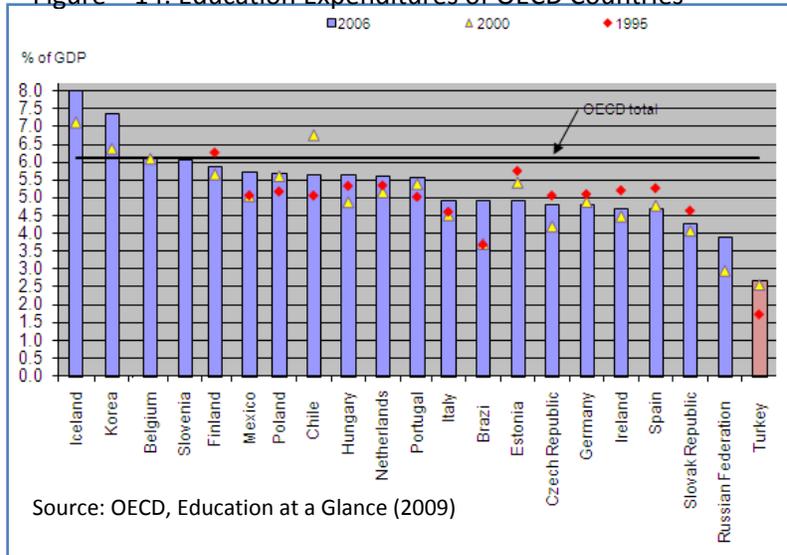
82. **Turkey has made significant progress in the development of its education sector.** Due to the investments into the education sector in recent years. The literacy rate has reached 90% and gross enrollment rates for primary, secondary and higher education schools have reached to 103.8%, 76.6% and 54.2%, respectively, according to 2010 Annual Program figures. Increasing access to the education at all levels was the primary driver of the education policy. To increase access to higher education, new public and private universities constructed in all provinces helped to raise the enrollment rate, by 8% between 2007 and 2009.

83. **The Government places education as one of the important pillars of its 2009 "Lifelong Learning Strategy Document"** with a vision of a competitive economy and an information society through access to learning opportunities to every segment of the society. Main axes of the strategy are to address physical infrastructure and human capital needs in the sector, to have compulsory pre-school education, and to restructure vocational education in a modular and flexible system.

84. **Total expenditure on educational institutions at all levels –primary, secondary, tertiary- appear to be amongst the lowest in the OECD as a percentage of GDP.**¹⁸ (See Figure 14)

85. The relatively low expenditures on education underline the importance of addressing the two main challenges outlined in Section II facing the educational sector: increasing the access to and quality of education at all levels, and enhancing the sensitivity of education to labor demand.

Figure – 14: Education Expenditures of OECD Countries



a) Increasing the access and quality of education through pre-primary school education:

86. **Quality of education at all levels and qualification of teachers need to be improved.** The 2006 PISA test results, as noted in Section II, reveal that half of the students in mathematic skills and one third of the students in reading skills are at low achievement levels. Inadequate generic skills such as analytical thinking, social and communication skills are among the top problems mentioned in a survey.¹⁹

87. **Contributing to the problem in quality, enrollment rates, especially at non-compulsory levels, are still lagging behind the EU and OECD averages.** Late enrollments, drop-outs, and access to education of girls and rural children are the main problems at the primary education level. This is partly due to the low coverage of pre-primary education where gross enrollment rate is 33.9%. Significant regional disparities remain regarding the access and number of students per classroom and per teacher.

88. **The world wide experience shows that early child education has a positive impact on learning achievements** throughout the education system particularly at primary and secondary education levels. The objective of the Government for pre-primary education pillar is to increase the gross enrollment ratio from about 34% to 70% by 2015 by providing one year of pre-schooling to children 60-72 months old. During the first phase, the Government has covered 32 provinces out of 81. The second phase, 2010-13, will cover 24 provinces with an estimated cost about US\$493 million. IDB could assist the Government in increasing the access to pre-primary schools to contribute to the overall target of the program through financing the construction and

¹⁸ Turkish figures are for public sector. EU,2008 (http://ec.europa.eu/education/lifelong-learning-policy/doc/report08/invest_en.pdf) suggests that private investment in education in Turkey is insignificant.

¹⁹ See "Higher Education and the Labor Market in Turkey", 2007

equipment of pre-primary schools. The outcome of the Government program supported by IDB will be increasing the enrollment ratio in for pre-primary schools to 70% in 2015.

b) Enhancing the sensitivity of education to labor demand through vocational education:

89. **Increasing the sensitivity of education to labor demand is necessary to address skills mismatch arising from structural transformation of the economy.** There is insufficient interaction between the vocational training system and the labor market. The imbalances between demand and supply of labor due to low qualification and productivity of labor force hamper the effectiveness of the labor market. This fact simultaneously leads to unemployment and vacant positions. Surveys show that language and computer skills are especially important for vocational school graduates to operate advanced machinery and communicate with foreigners. The existing vocational training system is characterized by regional disparities, insufficient physical infrastructure and equipment, and inadequacy of the curriculum with the labor market needs. The number of students per teacher has decreased in primary, secondary and general high school but it has increased in vocational schools.

90. **The objectives of the Government are (i) to improve the quality of delivery and to increase the access to vocational training and (ii) to restructure the existing vocational training network in order to increase its quality and improve its responsiveness to labor market needs.** The post secondary vocational education program intends to improve the physical learning environment through availability of adequately equipped and furnished classrooms, workshops, libraries, laboratories. The overall cost of the program is estimated at about US\$1.2 billion. The Curriculum will focus on knowledge, skills and competencies so that the graduates will be qualified for the labor market. The training will last 6 trimester including 3 trimesters of practical training in the labor market. A Quality Assurance institution is planned to be established with the responsibility of assessing the qualification of the candidates for the labor market though delivery of a license “ready for the job”.

91. **IDB could assist the Government through a technical assistance grant to prepare a study on the needs of vocational education.** The study should review the supply and demand (skills mismatch) in the vocational education area and policies and priorities of the Government and outline the options for enhancement of the vocational education and how IDB can be a part of the solution. A vocational education program for financing the construction, equipment and curriculum development of vocational schools and colleges (including the relative priority between the secondary and post-secondary programs) and a quality assurance institution could be designed following the above-mentioned study.

92. **The total IDB allocation for the education sector could be between US\$400 to 500 million for 2010-13.** Exact distribution among subsectors will be agreed upon with the Government.

PILLAR 3: Raising Employment through Private Sector Development:

93. **A major thrust of the NDP is to enhance employment opportunities in Turkey.** As noted in Section II above, achievement of this goal hinges on how the key sectors of the economy especially the labor-intensive industries, like textile and clothing, dominated by SMEs that were the engine of growth in the 2001-2007 period, invest and restore their competitiveness. The following selected areas of intervention, clustered under this pillar, support this NDP goal: addressing barriers to SME growth, supporting trade finance and insurance, development and diversification of financing instruments through Islamic Finance.

a. Addressing barriers to growth of SMEs and ICD role

94. **Micro, small and medium enterprises have a significant role in the Turkish economy.** According to the latest available survey, SMEs accounted for 99.6%²⁰ of total enterprises, 77% of total employment, 27% of value added and 38% of investment.²¹ More than 2.4 million SMEs operated in Turkey, employing nearly 9 million workers. However, accurate figures on the SMEs are hard to get since some of the activities of SMEs are concentrated in the informal sector.

95. **SMEs are mainly concentrated in trade, basic crafts and traditional industry.** Trade and commerce account for about of half of all SMEs; transportation, storing and telecommunication for around 20%, while manufacturing accounts only for 13%. In manufacturing sector, SMEs accounted for nearly 99% of total number of the manufacturing firms, 64% of total manufacturing employment generated, and 35% of the sectors value added. Within manufacturing, SMEs are concentrated in industries that need low-skilled labor and domestic raw materials. Industries such as textiles and leather, wood, furniture, food and drinks together account for 89% of total number of the SMEs in manufacturing sector.

96. **Available surveys indicate that lack of competitiveness is the main constraint to expansion of SMEs.** The results of a EU funded survey of 1500 small firms in 2008 found that having too “few clients” is the most significant constraint faced by the SMEs. The results also highlight the changing nature of constraints, as availability of finance, and government procedures including taxation, which were indicated as major constraints in 2005/2006, were no longer among the top five concerns faced by SMEs. The survey, as noted above, concluded that small firms are finding it difficult to compete with both the international firms and the informal sector in the current business environment. The 2008 OECD study also found that these firms have been unable to take advantage of growth opportunities available to them, i.e, they are having difficulty moving up the value added chain, and therefore, it is necessary to restore their competitiveness to achieve growth and expansion of SMEs.

²⁰ KOSGEB Presentation to the MCPS Mission, Turk Stat (2008)

²¹ 2004 OECD survey

97. **There are three sets of issues, which inhibit SME expansion and limit the capacity of SMEs to move up the value added chain:**

- I. *In addition to the problem of skills mismatch, discussed above, a lack of innovation capacity is also having an adverse effect on the ability of SMEs to compete.* The lack of innovation capacity of Turkish SMEs is highlighted in the low rate of new product introduction as well as low frequency of existing product line upgrading (ICA 2007) and their innovation levels are low compared to OECD/EU countries. Development of new product is strongly linked to the expenditure on R&D and technology adoption from abroad, which remains low in Turkey compared to other comparators.
- II. *Successful development of SMEs beyond subsistence activities requires a complex set of diverse institutions to create an SME friendly business environment.* Despite extensive government efforts to support SMEs, there is still a dearth of institutionalized support for SMEs in Turkey in some critical areas—for example, the absence of specific accounting standards suitable for SMEs means that most SMEs do not have reliable financial statements deemed an important determinant of firm growth. The problem of lack of accounting standards is compounded by the lack of corporate governance practices in SMEs and there is no clear distinction between owners and managers or household and business. As a result, most informal institutions have failed to formalize, micro-enterprises have been unable to grow and graduate into small and medium enterprises, and this may explain the lack of clustering.
- III. A third set of issues relate to the lack of availability of long term finance for SMEs which is directly linked to the growth of the firms as highlighted in the results of ICA, 2007. The credit of commercial banks to SMEs has grown since 2003, and its share in total financing to SMEs increased from 9.9% in 2005 to nearly 19.3% in 2008²². However, SMEs still face several constraints in obtaining long-term finance. The easing of constraints under this pillar is related to both the improvements in macroeconomic environment and providing SME friendly financial infrastructure at financial intermediaries including enactment of laws specifically related to centralized collateral registry system.

98. **Government realizes the vital role SMEs play in the Turkish economy, and a well-developed institutional structure is in place for SME policy development and implementation but some specific issues remain.** ²³ The most recent action plan prepared by the Government in 2010 calls for several measures including: a) composing new programs in order to encourage entrepreneurship; b) vocational and technical education; c) easing the access conditions of small

²² EU Study, 2008.

²³ There are several active public sector institutions and committees working on SME development include SPO, KOSGEB, MOIT, and YOIKK. These institutions are interacting closely with NGOs include TOBB and TESK that represent and support SMEs. In 2010, YOIKK prepared the latest Government Action Plan for SMEs. .

and micro enterprises to Government support; and d) proper functioning of Credit Guarantee Fund. The strategy appears to be sound but all encompassing and it may be better to focus on a package of binding constraints. Government strategy could also address policy support for firms and universities that undertake research and innovation. At the same time of particular importance is for the Government to facilitate development of accounting standards for SMEs to enhance transparency and improve governance.²⁴

99. **IDB interventions: IDB strategy will take a three-pronged approach** by (a) extending a line of long-term financing to SMEs, (b) providing technical assistance to carry out a survey of the constraints facing SMEs that affect their competitiveness and access to finance including financial reporting practices, and (c) providing capacity building programs based on results of the survey.

ICD Strategy for Turkey

While Turkey is in the process of ratifying the ICD Articles of Agreement, ICD will explore viable means of increasing its exposure to private sector in Turkey, through a number of activities such as co-financing, syndication and possible increase of Unit Investment Fund exposure. However, timely ratification of ICD Articles of Agreement by the Turkish Government is essential for successful implementation of the above mentioned IDB Group private sector/SME development programs in Turkey.

b. ITFC & ICIEC Role in Trade Finance and Insurance

100. **Trade finance is one of the most important factors enabling global economic integration.** Turkey has one of the largest international trade volumes among the IDB Member Countries. Exports and imports of Turkey reached US\$132 billion and US\$ 202 in 2008, respectively. Despite the improvements in the Turkish banking sector, there is a significant financing gap to cover financing of foreign trade.

101. **Line of trade financing operations of ITFC through local banks in Turkey has proved to be an efficient way to do business with Turkish SMEs.** The disbursement level and the developmental impact under the Line of Financing operations are higher compared to the direct operations. Other Multilateral Financial Institutions active in Turkey follow a similar approach where they reach the SMEs through the local banks via line of trade financing operations or confirming the L/Cs. In this regard, ITFC has been collaborating with public and private conventional banks for establishing new lines beside the well established cooperation with Turk Eximbank and the 4 Participation Banks which have already utilized several facilities and are interested to renew the lines.

102. **The main concern for extending the volume of lines with Turkish banks is the lengthy and detailed Line of Trade Financing Agreement format, which is not acceptable to some**

²⁴ The accounting standards set by Turkish Accounting Standards Board (TASB) are applicable to international firms but these pose onerous demands on SME enterprises, making construction of financial statements a problem for these firms.

conventional banks who argue that certain clauses are not in line with the local laws and regulations. IDB Group may assist the Government to develop a simpler legal framework for 2-Step Murabaha Agreement which is found unacceptable by not only the conventional banks but also the Participation Banks in Turkey. Besides the lines through the local banks, ITFC will continue to provide financial assistance to larger Turkish companies directly.

ITFC Strategy for Turkey

ITFC's objective for Turkey is to scale up its operation from its current target level in 1431H(2010G) of US\$150.0 million to about US\$200.0 million in 1432H and reaching US\$250.0 million by the end of 1434H.

A dynamic and competitive economy like Turkey, which is highly integrated with the global financial markets, requires ITFC to monitor the trends and position itself well to address the market needs. In this respect, the ITFC strategy for Turkey will be a flexible one and revisited according to the most recent available information during the year.

ITFC will continue to build on the ongoing operations mainly intervening by providing lines of trade financing through local banks. In this framework, partnership will be strengthened with the Turk Exim Bank, and the four Participation Banks which have successfully implemented similar mechanisms in the past. If the legal issues related to financing documents are resolved, ITFC will be able to pursue and develop business opportunities with intermediary banks, including Ziraat Bankasi, Vakifbank and Halkbank, where an SME financing scheme would be developed in cooperation with Undersecretary of Treasury and KOSGEB. With regards to ITFC's relations with Turkish companies, the focus will be on the 2nd tier companies on secured basis and the top tier companies will be considered for unsecured operations. ITFC would also lead syndications for mobilizing resources for large Turkish entities. Another possible intervention of ITFC would be in the structured commodity trade finance area especially for the exportation of agricultural products. ITFC would consider structuring export/import financing transactions in favor of Cooperatives and companies in agricultural and food sectors.

In addition to its trade finance operations, as a trade promotion and trade facilitation arm of the IDB Group, ITFC has developed very strong partnership relations is with Turkish Trade Support Institutions, which includes Export Promotion Centre of Turkey (IGEME), The Union of Chambers and Commodity of Exchanges of Turkey (TOBB), Independent Industrialists and Businessmen's Association (MUSIAD), Confederation of Businessmen and Industrialists of Turkey (TUSKON), Istanbul Chambers of Commerce (ICC). Based on this strong partnership relation, ITFC will continue to cooperate with Turkish TSIs in jointly implementing trade promotion and capacity building activities with view of transmitting Turkish experience and expertise in trade and industrial development to the OIC MCs. ITFC, within the framework of the MCPS, is ready and plans to strengthen its collaborations with Turkish government and non-government institutions in the area of trade and transport facilitation in order to accelerate trade and economic integration process of OIC MCs, through involving in preparation and implementation of cooperative OIC trade and transport facilitation strategy.

103. **ICIEC has recently selected Turkey as one of the primary targets for its activities.** In this regard, a considerable business development effort has been deployed since mid 1430H (2009G) for Turkey in order to raise awareness the Turkish Business Community about ICIEC export credit and investment insurance services. The main services that ICIEC has been promoting are medium

term export credit insurance services, investment insurance services and insurance of L/Cs in favor of banks, reinsurance of Turk Eximbank in addition to short term export credit insurance for non-clients of Turk Eximbank.

104. **The Turkish market is characterized by stiff competition in the field of short term export credit insurance services between Turk Eximbank and international credit insurance companies who are present in Turkey.** However, these players are only partially covering the market and there is a room for other players to enter the market.

ICIEC/ITAP Strategy in Turkey

ICIEC is planning to focus more on reinsuring Turk Eximbank and providing its services directly to exporters who are not covered by Turk Eximbank in order to complement the role Turk Eximbank is playing in Turkey. In opposition to short term credit insurance services, medium term credit insurance services are not developed enough in the country, which prevents Turkish exporters and contractors from providing long term supplier credit facilities to their cross-border clients. ICIEC will focus on providing such kind of services to exporters of capital goods and contractors who are executing projects outside Turkey to help them to increase their competitiveness. In addition, investment insurance services are not directly available in the Turkish market. By providing these services, ICIEC would encourage Turkish investors and contractors to invest and execute projects in many of its member countries especially in those where they don't have enough experience. Insurance of Letters of Credit to be confirmed by Turkish Banks is an important product that enables Turkish Banks to enhance their confirmation capacities on banks from importing countries and extend their confirmation business to more countries. ICIEC is paying a special attention to raise awareness among Turkish banks about this product.

The channels that ICIEC will be using to develop its business in Turkey are: (i) ICIEC's local agents (Aktif Bank and PGlobal Advisory Services); (ii) Turk Eximbank; (iii) Major international and local brokers based in Turkey; (iv) Turkish Banks; Organizing seminars and workshops in coordination with Turk Eximbank and different professional associations and governmental entities, such as Turkish Contractors Association, Chambers of Commerce, the Foreign Economic Board of Turkey (DEIK), and the Undersecretary of Foreign Trade of Turkey.

ITAP capacity building for investment promotion: *ITAP could capitalize on IDB Group relation with TOBB to transfer Turkey's best practices in attracting inward Foreign Direct Investment (FDI) to the Investment Promotion Intermediaries (IPI), in IDB member countries, in the framework of the cooperation which includes the development and implementation of "Business Support Program" to support private sector development in selected IDB member Countries, the development of training programs and capacity building on chamber management/chambers development, entrepreneurship, development and running of industrial zones, international trade, project cycle management, the promotion of business matching activities among the private sector and member investment business among IDB member Countries, the collaboration with regard to research projects leading to increased trade and investment business among IDB member countries, and sharing and transferring know-how between the IDB group and TOBB. ITAP will operationalize the cooperation by jointly conducting an upcoming training program on "Improving the Investment Climate." This program is designed for public policy officials from IDB member countries. The program will be policy oriented and cover the common problems encountered in investment climate reform and particularly lessons learned in Turkey's reform experience.*

c. Development and diversification of innovative financing instruments including Islamic Finance

105. **Improving financial system by developing new markets and products is one of the core pillars of Turkey's strategy to improve competitiveness.** There is particular focus on developing asset based security instruments to improve availability of long term financing in capital markets. Further, increasing financing opportunities available for SMEs is spelled out as a strategic priority under the SME Strategy and Action Plan. The Government aims to achieve this objective by introducing instruments based on joint ventures and partnership structures.

106. **Promoting the Islamic financial industry provides a promising opportunity to support Government goals and improve effectiveness of IDBG interventions.** The Islamic financial services industry started in Turkey some 25 years back with the start of Participation (Islamic) Banks. Turkey has been utilizing Islamic finance tools since the late 1980s through financial institutions known as "Special Finance Houses" (Ozel Finans Kurumu), which became the "Participation Banks" (Katilim Bankasi) with the enactment of the Banking Act No. 5411 ("Banking Act") on 1 November 2005. However, it remains a small segment of the Turkish financial sector. The participation banks - Albaraka Turk, Bank Asya, Kuveyt Turk and Turkiye Finans - administer about 5.2% total banking assets. The conventional banks hold 92% and investment banks hold the remaining of the Turkish banking system assets. The number of participation accounts grew by 92% from 1.2 million in 2005 to 2.3 million in June 2009. The share of number of participation accounts in the total banking system was 1.45% in 2005 and it increased to 2.46% in June 2009. Given the asset backed and partnership based nature of Islamic financial instruments, and its emphasis on profit- risk sharing makes it a suitable option to achieve the Government objectives.

107. **The industry growth is constrained by the lack of enabling institutional environment, including legal, supervisory, and regulatory structures necessary for effective operations of the participation banks.** The number of participation banks as a result could not grow due mainly to the limited use of financing and resource mobilization instruments. The main products used by the Participation Banks in Turkey are Murabaha, Ijara, and equity. Participation Banks are not allowed to use Istisnaa' as a mode of financing in which the bank acts as a provider of finance to the builder/construction company on behalf of a client. This is an important mode of finance in Islamic finance which enables banks to get involved in large projects which require some time to complete e.g. building ships, aircraft financing, large real estate projects. This is prohibited in Turkey due to the fact that it requires the bank to sign a contract for construction which is prohibited under Turkish Banking law.

108. **The Participation Banks raise resources from the market through deposits under Mudaraba as well as through Commodity Murabaha.** Both these instruments are used by the participation banks for raising short term funds. However, the long term funds are difficult to

mobilize as the current legal framework does not encourage issuance of Sukuk due to the tax implications and decline in the leasing portfolio of the participation banks.²⁵

109. **Government institutions dealing with the financial sector have an understanding of the problems faced by the Participation Banks.** Recently, two major initiatives have been taken in this regard. A regulation for issuance of Rent Certificates (Sukuks) under a modified structure using the services of Asset Renting Companies (ARC) in lieu of an SPV has become effective. This will enable private companies to issue Sukuk.²⁶ Furthermore, the Treasury has prepared a draft law on Sukuks. The second initiative taken by the Government is the introduction of Revenue Indexed Certificates, acceptable to a majority of Participation Banks (three out of four) as an Islamic Finance instrument to manage liquidity.

110. **IDB Group interventions will focus on creating awareness about the benefits of Islamic finance among the stakeholders and supporting the Government's efforts to provide enabling environment for Participation Banks to Operate.** In view of the current situation regarding the Islamic financial services industry in Turkey, IDB may intervene through the following means:

- 1) Provide a TA to the Government to conduct a diagnostic study of the Islamic financial services industry, including Sukuk, with a view to assess issues and opportunities including the feasibility of introducing "Takaful" instrument to enhance private savings.
- 2) Issuance of Sukuk will be facilitated based on the results of above study and in view of the substantial funding requirement of some of the large infrastructure projects, particularly in the transportation and power generation sector.
- 3) IDB Group can collaborate with Union of Participation Banks of Turkey to promote further development of Islamic Finance.
- 4) IDB Group will seek to assist in developing partnerships among Participation Banks and strategic institutes from other Member countries with the aim to enhance the capitalization, growth and product development capacity of Participation Banks.

²⁵ Sukuk issuance requires the selling of leasing assets to an SPV. Turkish law does not allow SPV (Trust structure) therefore assets can only be sold to an Asset Renting Company, which would attract double taxation. Besides, the leasing portfolio of the participation banks is facing a steady decline due to the increase in the value added tax, restricting the available assets to issue a Sukuk.

²⁶ The Government is working on the issues of double taxation regarding the ARC.

The Role of IRTI in Turkey

The Islamic Research and Training Institute (IRTI) undertakes research for enabling economic, financial and banking activities in member countries to provide training facilities to personnel engaged in economic development activities. One of IRTI's main activities is to create, promote and disseminate knowledge on Islamic economics, banking and finance through internal research on various topics of interest, production of high quality research and academic publications, organizations of research conferences and other events, and provision of learning and training activities.

IRTI has built strong partnership with various academic institutions, training institutions, infrastructure institutions and centers of excellence across the globe. Hence, IRTI has working relationships with universities, academic and training institutions for cooperation in research and its dissemination as well as capacity building efforts in the areas of Islamic economics and finance. IRTI encourages innovative research by external scholars, researchers and institutions and seeks to directly influence the process of knowledge creation and dissemination through several programs, such as scholarship and grants, visiting scholar scheme and annual prizes to distinguished scholars of Islamic economics and banking for their seminal contributions in the field.

During 2007 and 2008, IRTI conducted a course on Financing Small Businesses in collaboration with KOSGEB. IRTI will provide assistance to TOBB University of Economics and Technology to setup Islamic Financial Courses in the University. IRTI is also planning to organize Islamic Microfinance Training Programs in Turkey, in coordination with TOBB.

PILLAR 4: REVERSE LINKAGE: SUPPORT TURKEY CAN PROVIDE TO OTHER MEMBER COUNTRIES

111. **The support Turkey is willing to provide to other member countries in areas where it has developed a high level of expertise is a unique feature of the Turkey MCPS.** The IDB Group is a South-South MDB with experience in matchmaking between stronger and weaker partners where the Bank facilitates the transfer of resources and the sharing of knowledge. Given this background, the MCPS for Turkey will capitalize on Turkey's positive experience to give support to other IDB Group MCs to improve their trade and economic development through human and institutional capacity building.

112. **Turkey has an active technical development assistance program.** Turkish International and Development Agency (TIKA) is the main implementing agency for bilateral cooperation. The review of the development assistance from Turkey reveals the following areas of strength where Turkey can assist IDB MCs: (i) Social and Economic Infrastructure and Services; (ii) Business development, especially SMEs and Public-Private Partnership; (iii) Security; (iv) Emergency relief. Turkey and IDB Group has had a fruitful cooperation.

113. **IDB Group has signed several MOUs with GoRT involving TIKA, the Union of Chambers and Commodity Exchanges of Turkey (TOBB) and other institutions to enhance cooperation.** IDB Group mobilized 31 Turkish experts in 25 operations. The areas covered were mainly public

services, economy and international finance, SMEs/SMIs, water resources/irrigation, shipbuilding, leather industry, metallurgy, railways construction, science & technology, education planning and architecture, food processing and marketing, agriculture and transport. IDB Group further availed the training capacity of Turkey to finance the on-the-job training and study visits of around 400 people in several areas. IDB Group also receives support from Turkish institutions to organize seminars, meetings, workshop on a wide range of subjects such as promotion of intra-OIC trade, trade information system, cotton, "Halal" industry, commodity exchange etc. In the last four years, the IDB Group organized a total of 15 capacity building and trade promotion activities in Turkey for MCs in cooperation with Turkish Trade Support Institutions (TSIs).

114. Based on IDB Group experience in delivering technical assistance and on the strengths of Turkey, the following areas could be considered for cooperation in technical development assistance between Turkey and IDB Group:²⁷

- A. **Capacity building programs:** (a) preparation and implementation of national development programs and foreign direct investment strategy; (b) public fiscal management; (c) central bank management; (d) banking supervision; (e) agriculture; (f) environment; (g) education; (h) privatization; (i) public private partnerships and energy market regulation; (j) custom procedures; (k) standards; (l) science and technology policies; (m) research and development support programs; (n) technology recycling and know-how transfer; (o) health; (p) tourism; (q) earthquake preparation and disaster risk management; (r) public procurement (e-procurement, law, platform, etc.); (s) regional development and development agencies; (t) electricity interconnection and planning
- B. **Private sector focused programs** (a) trade promotion and facilitation; (b) establishment, management and operation of industrial zones and free trade zones; (c) establishment of manufacturing cluster and/or industrial zone in one selected MC as a pilot project; (d) private sector/ SME development and support programs; (e) preparation of sector export strategies; (f) establishment of business development centers in a MCs; (g) organization of business-matching and joint trade mission activities; (h) establishment OIC SME Support Institutions Network; (i) inviting Turkish contractors/consultants to participate in IDB Group financed projects throughout the MCs; (j) facilitating investments of Turkish companies in MCs²⁸
- C. **Emergency Relief and Humanitarian Assistance** programs in cooperation with Turkish Red Crescent in conflict and disaster areas and in cooperation with TIKA in post-conflict reconstruction activities.

²⁷ As a follow-up to the MoU signed between Turkey and IDB Group in March, 2010, an interagency committee comprised of TIKA, Turkish Red Crescent, Ministry of Education, Higher Education Council and Religious Affairs Administration visited IDB HQ on 30 May-2 June 2010 and identified cooperation possibilities with the IDB Group. An activity list encompassing below listed 5 areas has been prepared.

²⁸ IDB Group may cooperate with following private sector organizations, among others: The Union of Chambers and Commodity of Exchanges of Turkey (TOBB), Turkey Businessmen and Industrialists Association (TUSIAD), Independent Industrialists and Businessmen's Association (MUSIAD), Confederation of Businessmen and Industrialists of Turkey (TUSKON), Istanbul Chambers of Commerce (ICC).

- D. **Cooperation under COMCEC:** (a) Replication of Turkey-Syria Cross Border cooperation program, which is supported by IDB Group with a US\$ 1 million grant; (b) Implementation of COMCEC programs to improve and enhance trade and economic integration among OIC MCs through establishing working group, organizing seminars, workshops on the implementation of OIC Trade Preferential Agreements, harmonization of custom regulations and identification of non-tariff barriers to trade. (c) Establishing a new IDB scholarship program benefiting from the experience of OIC-VET Program developed by SESRIC. This program could focus on two major areas: (i) Scholarship opportunities for promising students from Member Countries for master's degrees in trade, economics and finance, (ii) Training for officials and professionals from the Least Developed Member Countries in coordination with the relevant Turkish organizations and institutions.
- E. **Cooperation for Muslim Communities in Non-Member Countries,** especially in Eastern Europe and Caucasus, through development of joint assistance programs with TIKA, Turkish Red Crescent, Ministry of Education and Turkish Administration of Religious Affairs as well as enhancing the cooperation for scholarship programs.

115. **TIKA could be considered as the national coordinator in Turkey for capacity-building programs and other technical assistance activities towards third countries** that are financed by either party. However, TIKA's coordination role shall not exclude existing framework agreements between IDB Group and other Turkish institutions. The proposed scheme is basically a tri-partite arrangement with a donor country (Turkey), a beneficiary country and a facilitator (IDB Group). Responsibilities shared, possibly, as follows: **Beneficiary:** to formulate requests; to provide reliable counterpart; to provide local administrative and logistical support, to mobilize in-kind contributions and absorptive capability to retain transfer knowledge and skills. **Donor:** to participate in formulation and supervision of assistance programs; to supply human and financial resources; to maintain rosters of consultants, experts, skilled workers; to coordinate and make available resource institutions and persons; and share in the cost of related activities. **Facilitator:** to help align supply and demand sides; to firm up assistance program; to develop financial and technical partnerships; to provide guidance and supervision; to mobilize financial resources; and to manage the assistance programs/projects.

116. **Benefits from Reverse- Linkage to IDB Group and Turkey:** Both IDB Group and Turkey will benefit from this reverse linkage, through interventions proposed within the reverse linkage framework. The benefits to Turkey include: (a) business opportunities for Turkish firms, (ii) enhances the image of Turkey in OIC member countries, (iii) new export markets for Turkish goods and services. The eventual outcome of this would lead to a resources transfer, which will be much larger than the amount of funding provided by IDB Group through technical cooperation, grants and financing under this framework. Concrete examples of additional benefits beyond IDB Group direct financing can include the positive outcome of Turkey- Syria Cross Border cooperation program, Turkey's enhanced opportunities for investment and trade in African and Southeast Asian countries, potential opportunities for Turkish contractors and consultancy companies in IDB Member Countries.

F. INDICATIVE MCPS PROGRAM AND POTENTIAL AREAS OF COLLABORATION WITH OTHER DEVELOPMENT PARTNERS

117. **The Government has indicated that its main interest is in seeking financing for large projects and programs which is consistent with IDB Group's objective to scale-up.** Within this context, a sizable financial envelope of around US\$ 2.0 billion for IDB Group intervention (for which Turkey has sufficient absorptive capacity at the project and country level) has been planned under this MCPS for the 2010 – 2013 period. An Indicative Program for the 2010-2013 period is attached. The actual financing amounts, however, will be determined during the programming phase taking into account country needs, growth scenarios, country exposure limits as well as the IDB cap on the size of a single project.

118. **During the external consultation with the development partners in Turkey following areas are identified as possible areas of cooperation:** (i) Vocational and pre-school education and disaster management with World Bank; (ii) Transport and energy with European Investment Bank; (iii) Public private partnerships with European Bank for Reconstruction and Development. **IDB Group will also share this MCPS document with the "Coordination Group" to explore and identify areas of cooperation.**

Non-project related support:

119. **In each area of planned project-based intervention during 2010-2013 IDB Group will discuss with Government possibilities of providing non-project support (TA, sector work, etc.) to complement the selected interventions and add to their value.** Sector work is additional areas (e.g. rural development or urban infrastructure) can be done to prepare for intervention in the next MCPS cycle.

G. ITEMS FOR FUTURE DIALOGUE AND NEXT STEPS:

120. Several important issues have emerged during the MCPS discussions between the Government and IDB Group to further enhance and enrich the dialogue and relationship for mutual benefit:

- Establishment of IDB Group local presence in Turkey (preferably in Istanbul, as per the Government request, which is advocating the city as a financial hub) to coordinate IDB Group activities, increase IDB Group awareness and visibility, enhancing the implementation and effectiveness of IDB Group operations
- Finalization of the ICD Articles of Agreement ratification process to allow full fledged ICD operations for private sector development which is one of the pillars of the MCPS. The Government requested ICD, in the interim, to consider extending activities to IDB MCS which are not member of ICD
- Further development and diversification of financing instruments through Islamic Finance

- Supporting the enhancement of Turkey's role and image in OIC and affiliated institutions including COMCEC and Statistical Economic and Social Research and Training Center for Islamic Countries (SESRIC)
- Encouraging Turkey to play a greater role and provide support to Islamic Solidarity Fund for Development
- Establishing a new IDB scholarship program benefiting from the experience of OIC-VET Program developed by SESRIC
- Secondment of Turkish staff to IDB to gain exposure to international development matters, as per the request of the Government
- Improvement of trade finance instruments in terms of pricing, maturity, buyer credit and pre-shipment mechanisms for export finance
- Development of joint political risk insurance model between ICIEC and Turk Eximbank

Key Steps:

1. Familiarization visit from IDB Governor's Office to IDB Group HQ;
2. Official launch of the MCPS in Turkey;
3. IDB Group road show in Turkey to 3 major cities, as suggested by, and to be organized in coordination with, the IDB Governor's Office;
4. IDB programming mission to Turkey to develop a project pipeline for 2011-2013;
5. Mid-term review of the implementation of MCPS in 2012;
6. Final review of the MCPS to assess the impact and initiation of the next MCPS in 2013

Table 5: Indicative IDB Group MCPS Financing Program for 2010-2013 (1431H-1434H) for Baseline Growth Scenario (US\$ million)

2010	2011	2012	2013
IDB			
1. Energy 2. Private sector development US\$ 200-300	1. Education 2. Energy 3. Private sector development 4. Disaster management and/or Transport US\$ 300-500	1. Transport 2. Education 3. Energy 4. Disaster management 5. Private sector development US\$ 800-1,000	
ITFC			
Trade finance target: US\$ 150-200	Trade finance target: US\$ 150-200	Trade finance target: US\$ 150-250	Trade finance target: US\$ 150-250
Total project and trade finance: US\$ 300-500	Total project and trade finance: US\$ 400-600	Total project and trade finance: US\$ 900-1,300	
Indicative total project and trade finance: US\$ 2,000 (approximately)			
ICIEC			
Export/Import insurance: US\$ 100-120 Investment insurance: 1 investment / project	Export/Import insurance: US\$ 100-150 Investment insurance: 1-2 investment / project	Export/Import insurance: US\$ 250-300 Investment insurance: 1-2 investment / project (per year)	
<p><u>Reverse Linkage:</u> Setting up of a facility, with contributions, in kind or in cash, from Turkey and IDB Group, for the implementation of the activities related to Reverse Linkage and assistance.</p> <p><u>Technical Assistance:</u> Developing a creative instrument to finance sector works, capacity building, feasibility studies, conferences, seminars, workshop for the implementation of MCPS.</p>			

V. RISKS AND UNCERTAINTIES

Size of the Financing Envelope:

121. The financing envelope agreed with the Government is in accordance with the baseline growth scenario outlined in the MTP. Under a higher growth scenario, financing requirement could be higher due to the investment needs especially in the energy sector as well as external financing required to fill the investment-savings gap. Moreover, sectoral distribution of the financing envelope was prepared according to the baseline growth scenario. Some sectors could be front or back loaded depending on the needs.

122. **Mitigation:** The size of the financing envelope reflects consultations with the Government and within IDB Group. Though the program appears robust for the base case scenario, a built –in midterm review mechanism is included to mitigate the overall risks. The midterm review of the MCPS will provide an opportunity to consider alternate growth scenarios and availability of financing from other development partners and international markets.

Potential Areas for Future IDB Group Engagement:

Since the financing envelope for Turkey is high, relative to IDB Group norms, the Government’s willingness to implement agreed new programs and projects with IDB Group in identified areas of engagement is important for the utilization of the agreed financing amount. Since these are new areas for the IDB Group in Turkey, there is a level of uncertainty about the actual implementation of these programs. At the same time, it is not possible to exclude the possibility of the emergence of unexpected new priorities, as the program evolves.

123. **Mitigation:** The areas for potential IDB Group interventions mentioned above-- energy, transport, education, disaster management and private sector development—have been selected using criteria consistent with IDB reform process and after extensive discussion with Government to ensure endorsement. In addition, unexpected developments or priorities can be considered consistent with the selection criteria, especially at the mid-term review.

Implementation:

124. Since the MCPS program covers several sectors and projects, the implementation process will include many executing agencies and private sector partners, which will be dealing with IDB Group project implementation arrangements. In addition, the IDB Group will be implementing some new financing models in Turkey for the first time. Therefore, familiarization of executing agencies and business partners with the IDB Group rules and procedures as well as project implementation arrangements will be critical for improving future project implementation. However, risks remain particularly in relation to implementation of complex public projects with new executing agencies, disbursements through private banks and harmonization of IDB Group procedures with private sector.

125. The MCPS process focuses on private sector development, trade finance and also implementation of some projects through private sector sponsors (such as for renewable

energy). Turkish banks will most likely play a significant role during the implementation process through guarantees for private companies. However, IDB Group country exposure limits for trade finance operations and low exposure limits to Turkish banks may pose significant obstacles.

126. **Mitigation:** IDB Group will arrange workshops, familiarization visits and IDB Group days to mitigate the risks related to the implementation. As observed during the implementation of the Railway Tracks project with Turkish State Railways, well designed appraisal process and familiarization of the executing agency are key to proper implementation of the projects. IDB will carry out an internal review of the Turkish financial sector and risk assessment of individual banks regarding the exposure limits extended to Turkish banks.

Impact:

127. There are also some risks related to outcome and impact of the MCPS program. The results matrix outlining the expected impact of MCPS program has been prepared taking into account the planned investments of the Government as well as the interventions of other development partners. Expected impact depends on implementation of the MCPS in coordination with the Government and other development partners. Therefore, IDB Group will continue active dialogue with Government and development partners during implementation.

Political Economy Considerations:

128. The electoral cycle calls for new parliamentary elections in Turkey in 2011. A change in the Government may affect the development priorities of the country. To mitigate this political-economy risk, this MCPS has been designed, based on a careful analysis and wide consultation, to address the key constraints facing the country in meeting the goals outlined in the NDP, approved by Parliament. In addition, there has been extensive consultation with the public and private sector institutions and civil society in the design of interventions. Therefore, the priorities outlined in the MCPS are likely to be relatively immune to political-economy developments.

Pricing:

129. According to the figures presented by the Government, the financing cost of the IDB Group is higher, compared to other major development partners. The Government expects IDB Group financing to be more competitive and accepts IDB Group financing because of the value-added that IDB Group brings to the country, such as alternative financing modes and reverse linkage consistent with its needs. However, if the financing cost margin between the IDB Group and other development partners widens, it will pose a risk to the implementation of the MCPS program, as designed. On-going monitoring of relative financing costs and effective implementation are important to manage this risk.

Legal-Tax Issues:

130. There are certain legal and tax implications for IDB Group financing arising from inadequacies in the regulatory framework for Islamic banking and finance in Turkey. The Government has agreed to review and study this matter at the earliest possible opportunity to avoid any negative impact on financing operations in Turkey.

V. CONCLUSION AND WAY FORWARD

131. Turkey's economic development has great significance given its size, its strategic role in the region and as the largest economy in, and leading member of, the Organization of Islamic Countries. Turkey's development is also significant as it is the only member country represented in the OECD and a candidate for European Union membership.

132. Turkey has a seven-year record of strong macroeconomic performance and structural reforms. It made remarkable progress in economic management, which greatly improved macroeconomic stability and facilitated strong growth of the economy between 2002 and 2007. In the wake of the 2001 economic crises, the Government also introduced structural reforms to reduce the role of the state, improve the business environment for private investment and strengthen the financial sector to facilitate continuing transformation of Turkey into a modern industrialized economy. During this period, economic growth accelerated to 7%, inflation declined to single digits and poverty, as measured by the US\$2.15 per day guideline, became almost non-existent. More recently, the economy's relatively quick turn-around from a major downturn triggered by the global financial crisis, reflects the efficacy and soundness of the Government's economic policies and performance.

133. Looking forward, as analyzed in this report, significant challenges remain, however, in the medium term. In particular, the prospects for achieving the 7% economic growth target, as envisaged in the Ninth Development Plan, and creating more jobs hinge on how key sectors of the economy, especially the labor-intensive industries like textile and clothing that were the engine of growth in the 2001-2007 period, invest and restore their competitiveness in the face of structural constraints. The latter include a relatively low national savings rate, human development to match the needs of an industrialized economy, infrastructural bottlenecks, availability of and access to long-term finance, and measures to encourage expansion of SMEs.

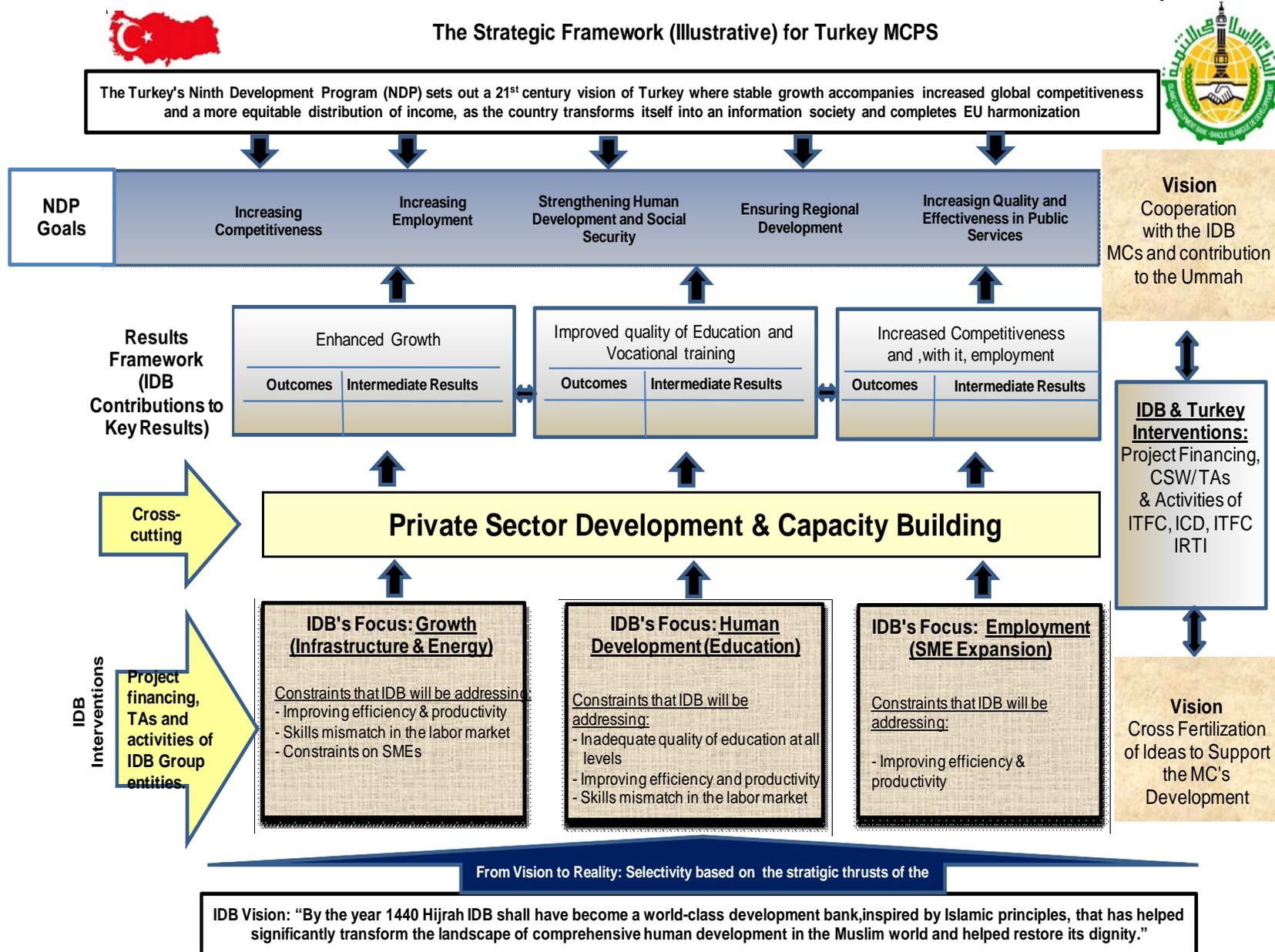
134. The MCPS outlines a substantial IDB Group Program of cooperation spread over next four years to help Turkey meet its medium-term challenges. Key steps in the way forward to ensure success include more detailed programming, enhancing the effectiveness and role of IDB Group entities particularly to facilitate private sector development, and a mid-term review to assess progress and make needed corrections. These steps will help to encourage effective implementation of the MCPS as an instrument of IDB Group's partnership with Turkey

135. There are significant benefits to both sides of the partnership. The partnership will help Turkey in its quest to achieve its long-term vision of a prosperous Turkey with closer economic relationship with other members of the OIC through "Reverse Linkage" and convergence with EU in terms of quality of life and living standards. For the IDB Group the MCPS will form the cornerstone of its dialog with Turkey—it will leverage internal Group synergies and enhance the country's ownership, and with it, the development impact of IDB Group interventions.

THE STRATEGY OF THE NINTH DEVELOPMENT PLAN (2007-2013)



Source: NDP



Pillar 1: Supporting Growth (through Infrastructure Development - Transport)					
<i>Government Goals/ Strategy</i> <i>Source: 9th Development Plan</i>	Current Challenges/Binding Constraints	Outcomes that the IDB Group Expects to Support	Intermediate Results that IDB Group Expects to Influence During the MCPS Period	IDB Group Interventions	Output
Creation of a balanced and efficient transportation infrastructure	<p>Passenger and freight transport are excessively dependent in the road network in Turkey.</p> <p>Inadequate and substandard physical infrastructure for railways and maritime transport</p> <p>Lack of access to integrated multimodal transport modes</p> <p>Big cities without modern in-city rail transport networks</p>	<p>Improving East-West and South-North road and railway transport corridors</p> <p>Increasing the share of railways in passenger and freight transport</p> <p>Increasing the competitiveness of the transport sector through multi-modal solutions</p> <p>Lower transportation costs to businesses</p> <p>Better urban transport networks</p>	<p>More efficient railway transportation with an introduction of electric locomotives to selected areas</p> <p>Completion of the rehabilitation work of the selected section of the railway network</p> <p>Starting the construction of an hub-port, logistics village, new railway route and a major highway</p> <p>Identify the potential financing needs in the urban transport system</p>	<p><u>Ongoing:</u> Procurement of railway tracks Procurement of 80 electric locomotives</p> <p><u>Planned:</u> TA to study alternative solutions creating a balanced and efficient transport network Expansion and modernization of the railway network</p> <p>Construction of a major hub-port and integration/connecting of ports to other transport modes</p> <p>Construction of a logistic village and integration/connection of logistics villages to other transport modes</p> <p>Expansion of highway network under public private partnership model Modernization of in-city transport networks</p>	<p>Delivery of 80 electric locomotives</p> <p>Reconstruction/ rehabilitation/ modernization (signalization and electrification) of railways</p> <p>Construction of a new railway line connecting Turkey to other IDB MCs</p> <p>Construction of a major port and Integration with the railway network</p> <p>Construction of a logistics village</p> <p>Construction of highways</p> <p>Modern city transport systems for the identified areas</p>

Pillar 1: Supporting Growth (through Infrastructure Development - Energy)					
<i>Government Goals/ Strategy Source: 9th Development Plan</i>	Current Challenges/Binding Constraints	Outcomes that the IDB Group Expects to Support	Intermediate Results that IDB Group Expects to Influence During the MCPS Period	IDB Group Interventions	Output
Increasing Competitiveness through improving the Energy Infrastructure	<p>Turkish economy is highly dependent on imported fossil-fuels to satisfy its energy needs which make it vulnerable to price increases and supply interruptions</p> <p>High electricity tariffs</p> <p>Inadequate awareness of the benefits of energy efficiency and perceived high technical and financial risks of such projects among industry</p> <p>Lack of availability of long-term financing</p>	<p>Enhanced competitiveness of firms through access to cheaper and reliable energy.</p> <p>Improve Energy Security by:</p> <ul style="list-style-type: none"> a. Development of indigenous energy resources, including RE b. Reduced dependence on imported fossil fuels c. Better demand management by decreased energy wastage in households and energy intensive industries <p>Lower electricity tariffs by optimizing fuel-mix and promoting economic hydropower and wind power plants</p>	<p>Utilization of IDB Financing Facilities to Turkish Banks for Energy Infrastructure development</p> <p>Completion of Studies to identify suitable Energy Enhancement projects/programs for IDB financing and quantification of their benefits</p>	<p>Develop strategic partnerships with local financial intermediaries as well as concerned State entities to support:</p> <ul style="list-style-type: none"> i. Development of country's Renewable Energy (RE) infrastructure (includes transmission interconnections); ii. Sector Study to identify and quantify benefits of energy enhancement projects, i.e. <ul style="list-style-type: none"> a. Replacing energy inefficient equipment b. Utilizing waste heat for energy production c. Improving building insulation system 	<p>Incremental power capacity of renewable energy connected to the grid;</p> <p>Additional production of electricity using RE resources</p> <p>Energy Savings measures through implementation of RE projects;</p> <p>GHG Emission reduction potential achieved.</p> <p>Incremental revenue through sales of Carbon Credits generated through RE and EE projects.</p>

Pillar 2: Enhancing Human Development (through Interventions in Education)					
<i>Government Goals/ Strategy</i> <i>Source: 9th Development Plan</i>	Current Challenges/Binding Constraints	Outcomes that the IDB Group Expects to Support	Intermediate Results that IDB Group Expects to Influence During the MCPS Period	IDB Group Interventions	Output
Improving quality and efficiency of education through increased access to pre-primary education	<p>Limited access to pre-primary education (that has negative impact on primary school student’s retention and learning achievement)</p> <p>Note: Only 32 provinces out of 81 covered by the pre-schooling program (Enrollment ratio 33.9% versus EU-27 average of 88.4%)</p>	<p>Enhanced and measureable improvement of quality of education at all levels</p> <p>Increased Pre-primary education gross enrollment ratio from 34% to 70% by 2015</p> <p>Improvement of retention ratio for the primary schools</p>	<p>Children in 24 additional provinces will be attending the pre-primary schools</p> <p>Reduction of late enrollments and dropouts at primary education, particularly in rural areas and for girls by 2013</p>	<p>Financing for the construction of pre-primary schools and provision of related equipment and furniture (in year 2011)</p> <p>TA for baseline study (through achievement test) and for performance monitoring</p>	<p>Construction and equipment of pre-primary schools</p> <p>Recommendations from the baseline study are implemented</p>
Increasing the sensitivity of education to Labor demand	<p>Skills miss-match due to the transition to an industrialized economy</p> <p>Availability of skilled manpower</p>	<p>Substantive increase in the quality and level of vocational training</p> <p>Reduce skills mismatch through availability of skilled labor</p> <p>Quality Assurance Mechanism in place for independent monitoring of the “licenses”</p>	<p>Share of vocational training in total enrollment increases to 50% by 2013 and modular and flexible system for interaction with the labor market implemented</p> <p>Restructuration of the existing network to increase output qualified for the labor market</p> <p>A Quality Assurance Institution assesses the graduates and delivers license “ready for a job”</p>	<p>TA to carry out a study for assessing vocational training needs in secondary and post-secondary level</p> <p>Financing for the new secondary and post-secondary vocational training based on the Study</p>	<p>Construction and equipment of new secondary vocational training centers</p> <p>Recommendations from the study are implemented</p> <p>A Quality Assurance Institution is constructed, equipped and furnished</p>

Pillar 3: Raising Employment (through SME Development/PSD)

Government Goals/ Strategy (Source: 9 th Development Plan)	Current Challenges/Binding Constraints	Outcomes that the IDB Group Expects to Support	Intermediate Results that IDB Group Expects to Influence During the MCPS Period	IDB Group Interventions	Output
<p>Increase Private Sector Investments</p> <p>Improve The Business Environment</p> <p>Reducing the Informal Economy</p>	<p>Lack of competitiveness and clientele</p> <p>Prevalence of individualistic approach in business rather than clustering</p> <p>Transparency issues: absence of audited financial statements in SMEs, especially micro enterprises</p>	<p>Significant increase in employment through the expansion of SMEs</p> <p>Substantive growth in SME exports in terms of revenue and share</p> <p>Turkish Investors and contractors increase their cross-border investments and projects via investment insurance services.</p>	<p>Medium to long term financing for SMEs has increased</p> <p>Significant increase in the employment of firms operating for more than 4 years</p> <p>Increase in the number of SMEs with audited financial statements</p> <p>Increase in the incidence of mergers by SMEs</p> <p>More awareness about ICIEC insurance services available for Turkish contractors and investors.</p>	<p>Provide a line of financing to SMEs to improve their access to finance</p> <p>Provide technical assistance to do a needs assessment survey for SME development</p> <p>ICIEC to organize a marketing campaign to introduce its services to Turkish investors and contractors (seminars, announcements, companies' visits, etc.)</p>	<p>Disbursement of the lines of finance in combination of TA for upgrading skills and transparency</p> <p>Use of consultants for improving accounting standards</p> <p>Use of technical assistance funds for skills upgrade</p> <p>Issue investment insurance policies in favour of Turkish companies for projects / investments executed in ICIEC member countries</p>
<p>Improving R&D and Innovativeness</p>	<p>Relatively low levels of expenditure for innovation and research and development by the private sector</p>	<p>SMEs moving up value – added chain and providing better quality goods for which they can charge a higher price</p>	<p>Increase in the productivity of SMEs</p> <p>Increase in the percentage of full-time researcher personnel employed in the private sector</p>	<p>TA program to SMEs through KOSGEB and financial institutions to assist SMEs (on cost-sharing basis) to invest in upgrading of products and skills by employing services of private sector firms and consultants</p>	<p>TA program “To enhance expenditure for R&D and innovation for the SME Sector”</p>

<p>Improved export competitiveness, Increase firms' access to finance and improve corporate governance</p>	<p>Lack of access to trade financing Tax burdens for borrowing of the trade oriented firms</p>	<p>Better access to finance for trade Increase in trade operations between OIC countries Better competitiveness of the Turkish Exporters in the global market</p>	<p>Tax burdens for the trade oriented firms have been revised Implementation of the recommendation of the study</p>	<p><u>Ongoing:</u> Existing IDBG Trade financing operations Trade finance lines with 4 Participation Banks and Turk Eximbank for an amount of US\$110 million. Direct operations with private companies for an amount of US\$89 million <u>Planned:</u> Provide trade finance facilities to Turkish banks and private sector companies TA for a study to determine the economic effects of reducing the tax on borrowing for less than 12 months.</p>	<p>Disbursement of the lines of finance Recommendations of the study on tax alleviation are presented in a workshop to the Government.</p>
---	---	---	--	--	---

Pillar 3: Raising Employment (through Diversified Islamic Finance Instruments)

<p>Government Goals/ Strategy (Source: 9th Development Plan)</p>	<p>Current Challenges/Binding Constraints</p>	<p>Outcomes that the IDB Group Expects to Support</p>	<p>Intermediate Results that IDB Group Expects to Influence During the MCPS Period</p>	<p>IDB Group Interventions</p>	<p>Output</p>
<p>Increase Private Sector Investments Improve The Business Environment Development of New Financing Instruments</p>	<p>Limited and small size market share of the Participation banks (Islamic Banks) Lack of diversified Islamic products, both on asset and liability side</p>	<p>Significant increase in the number/size of participation banks Significant increase in Islamic financial products to meet the requirements of the businesses</p>	<p>Changes to the legal, regulatory and supervisory environment to enable Participation banks to perform effectively and efficiently Increasing awareness of Islamic financial products</p>	<p>TA for the development of Islamic financial industry - Familiarization visit to study Islamic Financial legislation - Introduce the new liquidity management products - To conduct a detailed study on how Islamic Finance modes could bring additional financing for SMEs and Private Sector of Turkey. Assisting the introduction of strategic partners from other IDB member countries to enhance the capitalization of participation Banks and provide expertise from other regions Facilitate the expansion of the Participation banks to other member and non-member countries.</p>	<p>Expanded Islamic financial market with a larger no. of players with a greater size of operations Recommendations from Islamic Finance Study disseminated in a workshop Successful issuance of the 1st Sukuk in Turkey</p>

Pillar 4 : Reverse Linkage					
Government Goals/ Strategy and IDB Vision it supports	Current Challenges/Binding Constraints	Outcomes that the IDB Group Expects to Support	Intermediate Results that IDB Group Expects to Influence During the MCPS Period	IDB Group Interventions	Output
<p>Improve social and economic relations among OIC MCs and contribute to achieve the millennium development goals</p> <p>Enhance Turkey’s image and resource transfer through access to markets in OIC MCs for Turkish Goods and Services</p> <p>Achievement of IDB Vision 1440H for cross fertilization of ideas to support the MCs development</p>	<p>Lack of studies to identify development needs of OIC MCs</p> <p>Dispersed geographical location of OIC MCs</p> <p>Difficulties in sustaining outcomes of the interventions</p>	<p>Improvement in planning and delivery of technical assistance</p> <p>Resource transfer through enhancing trade between OIC MCs and access to new markets in OIC MCs</p> <p>Enhance South-South cooperation and trade</p>	<p>Substantive increase in the Technical Cooperation between Turkey and the OIC MCs</p> <p>25% increase in non-oil trade between Turkey and OIC MCs compared to 1430H (2009G)</p> <p>Multiplier effect of IDB Group Technical Assistance and Grants to the MCs through other parties including Turkey</p> <p>Increase in regional cooperation projects/programs involving Turkey and other OIC MCs</p>	<p><u>Ongoing:</u> Capacity building and knowledge sharing programs on economic and trade related subjects</p> <p>Facilitation of participation of SMEs and trade support institutions in trade promotion activities organized in Turkey</p> <p><u>Proposed:</u> Establishment, management and operation of industrial zones and free trade zones</p> <p>Private sector/SME support and development programs</p> <p>Establishment of business development centres in MCs</p> <p>Organization of business-matching and joint trade mission activities</p> <p>Establishment OIC SME Support Institutions Network</p> <p>PPP model in customs border gate construction and operation</p>	<p>Human and institutional capacity of trade support organizations improved</p> <p>Productive capacity of selected LDMCs enhanced</p> <p>New business contacted established</p> <p>Volume of intra-OIC trade increased</p>

Annex - 4 A

Turkey Selected Socio-Economic Statistics

Indicator					Estimated		Projected				
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Population (millions)	68.1	68.9	69.7	70.5	71.4	72.3	73.2	74.2	75.1	76.1	
Real GDP (LCU, Billions)	96.7	101.3	101.9	97.1	102.1	105.6	109.4	113.5	118.1	122.8	
Real GDP growth (%)	6.9	4.7	0.7	-4.7	5.2	3.4	3.6	3.8	4.0	4.0	
Nominal GDP (LCU, Billions)	758.4	843.2	950.5	954.0	1,094.0	1,197.9	1,308.5	1,417.1	1,536.3	1,661.7	
Nominal GDP (US\$, Billions)	529.2	649.1	730.3	615.3	710.7	743.4	778.7	801.9	826.7	852.4	
PPP GDP (Current \$, Billions)	824.9	888.1	913.0	880.1	932.2	977.9	1,031.2	1,090.1	1,155.4	1,224.5	
GDP Deflator (Index)	784.0	832.7	932.6	982.6	1,071.1	1,134.3	1,196.0	1,248.4	1,301.3	1,353.4	
Real GDP per capita (LCU)	1,419.8	1,469.7	1,463.2	1,376.4	1,429.9	1,460.1	1,493.8	1,530.5	1,571.9	1,614.4	
GDP per capita (current, LCU)	11,131.0	12,238.8	13,645.6	13,524.3	15,316.3	16,561.3	17,865.8	19,107.5	20,455.7	21,849.1	
GDP per capita (current, US\$)	7,767.0	9,422.1	10,484.3	8,723.4	9,950.4	10,277.9	10,631.8	10,812.7	11,008.1	11,207.9	
Consumer Price Index (2000=100)	361.3	392.9	433.9	461.1	505.9	534.7	564.6	590.1	616.5	641.2	
Inflation (%)	9.6	8.8	10.4	6.3	9.7	5.7	5.6	4.5	4.5	4.0	
Current account balance (US\$, Billions)	-31.9	-37.7	-41.3	-13.9	-28.3	-32.5	-33.5	-35.5	-37.6	-39.8	
Current account balance (% GDP)	-6.0	-5.8	-5.7	-2.3	-4.0	-4.4	-4.3	-4.4	-4.5	-4.7	

LCU = Local Currency Unit

Source : IMF's World Economic Outlook Database, April 2010

Prepared by Data Resources and Statistics Department (DRSD)

Issued on 26/04/2010

Turkey's profile at a Glance

Key Development Indicators

	2009			
	Turkey	UpMI	IDB 56*	IDB 28*
Population, total (millions)	73.9	948.5	1459.0	1013
Population growth (annual %)	1.24	0.82	1.8	1.7
GNI per capita, Atlas method (current US\$)	9340	7878	2049	2669
GNI, Atlas method (current US\$ billions)	690.7	7471.9	4245.0	3887.0
GDP growth (annual %)	3.8	4.7	2.1	1.6
GDP per capita (Constant 2000 US\$)	5099**	4568**	1616	2103
GDP per capita growth (annual %)	2.5	3.8	3.7	3.7

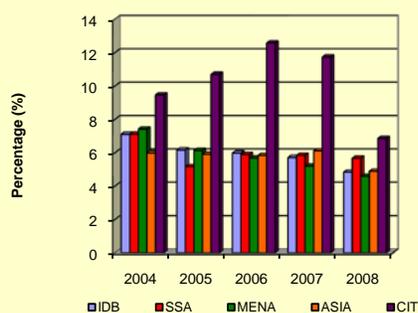
Most recent estimate, 2000-2009

	Turkey	UpMI	IDB 56*	IDB 28*
Poverty headcount ratio at \$1.25 a day (PPP) (% of population)	..	5	..	..
Poverty headcount ratio at \$2 a day (PPP) (% of population)	..	11	..	..
Life expectancy at birth, total (years)	72	69	..	..
Mortality rate, infant (per 1,000 live births)	24	23	53	45
Literacy rate, adult male (% of males ages 15 and above)	95	99	73	76
Literacy rate, adult female (% of females ages 15 and above)	80	96	55	55
Gross intake rate in grade 1, male (% of relevant age group)	96	98	84	86
Gross intake rate in grade 1, female (% of relevant age group)	92	96	78	81
Improved water source (% of population with access)	97	95	78	83
Improved sanitation facilities (% of population with access)	88	89	56	61
Unemployment Rate (% of total Labor force)	11.2	7.8	..	..

Turkey

	1988	1998	2008	2009
Inflation, consumer prices (annual %)	74	85	10	7
Inflation, GDP deflator (annual %)	69	138	12	..
Net barter terms of trade index (2000 = 100)	114	111	91	..
Population growth (annual %)	2	2	1	..
GDP (current US\$ Million)	90,367	269,008	734,853	615,329
Agriculture, value added (% of GDP)	18	14	9	..
Industry, value added (% of GDP)	34	36	28	..
Manufacturing, value added (% of GDP)	24	26	18	..
Services, etc., value added (% of GDP)	48	51	64	..
General government final consumption expenditure (% of GDP)	8	10	13	..
Exports of goods and services (% of GDP)	19	21	24	..
Imports of goods and services (% of GDP)	18	20	28	..
Gross domestic savings (% of GDP)	26	23	17	..
Rail lines (total route-km)	8,164	8,607	8,699	..
Railways, goods transported (million ton-km)	7,979	8,466	10,104	..
Roads, paved (% of total roads)	..	28	..	..
Roads, total network (km)	..	382,059	..	..
Primary school starting age (years)	..	6	6	6
School enrollment, preprimary (% gross)	..	6	..	..
School enrollment, preprimary, female (% gross)	..	6	..	..
School enrollment, preprimary, male (% gross)	..	7	..	..

Real GDP Annual Growth Rate in IDB MCs

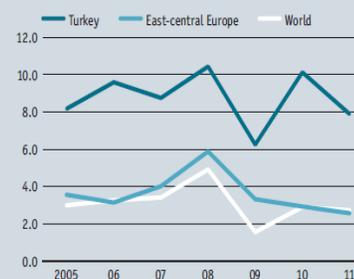


Real GDP growth (% change)



Source: Economist Intelligence Unit.

Consumer price inflation (av; %)



Source: Economist Intelligence Unit.

Source: Table based on multiple sources inclu. WDI, WB, Turkstat, IDB, OECD

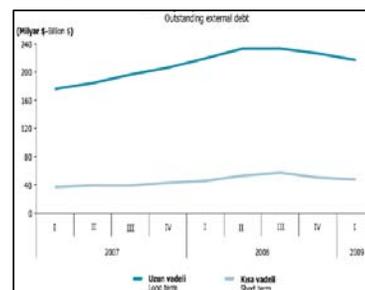
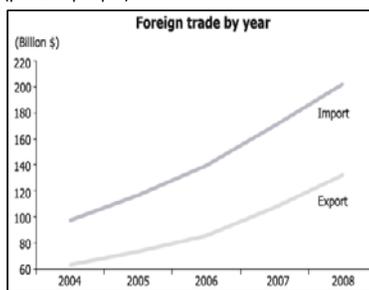
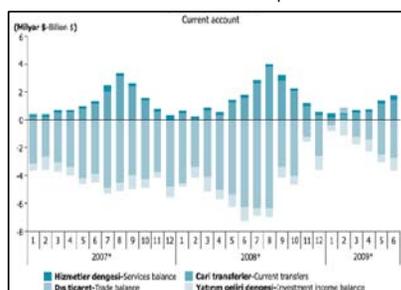
* IDB 56 is the Avg. of all IDB MCs; IDB 28 is the Avg. of all IDB Non-LDMC MCs

** 2008 Data

Page - 1

Turkey's profile at a Glance

	2000	2008*
Balance of Payments and Trade		
Exports of goods and services (current US\$ million)	53703	187200
Imports of goods and services (current US\$ million)	61710	227693
Workers' remittances and compensation of employees, received (current US\$ million)	4560	1360
Current account balance (% of GDP)	-4	-5
Total reserves (includes gold, current US\$ million)	23515	73674
Central Government Finance		
Revenue, excluding grants (% of GDP)	..	..
Tax revenue (% of GDP)	..	..
Cash surplus/deficit (% of GDP)	..	..
Highest marginal tax rate, corporate rate (%)	30	20
Highest marginal tax rate, individual rate (%)	..	35
Money and quasi money (M2) as % of GDP	30	42
Money and quasi money (M2) to total reserves ratio	4	5
Liquid liabilities (M3) as % of GDP	35	47
Quasi-liquid liabilities (% of GDP)	30	39
Bank liquid reserves to bank assets ratio (%)	4	11
External Debt and Resource flows		
Total debt outstanding and disbursed (US\$ million)	117108	207854
Total debt (% of GDP)	44	39
Total debt service (% of Export)	39	34
FDI (Net inflow)	982	20070
Portfolio Equity (Net inflow)	489	1939
Private Sector Development		
Time required to start a business (days)	9	6
Time required to obtain a construction license (days)	232	36
Time required to register property (days)	9	6
Market capitalization of listed companies (% of GDP)	31	15
Environment		
Agricultural land (% of land area)	53	54
Forest area (% of land area)	13	13
Nationally protected areas (% of total land area)	..	3
CO2 emissions (metric tons per capita)	3.3	3
GDP per unit of energy use (PPP \$ per kg of oil equivalent)	7.8	9
Energy use (kg of oil equivalent per capita)	1157	1182
Infrastructure & Technology		
Paved roads (% of Total)	34	..
Rail lines (total route-km)	8671	8697
Mobile and fixed-line telephone subscribers (per 100 people)	52	110



Source: Turkstat

Source: Table based on multiple sources includ. WDI, WB, IMF, Turkstat, IDB, OECD

* Latest available Data

Page - 2

Map of Turkey:



The boundaries, colors, denominations, and other information shown on any map in this document do not imply any judgement on the part of the IDB concerning the legal status of any territory or the endorsement or acceptance of such boundaries.