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# **Economic Overview of Turkey**

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**Draft Version**

The author is the sole responsible for the content of this article which do not reflect the opinion of the coordinators of the IEPN project or the Friedrich-Ebert-Stiftung.

## **Introduction**

The Turkish economy is dynamic and growing. It is a blend of traditional agriculture, modern industry and commerce. One-third of those employed in industry work in textiles. However, textiles are not the main export. This sector has been overtaken by the rapidly growing automotive and electronic industries. Turkey also has an awakening science and innovation sector, though it lags behind most OECD countries in this area.

With rapid growth rates and a young and increasing population of over 70 million, Turkey has the potential to be the largest economy in Europe after Germany and the most populous if it should be accepted into the EU. Turkey is now a member in the G20 club of important economies, and it is almost on par with the emerging giants of the BRIC club. Some forecasts even suggest that during the next decade Turkey will grow faster than any other country besides India or China.

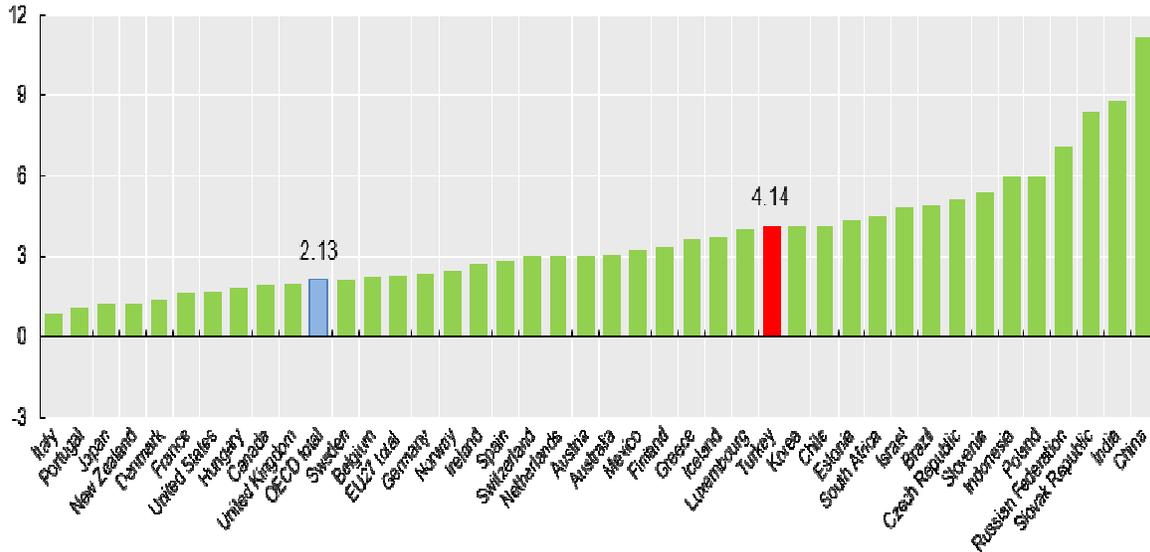
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## Real GDP growth

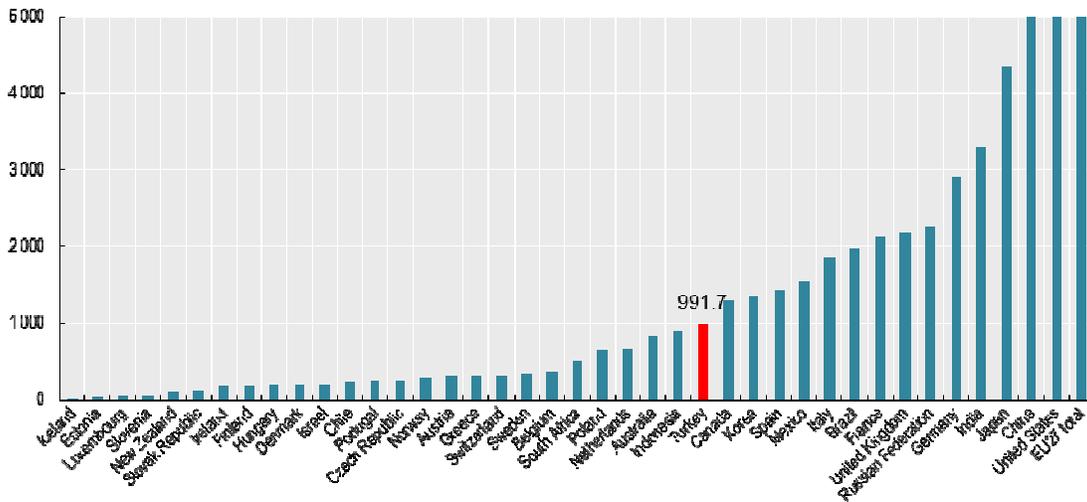
### Average annual growth in percentage, 3-year average (2006-2008)



Source: OECD Fact book 2010: Economic, Environmental and Social Statistics.

## Gross domestic product

### Billion US dollars, current prices and PPPs, 2008



Source: OECD Fact book 2010: Economic, Environmental and Social Statistics.

Economic growth in Turkey has confronted many obstacles over the past decades. Historically since the 1950s, the country has suffered serious disruption to its economy about every 10 years. In 1994, due to excessive public spending and deterioration of macro-economic fundamentals, the country's economy faced one of its worst recessions up to that time, bringing an end to 13 straight

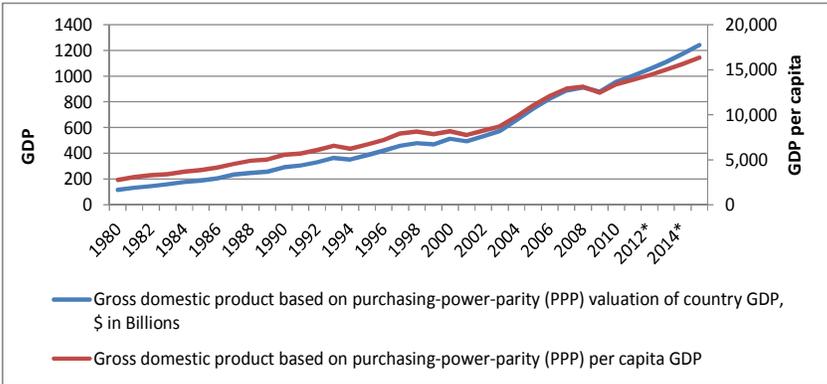
years of growth. However, the economy bounced back strongly over the next 3 years, growing by over 8 percent (OECD, 2010 fact book). In 1998, slowdown returned as a result of the Asian and Russian financial crises.

In 1999, two disastrous earthquakes, measuring 7.4 and 7.2 on the Richter scale, hit northwestern Turkey right in the middle of its industrial heartland, causing Turkey to suffer its worst contraction in several decades. Ten years ago Turkey's economy was once again in turmoil. Inflation was extremely high and its banks were on the verge of collapse. By the 2000-1 liquidation crises, the nation's currency collapsed, the banks had to be rescued, public debt amounted to 74% of GDP (IMF, World Economic Outlook Database), and for the 18<sup>th</sup> time, the IMF was asked for assistance.

Since then, Turkey's economy has entered an era of high growth and structural reform. A comprehensive reform program, which encompassed an exchange float rate, financial-sector supervision and privatization, led to significant economic growth with an annual GDP growth rate of 6.8% between 2002-2008, compared to an annual average of 4% in the 1990s<sup>3</sup>. The private sector grew considerably in recent years, but the government still plays an important role in leading industries such as banking, transport and communications.

The inflation rate fell to historic lows, reaching 6.4% in the past year compared to 75% in the 1990s (Turkish Statistical Institute, “Turkstat”). Significant improvement in budget management was introduced, and government debt declined significantly from 76% of GDP in 2001 to about 35% in the second quarter of 2010 (IMF).

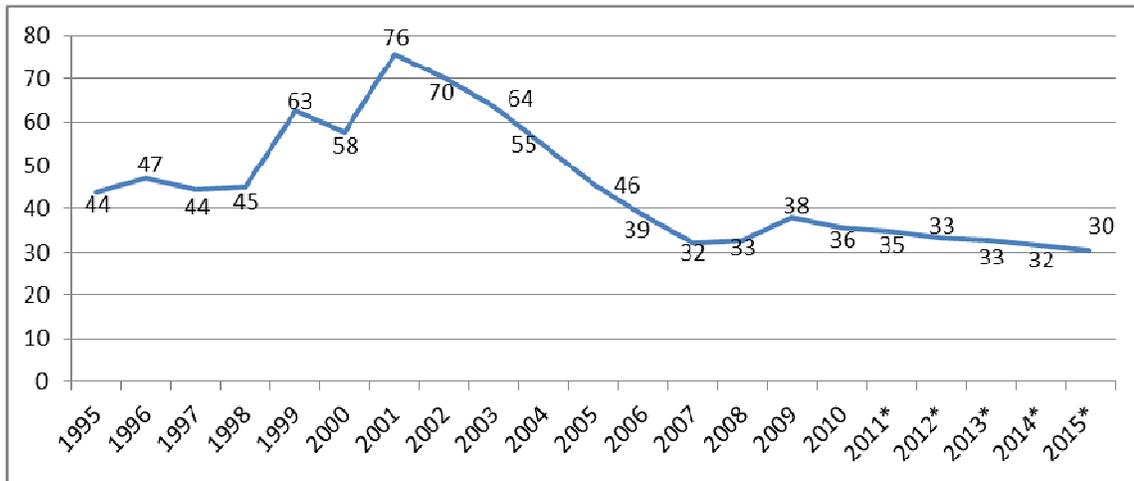
**Gross domestic product, (PPP)**



Source: IMF, World Economic Outlook Database, October 2010, \* IMF Projection.

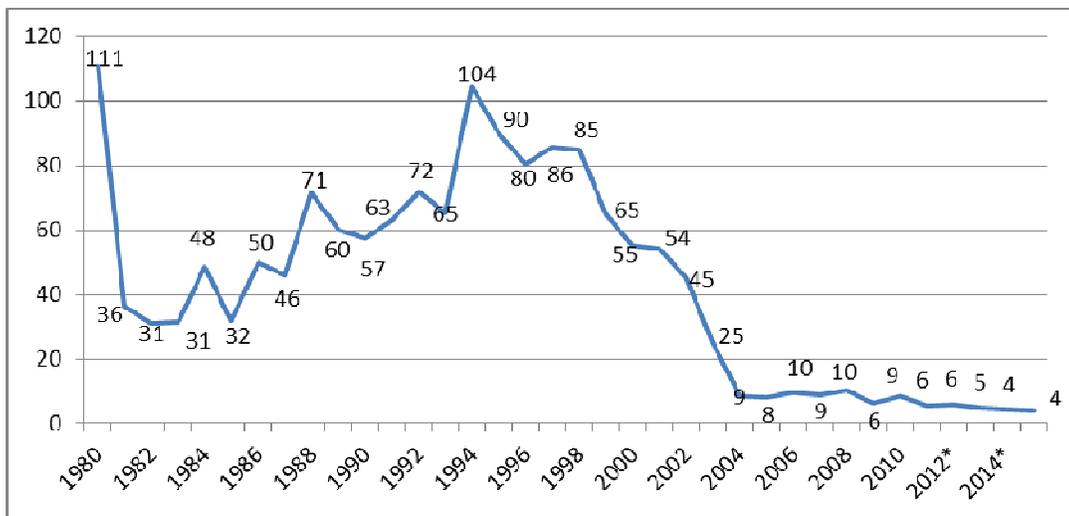
<sup>3</sup> OECD outlook 2010 and the Turkish statistical institute.

### General government net debt (Percent of GDP)



Source: IMF, World Economic Outlook Database, October 2010, \* IMF Projection.

### Inflation, average consumer prices, (Percent change)



Source: IMF, World Economic Outlook Database, October 2010, \* IMF Projection.

### Turkey's political arena

The political situation has improved as well. Turkey's politics used to be unstable and highly volatile. Parties would form and quickly disappear, politicians would abruptly be banned, and several times the army interfered and removed the ruling government. However, all this changed after the election of November 2002, when the single party government, led by the mildly Islamist Justice and Development (AK) party of Mr. Erdogan's, was formed. It has been in power ever since. After over eight years of rule by Mr. Erdogan's AK party, an array of impressive political

and economic reforms was implemented. In addition, last September, Mr. Erdogan won an important referendum enabling him to increase government control over the army and judiciary system. The part that Turkey's political stability plays in Turkey's overall market improvement is unquestionable. Yet, the results of the September referendum have revealed that the country remains deeply divided. Mr. Erdogan has also proved highly partisan and intolerant of criticism. Freedom of the press in the past years is no longer taken for granted. This was apparent in the government's handling of the country's biggest media group, known as Dogan. After a few unfavorable articles, the media group found itself the object of unusually vigorous tax inspections, reminiscent of Russia's treatment of the Yukuse oil company. Since then, journalists realize that it is unwise to criticize the AK party. In its 2009 progress report, the European Commission reprimanded the government over this episode.

Turkey has traditional strong ties to the Arab and Muslim world which have been growing stronger under the leadership of the current government. These ties relate to domestic issues, for instance, the removal of the ban on wearing a veil in state institutions and universities, and to foreign issues such as the deteriorating relations with Israel. Turkey, which was largely ignored for many years, now has a stronger presence in the region, which has proven advantageous to economic growth. Traditionally Turkey has relied mainly on exports to the West, especially Germany and the rest of Europe. But although the EU is still Turkey's biggest market, its share is falling, and exports to the Middle East and Iran increased significantly. This has given Turkey access to more diversified markets and lowered Turkey's dependence on the economic recovery in Europe.

#### Turkey and the global financial crises

Turkey's economy was hit by the recent global financial crises mostly through trade channels, setting back trade with Turkey's main trading partners in the European Union, and it resulted in a sharp fall in exports. Although capital inflows contracted, and private investment and the consuming of durable goods declined, there was no fundamental damage to Turkey's economy. Due to the reforms in the Turkish financial sector and tighter regulation, Turkey's economy recovered swiftly, and growth in 2010 was estimated at over 8% (IMF), mostly attributed to growing domestic demand. Inflation was just below the 2010 target, and capital inflows intensified driven by wide interest rate gaps and increased political certainty. In the 1990's, foreign direct investment was running at less than 1\$B a year but by 2007 foreign direct investment reached an all-time high of 22\$B. However, the high levels of FDI have declined and amounted to less than 9\$B in the past year (OECD). A significant rise in FDI in the near future is not likely as more than 80% of FDI comes from European countries. Whereas FDI has declined, other yet more volatile

investments (portfolio investments and debt securities investments) have risen due to low CDS spread. In the Istanbul stock exchange more than two-thirds of the stocks on are now owned by foreign investors<sup>4</sup>. Although this is a sign of global confidence in Turkey’s open markets, it also raises the prospect that foreign money is fueling an investment bubble that could end badly if foreigners exit the market as quickly as they entered.

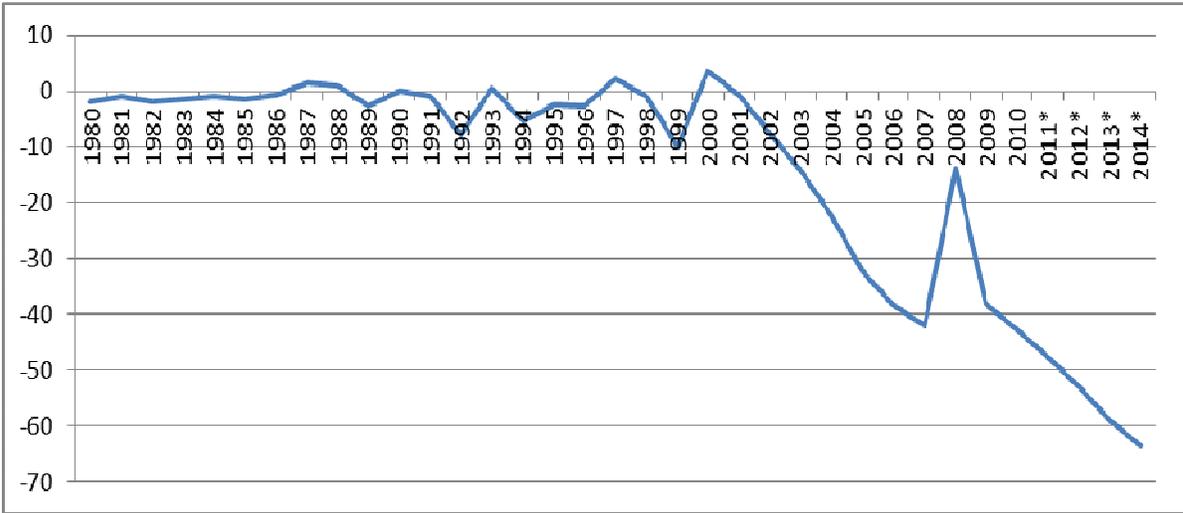
**Challenges and Obstacles**

Current account

In the past years Turkey accumulated a significant current account deficit which amounted to over 5% of GDP in 2010 (IMF). Turkey's high deficit reflects structural issues related to the country's trade composition, heavy dependence on imported energy, low external saving rates, and inadequate competitiveness. In particular, Turkish exports have high import dependence as does its domestic manufacturing. As a result, export and import tend to move hand in hand making it difficult for Turkey to rely on exports to lower its current account deficit.

**Balance of Payments, Current account balance**

**Exports minus imports of goods and services, (U.S. dollars in Billions)**



Source: Source: IMF, World Economic Outlook Database, October 2010, \* IMF Projection.

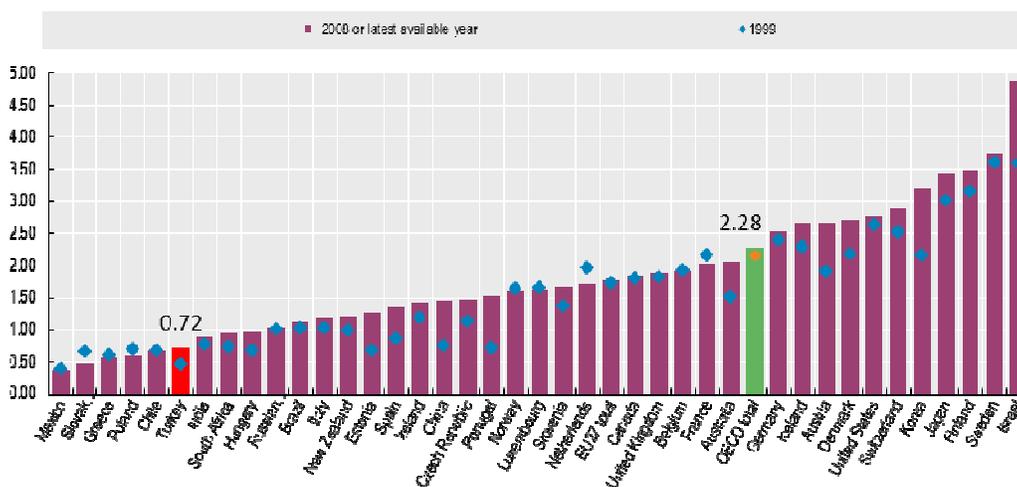
<sup>4</sup>. The Washington times: “Turkey leverages Economy for Global Power, (Jan 2011)

### Structural weakness

Turkey's intensifying current account deficit is also a reflection of Turkey's eroding competitiveness. Much of Turkey's successes are attributed to relatively low labor costs compared with a higher cost European market. China and India have become major threats to much of Turkey's low skilled industry.

The government is meeting this threat by strenuous efforts to promote high technology. 40% of current exports are in the medium or high tech sector compared to 15% in the 1990's. Yet Turkey spends only 0.72% of its GDP on research and development compared with an OECD average<sup>5</sup> of 2.28%. In addition, with a high share of its work force in agriculture, overall productivity remains low.

### Gross domestic expenditure on R&D As a percentage of GDP (2008, 1999)



Source: OECD 2010 Science and technology - Research and Development - Expenditure on R&D.

### Ease of doing business and corruption

Corruption is widespread in Turkey. According to the Transparency International's Corruption Perceptions Index, which ranks approximately 200 countries by their perceived levels of corruption, Turkey ranks on par with countries such as Malaysia and Namibia, and below countries such as South Africa and Kuwait. Turkey is also lacking major structural reform and deregulation. In the 2011 World Bank Doing Business report, Turkey was ranked 65 out of 183 economies, a drop from 60 in 2010. In addition, it is far below the OECD average on several indicators, such as time, procedures and cost. The OECD states in its last report that "Higher employment and productivity growth will not be possible without profound regulatory reform".

<sup>5</sup> OECD, Science technology and industry outlook 2010.

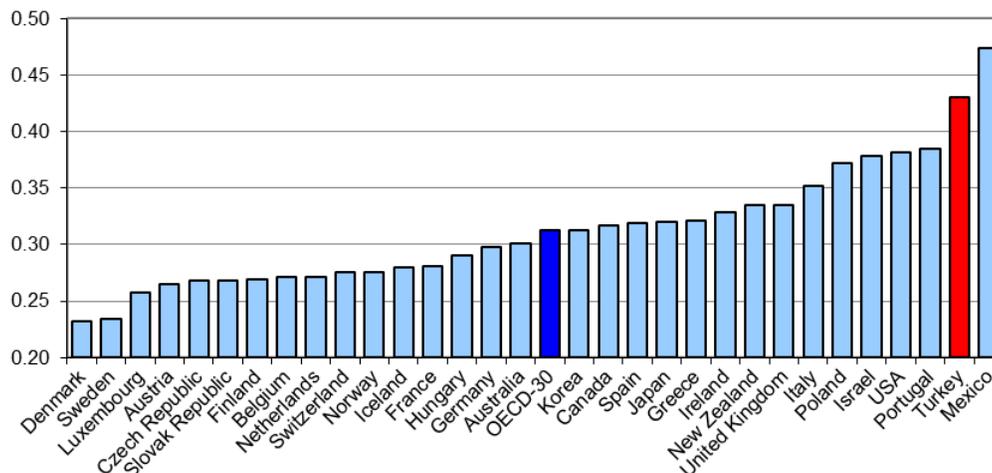
### Labor Market and Income Distribution

Despite the rapid growth, unemployment remains high. In 2007 an historical low 8.4% unemployment rate was recorded, yet unemployment increased to 14.8% at the peak of the global slow-down. The unemployment rate declined to 12% by August 2010 (Turkstat).

Turkey's employment rate declined increasingly in the past two decades. In 2006 it stood at 46%, below the rate of all EU countries and the sharp drop from 57% in the late 1980's. Another aspect of Turkey's labor market is the low quality of many of its jobs, with nearly one-third of all employment in the informal sector. Unemployment among university graduates is high as well at 6.9% (OECD).

Wide income distribution inequality was reduced and the Gini coefficient for income inequality dropped 0.06 points from the mid-1990s to the mid-2000s. Large income gaps are still a main feature of Turkey's economy; therefore Turkey has the largest income inequality among OECD countries besides Mexico. According to a study conducted by the Turkish Statistical Board in 2008, 45.5% of the population cannot buy new clothes, and 88.8% of the population cannot afford a one-week vacation away from home. The results reveal that the top 20% of income earners make 46.7% of all income in Turkey, while the bottom 20% earn only 5.8%.

**Gini coefficients of income inequality in OECD countries, mid-2000s**

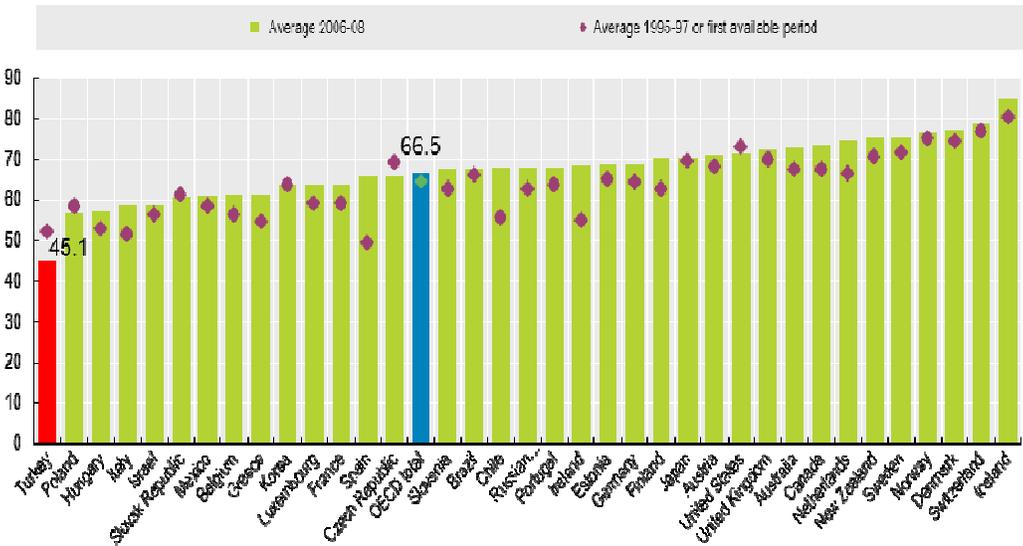


Source: OECD income distribution questionnaire.

Participation and employment rates by gender and location diverge significantly. For the overall economy, the male participation rate of 66.58% is more than two and half times the female rate of 23.1%, down from 34% in the late 1980's. Therefore, a significant part of the gap between

employment rates in Turkey and developed countries comes from the very low female employment rate, which is significantly less than the OECD averages (57.8%). Low employment among the young is also high (45.7% compared to 14.9% OECD average among youth between the ages of 20 and 24 who are not in school nor gainfully employed). Higher education levels are scarce. Turkey lags far behind developed countries with an average of 14% of those between the ages of 25-34 who have attained at least tertiary education in comparison to the 34% OECD average (OECD 2010 fact book). Turkey also has a high rate of informal employment, 33.2% of non-agricultural employment is in the informal sector<sup>6</sup>. This may indicate that the participation in the work force is in fact higher.

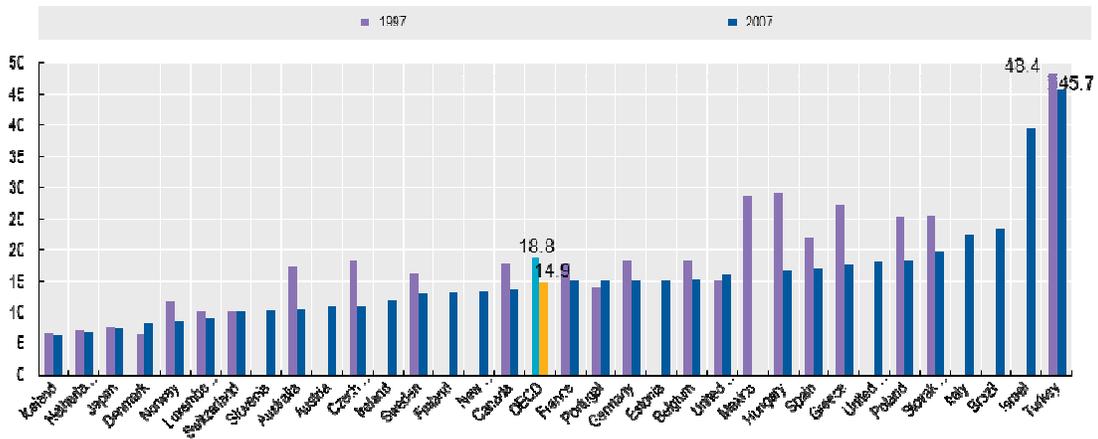
**Employment rates Share of persons of working age in employment**  
**Average 2006-2008, 1995-1997**



Source: OECD Fact book 2010: Economic and Social Statistics.

**Youths aged between 20 and 24 who are neither in education nor in employment**  
**As percentage of persons in that age group (1997, 2007)**

<sup>6</sup> Towards More and Better Jobs in Developing Countries', OECD, 2009.



Source: OECD, Fact book 2010: Economic and Social Statistics.

### Summary

As of today, Turkey has a fast growing, strong and sound economy. This was apparent in the recent financial down-turn. Nevertheless Turkey still has problems that need attention. Inflation is still prevalent, the current account deficit is large, corruption is widespread, competitiveness is an issue, and most problematic, unemployment is exceedingly high, especially in the east and south east, and among women and those first entering the labor market. The current semi autocratic leadership and the growing fears about limits to free press are also an increasing matter of concern. Turkey must overcome these obstacles in order to sustain healthy long term economic growth.

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