



# Research Report

INDEPENDENT INDUSTRIALISTS AND BUSINESSMEN'S ASSOCIATION



FINANCING GROWTH

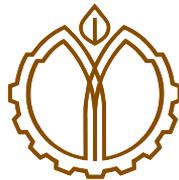
IN THE ECONOMY OF TRUST

**2013**  
**TURKISH**  
**ECONOMY**  
**REPORT**



**TURKISH ECONOMY REPORT 2013**

**FINANCING GROWTH  
IN THE ECONOMY OF TRUST**



**MÜSIAD**

**INDEPENDENT INDUSTRIALISTS AND BUSINESSMEN'S ASSOCIATION**

Sütlüce Mah. İmrahor Cad. No: 28 34445 Beyoğlu-İstanbul

Tel: +90 212 222 04 06 Faks: +90 212 210 50 82

[www.musiad.org.tr](http://www.musiad.org.tr) | [musiad@musiad.org.tr](mailto:musiad@musiad.org.tr)

**MÜSİAD Research Report: 83**

**TURKISH ECONOMY REPORT 2013  
FINANCING GROWTH IN THE ECONOMY OF TRUST**

**Contributors**

Prof. İsa Sağbaşı  
Prof. Murat Yülek  
Assoc. Prof. Mustafa Çelen  
Asst. Prof. Cenk C. Karahan  
Asst. Prof. Halil Tunalı  
Hikmet Baydar  
İsmail Ciğerci  
Ahmet Akif Demirbaşı  
and  
MÜSİAD Economy Advisory Board

**Imprint**

**Mavi Ofset**

İkitelli O.S.B. Eskoop Sanayi Sitesi  
C1 Blok No: 25 Başakşehir-İSTANBUL  
Tel: (0212) 549 25 30 Fax: (0212) 549 26 84  
www.maviofset.com  
Sertifika No: 12346

**Pressed**

Istanbul, September 2013

ISBN 978-605-4383-30-6

© 2013

All rights reserved by MÜSİAD. Short sections of this report can be quoted by permission of MÜSİAD. Also by complying copyright law, MÜSİAD TURKISH ECONOMY REPORT 2013.

## INDEX

<b>FOREWORD</b> .....	<b>5</b>
<b>Part 1: FINANCING GROWTH</b> .....	<b>11</b>
<b>1.1. INTERNAL AND EXTERNAL FINANCING RESOURCES</b> .....	<b>13</b>
1.1.1. The Economy of Trust and Financing Costs .....	13
1.1.2. Side Effects of Economy of Trust: Inadequate Savings Rates .....	13
<b>1.2. LIMITED FINANCING RESOURCE UTILIZATION</b> .....	<b>17</b>
1.2.1. Corporations and Access to Financing .....	19
1.2.2. Entrepreneurship and Venture Capital Financing .....	24
<b>1.3. RECOMMENDATIONS</b> .....	<b>30</b>
1.3.1. Generating Financing Resources .....	30
1.3.2. Companies and Project Financing .....	32
1.3.3. Changing Banking from a System Giving Loans on Collateral to a System Granting Loans to Projects .....	35
1.3.4. State Projects That Can Be Financed .....	37
1.3.5. Venture Financing with a New Structure .....	38
1.3.6. Encouraging Project Financing in the Banking System .....	39
1.3.7. Ensuring That State Banks Focus As Much on Investment Banking As They Do on Deposit Banking .....	39
1.3.8. Making Public-Private Sector Partnerships More Effective .....	40
1.3.9. Widening the Base in the Realization of Large-Scale Projects .....	40

1.3.10. Opening the Way for Medium Sized Enterprises in Energy Investments .....	41
1.3.11. Gradual Implementation of Large-Scale Portfolio Privatization .....	42
<b>Part 2: RECOMMENDATIONS .....</b>	<b>43</b>
<b>2.1. MACRO POLICIES .....</b>	<b>43</b>
2.1.1. Discreet Monetary Policies .....	44
2.1.2. Prudent Financial Regulation .....	44
2.1.3. Disciplined Fiscal Policies .....	46
<b>2.2. MICRO POLICIES .....</b>	<b>53</b>
2.2.1. Production Policy .....	53
2.2.2. Technology Policy .....	57
2.2.3. Employment Policy .....	59
2.2.4. Education Policy .....	63
2.2.5. Investment Policy .....	65
2.2.6. Savings Policy .....	71

## FOREWORD

The past year will be recorded for Turkey as a year in which macroeconomic indicators set a new balance. After a rapid and record rate of growth over the period 2010-2011 and the accompanying side effect of a growing current accounts deficit, 2012 may be considered a year in which the country stepped on the brakes and risks were controlled. Although the policies that made this slowdown possible could qualify as being overly cautious for those of us who are real sector players, the soft landing was validated with the high performance of economic indicators, both real and symbolic. As MÜSIAD, our hope is that following this short-lived period of respite, our economy will continue its robust growth in 2013 and beyond, picking up where it left off.

The purpose of the monetary policies of the Turkish Central Bank, interpreted by some as non-traditional and by others as innovative, was not only to achieve price stability but also to keep loan expansion, the current accounts deficit, and the volatility of the Turkish Lira in under control. Despite the occasional criticism, these policies have proved to be generally successful in retrospect. The monetary policies also targeted a soft landing for the economy in an atmosphere where risks could be controlled. On the other hand, the Gross National Product, growing by 2.2 percent in 2012, showed a decline that could not at all be considered a soft landing. Even though the rate appears to be high when compared to the 0.2 percent shrinkage in Europe, it is still low in terms of Turkey's standards. The interpretation of the growth rate should be carefully analyzed together with the components that constitute the growth. While the contribution of domestic demand to growth in 2011 had been close to 10 percent, in 2012 this went down to 1.9 percent. It must be underlined in this context that as potential economic risks are kept in check, a balance must be struck between domestic and international demand.

This dramatic cooling down of the Turkish economy in 2012 had the objective of keeping risks under control. Indeed, the trend in the balance of payments, considered one of the biggest risks in the country, displayed significant changes over 2012. First of all, the current accounts deficit, which contrary to the general trend, showed a reduction for the first time, fell from its level of 77.2 billion dollars in 2011 to 48.9 billion dollars in 2012. Although we do not foresee that this reversal in the trend will continue in the short term, there might be a chance to maintain the trend in the medium and long term with structural reforms.

Some positive political developments which contributed to keeping economic risks under control and maintaining controlled growth were validated in 2012 and in the first months of 2013 with the prestige Turkey gained in the international arena in terms of the state of its economy. The acknowledgment of Turkey's economic success came first from the Fitch Ratings in the last months of 2012, when Turkey was given its first credit rating of investability in 20 years. In the ensuing months, the symbolic ceremony Turkey held on the occasion of its payment of the last installment of its debt to the IMF and the recognition gained by the second investability rating given by Moody's were separate indications that positive developments would continue. The momentum of these circumstances brought with it a fall in interest rates and the rise of the stock exchange to record heights. It will not be wrong to say that the credit ratings of investability received from two principal rating organizations will make Turkey an attraction for foreign investors and will facilitate achieving the desired rate of growth. Not only that, but at the time this report was being prepared for publication, Turkey had come through unscathed from the most serious political crisis ever experienced in recent years, proving once more and providing reassurance that it is at a place that is far away from the days of its previous fragility.

and leading the country into the league of developed countries can only be made possible through the adoption of various structural reforms. I would like to stress once again, as we have noted in previous reports, that the economy needs a strategic transformation and that this is the only way we can overcome the obstacle that we refer to as the “middle income trap.” As a thematic extension of previous reports, we wanted to touch upon a more micro level in this year’s report and for this reason saw it appropriate to analyze the matter of financing, a subject that is of close interest to MÜSİAD members. A study conducted by the World Bank has set forth a fact that all of us can personally vouch for, that the issue that is seen to be the most important for our country’s corporations in access to financing. As part of the theme of our report for this year, the problem of finding funds for financing, using these monetary funds in the most efficient way possible, and direct this funds to corporations, projects and innovative concepts that will ensure Turkey’s advance are the subjects that have been treated here.

Although increases in shareholders’ equity through initial public offerings have been encouraged in Turkey in recent years, the desired level has not been reached due to both structural and cultural reasons. While it might be accepted that corporations in Turkey and the financial system would be ready to sell shares in the medium term, the most important external financing resource for corporations, all of which constitute the locomotive of the economy, is actually bank loans. Unfortunately, this channel of financing is not open to effective and productive access. The obstacles to access cause a financing deficit in the country and result in projects that deserve financing to remain idle. The deficit gives rise to a drop in economic productivity and causes Turkey to invest at levels below its potential, thus causing the country to miss out on growth opportunities.

The shortcomings of corporations in accessing loans and financing can be explained by many factors. The most important of these may be said to be the inadequate and overly challenging procedures regarding guarantees, contracts and bankruptcy laws, inadequacies in our

financial system and the low level of competition, limited financial resources and the inadequacy of corporation and bank employees with respect to their levels of training in matters of finance. Additionally of course, the tendency of the banks to avoid risks constitutes a disadvantage for corporations. As a solution to these problems, we suggest the realization of project financing models on the level of private corporations and on a project basis.

Project financing is the extension of a loan without asking for an additional guarantee, having accepted the investments of a particular project and the future financial revenues of that project as security. This model is widely used in the financing of large-scale public sector projects. If private corporations could benefit from such a system, they may be able to escape the limiting spiral of having to provide collateral. If commercial banks can assume a more effective role in project evaluation and risk analysis, they can create new business opportunities for themselves in a market that they were previously unable to take advantage of. Of course in this process, companies need to overcome the problem of financing gaps and produce projects that deserve investment. Heeding this recommendation will be that much more facilitated if state banks can lead the private sector in project financing.

Besides the problem of access to financing and the issue of project financing, we also wanted to share with legislators our recommendations with regard to public sector projects and the financing terms in bidding for this projects, a process that occupies a significant place in Turkey's economy. The large scale of public sector tenders and the weighty financial specifications that are required restricts the chance to benefit from the opportunity of working with the public sector to only a few major corporations. Our recommendation is that as much as possible, public sector service procurement should be opened for bidding in the form of small sub-projects to permit corporations of lesser stature to meet the terms of tender specifications. By doing this, the risks carried by the few public organizations will have been

diversified. At the same time, the opportunity of doing business with the public sector will be offered to a wider range of corporations, providing a fairer distribution of business. Most important, however, public sector projects can become investments that can be more easily financed and at a lower cost.

Even though Turkey's short- and medium-term growth is being supported by existing corporations, our development in the long term will be possible only with increasing numbers of innovation-focused enterprises. Particularly in the case of financing companies that have been formed through the commercialization of technological products and services, this is made possible not through commercial loans but more through the sale of shares in an investment environment unique to the company. The success of such innovation-focused initiatives financed by venture capital is particularly striking in the United States, and the model used there may constitute a model for our own country.

Turkey's young population of entrepreneurs, equipped with a steadily heightening level of education, provides a very suitable atmosphere for the sprouting out of technological initiatives. The state-supported research projects and entrepreneurial endeavors in recent years have been a step in the right direction in terms of tapping the country's potential in this context. A more operative and productive development in this area can be made possible with the private sector's playing a role in the realization and commercialization of ideas. Turkey's financial market regulations provide the opportunity to organize venture capital in the form of investment trusts.

The country's active venture capital trusts, however small they may be in scope, are similar to the structure of the models that were seen in the US in the 1960s, which unfortunately met with failure because of their lack of flexibility. The venture funds that Turkey needs are more in the form of the limited venture capital funds that have been successful especially since the 1990s. The flexibility of these

funds facilitates the financing of ventures at the time and in the format desired. Beyond this, what is most imperative for Turkey's entrepreneurs and financiers is to completely restructure the country's processes of incorporation and closure after bankruptcy, both from a legal standpoint and in terms of process management. As with other corporations, the commercial and participation banks can improve their risk analysis and evaluation procedures and play a role in the financing of innovative ventures.

What I tried to do in this introduction was to set forth the details of the financing problems and recommendations for solutions for projects and initiatives, which comprises the main theme of the Economy Report you hold in your hand at this time. In the rest of the MÜSİAD Report on the Turkish Economy for 2013, you will find the details of economic data for 2012 and the evaluations of experts. As is the custom every year, our report will end with suggestions from businessmen who keep their fingers on the pulse of the economy.

We hope the analyses, evaluations and recommendations that have been painstakingly prepared by academics who are experts in their respective fields are useful and beneficial to lawmakers and other actors in the economy in terms of guiding the way into the future. I have a debt of thanks to pay to our editors, the esteemed academic members of the MÜSİAD Economic Advisory Board and all our employees, who have all labored to make a regular presentation of this report in an effort to create a common wisdom that will help to reach the ambitious goals set out for the Centennial Year of the Turkish Republic and beyond.

**Nail Olpak**

President

MÜSİAD

## Part 1

# FINANCING GROWTH

Turkey painted a positive picture with the success it displayed in the macroeconomic sphere in the 2000s and ultimately found itself classified among the high-middle income countries. With a relatively robust risk profile, Turkey succeeded in receiving an investability rating from the credit rating organizations in the 2012-2013 period, this being the first time in the last 20 years. The positive picture, however, also carries with it risks for the future.

The optimistic picture and the long-term success that Turkey has experienced, a circumstance never recorded up until now, should not hinder the recognition of the structural problems in the economy nor obstruct the search for solutions to these problems. As has been emphasized repeatedly in the MÜSIAD Reports on the Economy in years past, Turkey is facing a real danger: the “middle income trap.” The economic policies implemented in the last 12 years has made it possible for a country with a potential like Turkey to be successful in easily reaching its goals. However, in order to overcome the obstacles

in front of us and achieve difficult goals, growth must be sustainable. For this, radical changes and a strategic transformation are needed in the economic structure.

With its reports on the economy in past years, MÜSIAD has called attention to the threats to the Turkish economy and has provided recommendations as to potential solutions. This year, we will closely analyze the issue of financing, one of the most important of these problems, and proceed to make our recommendations.

Our country continues to be dependent on outside sources for financing due to inadequate levels of savings. The growth and success experienced in recent years was the product of the significant role that was played by the abundance of the financial resources that stemmed from the monetary expansion policies adopted by the European and US Central Banks. Unfortunately, aside from the positive impact that this international connection had, it also exposed the country's economy to external risks. The fate of Turkey's economy is too important to be left to circumstances occurring in the international climate outside of its own control. Advantage should be taken of the opportunities that arise and investments should be given priority in order to provide funds to pay back accumulated foreign debts, thereby keeping risks under control.

The shortcut to eliminating capital deficiencies in the country is to lean toward foreign resources. It is fortunate that the stability and environment of trust that prevailed in recent years made it easier for both the public and private sectors to find international capital at the lowest costs ever seen in history. At this time, the financial resources that were accessed in this way are both a boon and a danger to Turkey. If low-cost financial resources are not channeled into the right investments, the risk of failure to pay back accumulated debts will appear in the long term. It can unfortunately be seen that Turkey's economic picture indicates that the resources accessed are

being channeled more toward consumption rather than to smart investments. In this section, we will discuss the correct utilization of resources.

The best way to solve the problem of finding capital is to create our own financing resources and reduce dependency on foreign resources. For this, the very low level of domestic savings that prevails at present must be expanded and the current accounts deficit must be taken under control. Recent changes in the laws have encouraged an increase in savings and effective steps are being taken to solve this issue. In this report, we will make our recommendations for strengthening the steps that are being taken in this context. Beyond this, however, we will also touch upon how capital can be utilized in the right way, regardless of the source. As the Central Bank and the economy administration has stressed, if the funds collected are channeled into investments more than into consumption, the country's economy will achieve a healthier structure in the medium and long term.

In this report, MÜSIAD will be discussing recommendations for generating financing resources, touching upon the entrepreneurial activities that will be shaping the future and our corporations, which together constitute the locomotive of the economy, and providing suggestions for solutions.

## **1.1. INTERNAL AND EXTERNAL FINANCING RESOURCES**

### **1.1.1. The Economy of Trust and Financing Costs**

In recent years, our country has shown a level of political and economic stability that has never been seen before in its history. After the 1990s, which were years of political and economic crises, and the last crisis of 2001, the country has displayed sustained growth, with the exception of a short slump that originated from abroad. The strong political structure that is supported by a broad base has con-

tinued to govern with stability for more than ten years now. Public finance was kept in check with the disciplined policies adopted in the aftermath of the crisis. As a natural consequence of all of these positive developments, financing costs in both the public and private sectors receded to their lowest levels in history after exhibiting astronomical rates that exceeded 70 percent. In the last year, the environment of trust was documented with our country's being brought up to the rating level of investable by the credit rating organizations. The graph of benchmark bond rate presented below shows clearly the dramatic change. At the time this report was being prepared for publication, even though Turkey was in the throes of one of its most serious political protest movements, the reaction of financial indicators such as interest rates was only limited, which confirmed once again the confidence that is felt in the country's economy.

The returns from the environment of trust are the increase in the number of foreign capital investors interested in Turkey and the low costs that these capital resources offer. Particularly the private sector has shown the desire to take advantage of these benefits and finance their investments with low-cost loans procured from abroad. As a result, the private sector's foreign debt displayed an increase of 425 percent in the period 2002-2012. This capital flow is the most important source financing the growth of our country, which is short on accumulated equity.

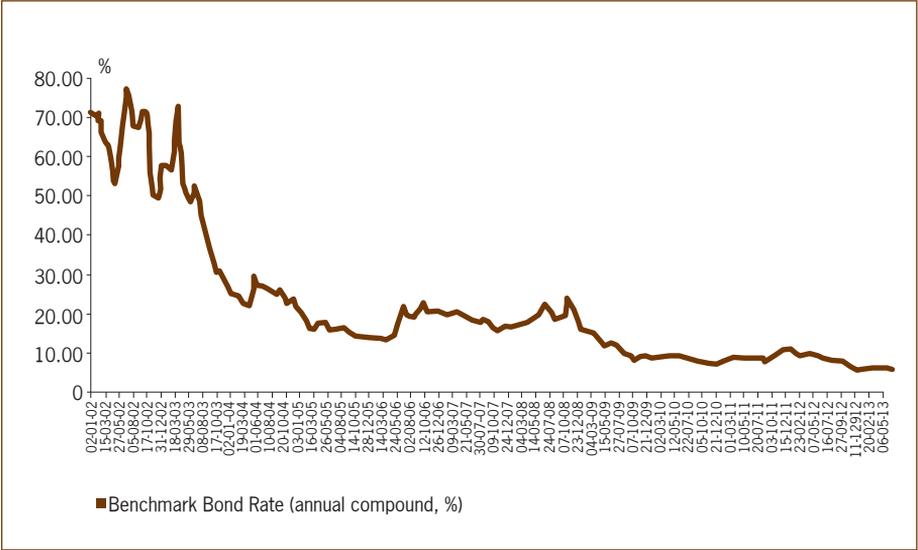
It is a fact that is frequently mentioned in statistical reports and the popular media that this expansion in loans, and particularly that part of the funds that are drawn in through bank syndicated loans, are used more to finance consumption rather than utilized as individual loans. The use of the flow of loans in this manner will unfortunately lead to difficulties in loan repayments. What would be right would be to utilize these funds in an economic infrastructure that would increase the productivity of low-cost loan opportunities and production so that the generated added value could be used in the repayment of accumulated debts.

The second element of risk is the economy's lack of protection against international financial movements. Whatever the extent of the confidence felt in our national economy and in public finance, a reduction in or rechanneling of external financing resources for reasons outside of our control has the potential of leading to undesired fluctuations in growth and therefore in the economy in general. This was a circumstance that was experienced in the wake of the global crisis of 2008. Actually, the record growth achieved in 2010-2011 may be linked to the monetary expansion policies of the European and US Central Banks. Indeed, recent statements about abandoning these policies have resulted in interest rate and stock price volatility. These external risks to our economy stem from our dependency on external financing resources for our growth. As much as it is necessary to make smart use of low-cost financing resources while they are available, in the long run, it is imperative that we generate savings that will build up our own equity capital.

### **1.1.2. Side Effects of Economy of Trust: Inadequate Savings Rates**

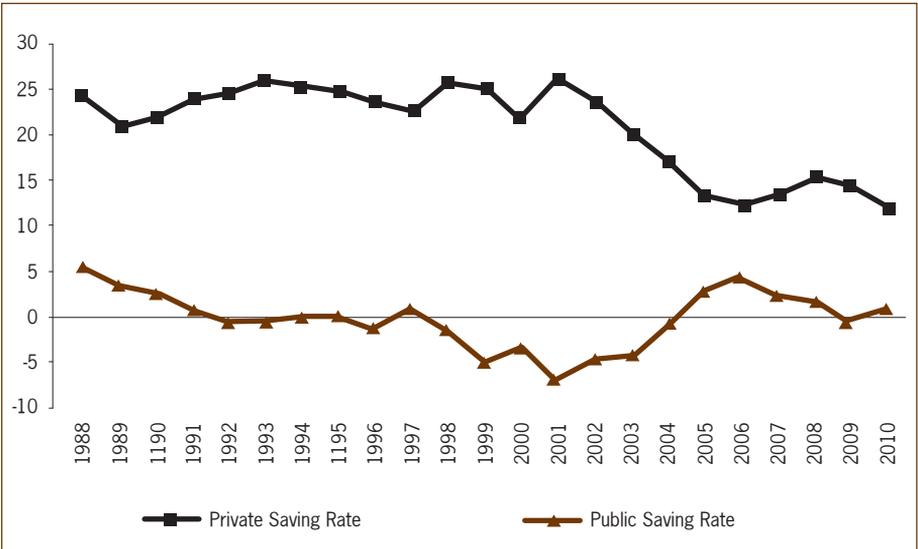
As discussed above, the long-term environment of trust sustained by Turkey and the ensuing fall in interest rates have provided a great advantage in recent years in terms of financing. The side effect of this trust and falling interest rates was unfortunately the drop in savings rates. The drop in private sector savings that is seen in the graph below can be explained by the avoidance of savings due to the trust consumers felt in the country's economy and the decreases in revenues from investment instruments in response to interest rates. The increase in the savings of the public sector was not even sufficient to compensate for the reduction in private sector savings. Indeed, the rate of private sector savings, which was 24 percent over 1991-2001, the period in which crises loomed large, receded to 13.4 percent in the period 2005-2010.

Figure 1.1. Benchmark Bond Rates 2002-2013



Source: www.makronomi.com

Figure 1.2. Private and Public Savings in Turkey, 1988 - 2010



Source: World Bank Country Economy Report for Turkey

Unfortunately, Turkey's savings rates are considerably behind the savings rates of countries that have managed to achieve sustainable growth. Savings behavior in countries on the rise, in those in transition and in China has been summarized below. Countries on the rise are defined as those developing countries that achieved high and sustainable growth rates over the period 1980-2008. It is unfortunate that Turkey will not be able to continue the growth it achieved in recent years with the current rates of savings.

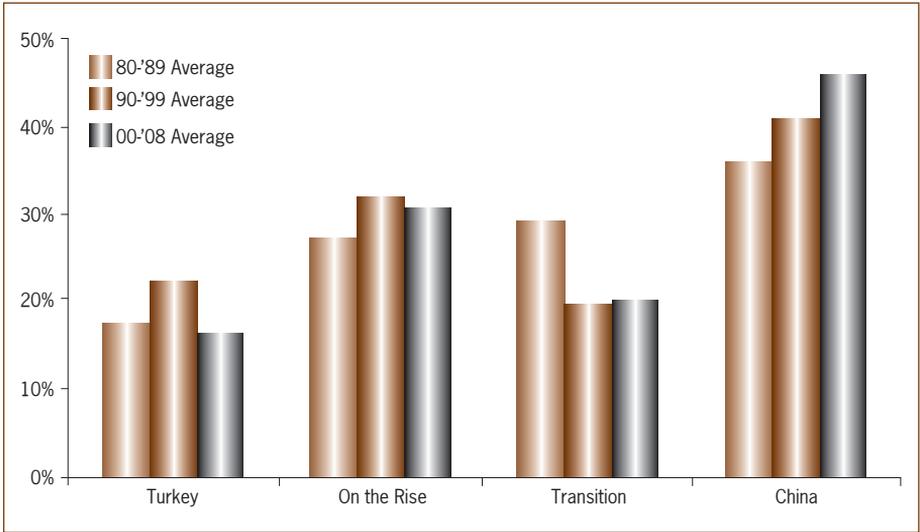
Rates of private savings are composed of two components: household savings and corporate savings. According to the household budget surveys conducted by TÜİK (Turkish Statistical Institute), savings displayed a pronounced decrease in 2003 and 2008 and this was followed by a general trend of decline. Corporate savings in Turkey, which make up a major portion of private savings, remains relatively low in the developing countries, as can be seen in the graph below. In the light of this data, it can be said that rates of savings in Turkey are lower when compared to world standards.

Turkey's remaining dependent upon external resources for financing with such a low level of savings triggers the current accounts deficit problem. This in turn throws sustainability into risk and exposes our economy to external risks.

## **1.2. LIMITED FINANCING RESOURCE UTILIZATION**

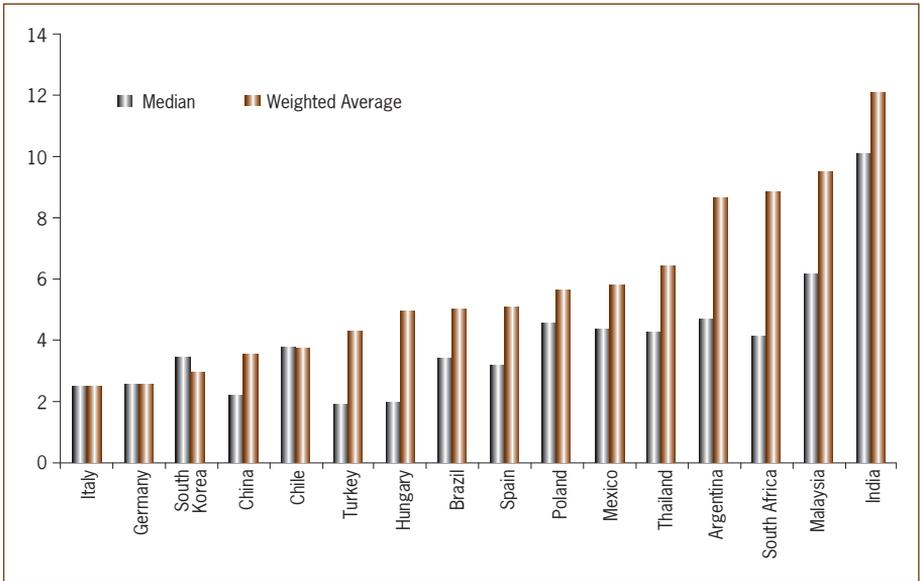
Besides the limited level of capital accumulation, Turkey is experiencing problems in accessing these resources. In this section, we will examine some problems in this context that we believe are important in terms of access to financing. In order to ensure that limited financial resources can finance sustainable growth, we believe that these resources must be channeled into organizations and concepts that justify investment. In this context, the main theme in this section will be to discuss the problems that stand in the way of a more productive financial system that can direct the flow of resources.

**Figure 1.3.** Savings Rates by Countries in Transition and Countries on the Rise



**Source:** World Bank Country Economy Report for Turkey

**Figure 1.4.** Mean and Median Corporation Savings Rates in Selected Countries (2003-2009)



**Source:** Worldscape Database, World Bank Country Economy Report for Turkey

### 1.2.1. Corporations and Access to Financing

As discussed in the section on savings, our corporations lag behind their competitors in the world in terms of savings. This falling behind leaves capital accumulation and equity generation at inadequate levels. For corporations to finance their investments and sustain growth, they are forced to apply to foreign funding. These funds might be procured by increasing shareholders' equity through initial public offerings or through loans. Constructive steps have been taken in modifying the legal infrastructure and incentives for initial public offerings. On the other hand, corporate governance and cultural tendencies in the country display a resistance to initial public offerings. As these factors are such that they cannot change in the short term, applying for loans appears to be the most easily accessible instrument of financing.

Up until 2010, Turkey's economic and legal infrastructure was not conducive to companies directly selling bonds to obtain a loan from the market. In the last three years, certain large corporations have pioneered in this respect and the chains have now been broken; private company securities may now be traded on the domestic and international markets. However, because of deficiencies in the corporate structure of companies, it has been mostly the large-scale corporations that have shown an interest in bonds.

The parties providing the biggest help to corporations in their financing needs have been the commercial banks with the loans they have secured. On the other hand, as we will soon discuss, access to these resources is not as productive as might be desired.

Problems with accessing financing is referred to in the literature as a "financing gap." The financing gap refers to the failure to procure financing and use it productively due to the fund inadequacies of enterprises and projects and/or problems in the structure of the fi-

nancial system, even though there is access to financial resources. Such circumstances hinder the effective and productive workings of markets and result in investments and growth below the potential of the economy.

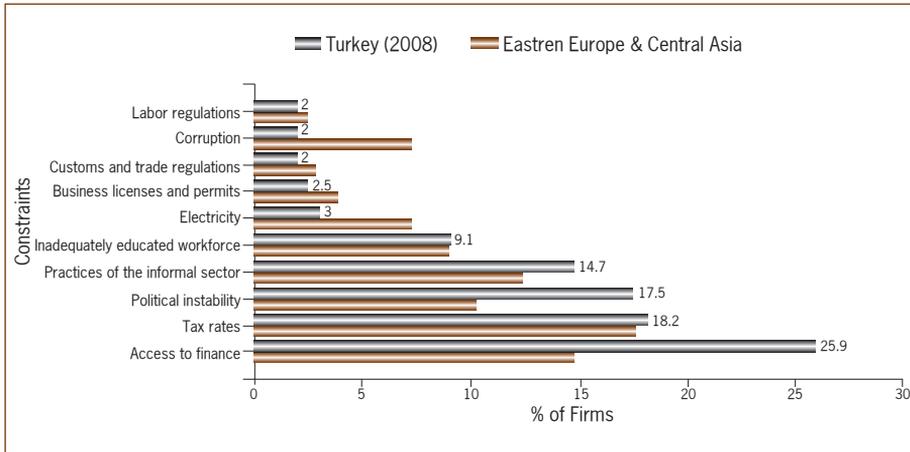
The financing gap problem is not unique to Turkey nor is it a new problem. Corporations around the world in developing countries are confronted with the issue of financing gaps. It can however be said that the problem in Turkey is more serious compared to other countries in the same classification. According to a survey conducted by the World Bank, the results of which are summarized in the graph below, 25.9 percent of corporations in Turkey view access to financing as their most significant limitation. In countries like Brazil and Mexico, which are on the same level of development as Turkey, the rates are half what they are in Turkey. In countries in our own geographical zone, corporations rate the problem of access to financing as 15 percent and after the problem of tax rates.

Although we have a general idea of the existence and dimension of the problem, the reasons for it may be stemming from many factors. In general, in developing countries such as our own, financing gaps appear due to structural weaknesses in the system of finance. In countries like Turkey, because the banking system leans more toward more profitable and less risky public sector-supported projects and also to consumers, corporations are confronted with problems in accessing loans and financing.

The reasons small and medium-sized enterprises in Turkey encounter problems particularly in accessing bank loans have been divided in a study by the State Planning Organization into two: reasons that stem from corporations themselves and reasons generated from the structure of the financial system.<sup>1</sup> Some reasons can be generalized as difficulties arising from the structural peculiarities of corporations:

1 Yüksel, A. "Türkiye'de KOBİ'lerin Banka Kredilerine Erişimi [The Access of the SEE's to Bank Loans]," <http://www.kalkinma.gov.tr>

**Figure 1.5.** 10 Significant Limitations that Corporations Face



**Source:** The World Bank Enterprise Surveys, [www.enterprisesurveys.org](http://www.enterprisesurveys.org)

The banks regard companies as risks and lean toward more secure loans. The risk involves the fluctuations corporations experience in growth, revenues and other indicators and also because of the fact that they are lacking the equity capital that will ward off such fluctuations. Banks extend loans secured by collateral to keep risks under control.

Credit evaluation costs of companies are higher for banks. This is because the means of obtaining information for evaluation are unproductive and also because financial statements produced in Turkey are unreliable. The asymmetry of information between banks and corporations constitute a major problem.

Company administrators have limited knowledge of financial instruments and opportunities. Financial literacy is unfortunately low among the professionals in Turkey’s business community.

Corporations in Turkey share the problems mentioned above with countries in the same scale of development around the world. The difficulties stemming from our financial system may be more pronounced in explaining the inability of corporations to access loans:

Turkey has widespread difficulties with regard to guarantee terms, implementation of contracts, the laws and proceedings of bankruptcy, judicial procedures, ownership rights and payment collection processes.

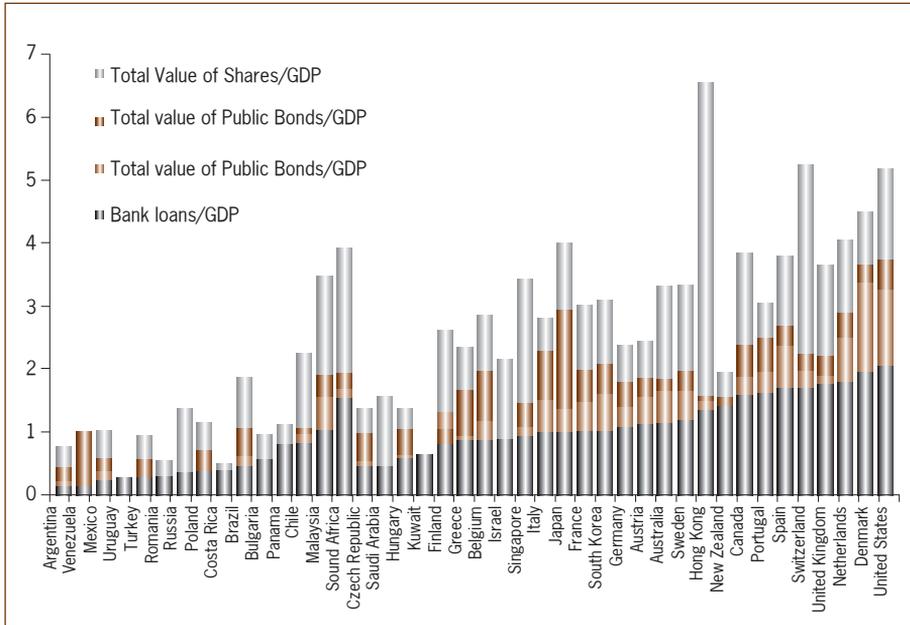
Inadequacies in savings and financial resources, limited resources through bank syndications only add to the competitive climate. It is for these reasons that commercial companies are unable to become effective customers among the competition.

Lastly, as can be seen from the graph below, the low level of competition and development in our financial system as well as the inadequacy of service quality and auditing mechanisms are also responsible for obstructing the channeling of resources to corporations where they will be used more productively.

Before offering suggestions for solutions to these structural problems, it would be useful at this point to discuss the situation in the public sector, the sector that is responsible for a major portion of the investments in Turkey, and to analyze the business relations between the public sector and private enterprises as well as the matter of financing public sector projects.

As a developing country, Turkey's public sector infrastructure investments and other projects occupy an important place in the country's economy. These big projects generally have access to project financing from Public Private Partnerships (PPP), which are of a structure that can undertake financing under the security provided by the public sector. The specifications for these projects, however, force the tenders to catch the exclusive attention of only companies of a specific scale. The step taken recently with regard to consortium participating in tenders that eliminated requiring all of the members of a consortium to submit work completion certificates has been a positive move in the way of stopping this unfair practice.

**Figure 1.6.** Financing Resources for Corporations around the World



**Source:** The World Bank, Financial Structure Dataset, [www.go.worldbank.org](http://www.go.worldbank.org)

Keeping tenders on a large scale and opening a multiple of projects to bidding make tenders only accessible to the bids of large-scale corporations. Since only few companies exist that can meet the specifications of such projects and be able to provide the equity for financing or the security to obtain loans, even if some companies may be capable of providing the service, the public sector leaves these companies out of the bidding. This triggers off a general imbalance in the country's economy. The system causes large-scale corporations to grow to an even larger scale, leaving smaller scaled companies devoid of the opportunity to expand their volume of business by participating in public sector projects. The major size of the projects, too big to be financed, in turn leaves the public sector to the mercy of a few huge corporations, causing public funds to be utilized unproductively. At the same time, these huge infrastructure projects that only a limited number of companies can take on, become an element of risk for the

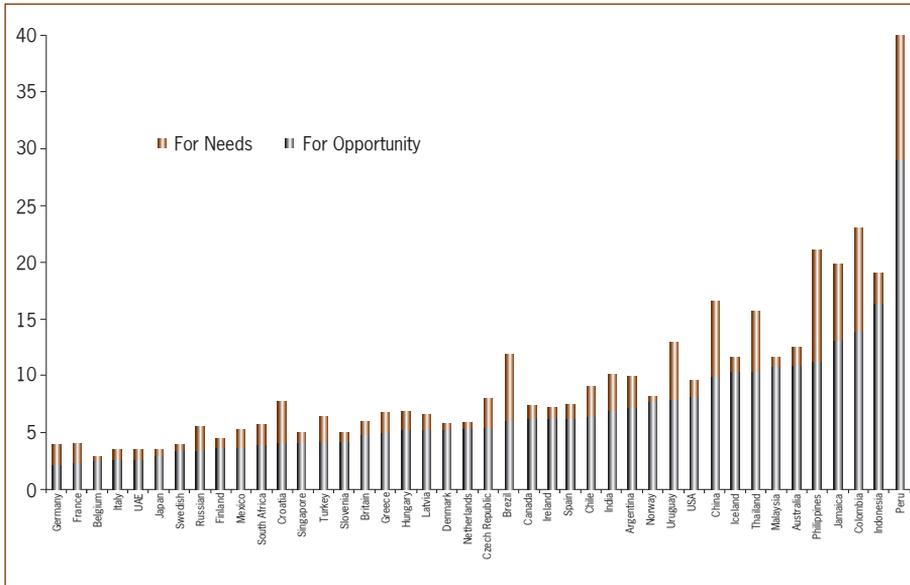
public sector. Even if only one of these companies should fall into financial difficulty, this may mean the disruption of a public sector investment worth billions of dollars.

Following the discussion of the financial terms involved in state tenders, it might also be useful to talk about new initiatives, which make up a significant percentage of enterprises. The importance of new initiatives and especially of innovative entrepreneurship in our country cannot be denied. We think there is benefit in making a special effort to analyze these enterprises and their financing, and to look at successful examples of innovation financing.

### **1.2.2. Entrepreneurship and Venture Capital Financing**

Entrepreneurship is nurtured by different resources in different countries, depending upon cultural and structural attributes of that country. The differences between countries are reflected in their entrepreneurial activities. In some of Europe's developed countries, for example, innovative entrepreneurship is the realm of well-established major companies and research centers while in countries such as the US and China, this is accomplished through individual efforts. The table below summarizing the entrepreneurial activities of the workforce points to such cultural differences. The individual entrepreneurial activities in Turkey are neither as low as in the institutionalized countries in Europe nor as high as in the US. If there is anything we can learn from this table, it is that Turkey is not lacking in entrepreneurial spirit. What lawmakers must consider when supporting initiatives is which types of initiative is suitable to our cultural makeup. It is our belief that due to the cultural makeup of our country and its deficiencies in terms of institutionalization, it will be the entrepreneurial efforts of individuals that will be more effective in producing innovative companies and products. The most innovative products and the fastest growing companies have emerged from the efforts of individuals in small enterprises.

**Figure 1.7.** Participation of the Workforce in Entrepreneurial Activities

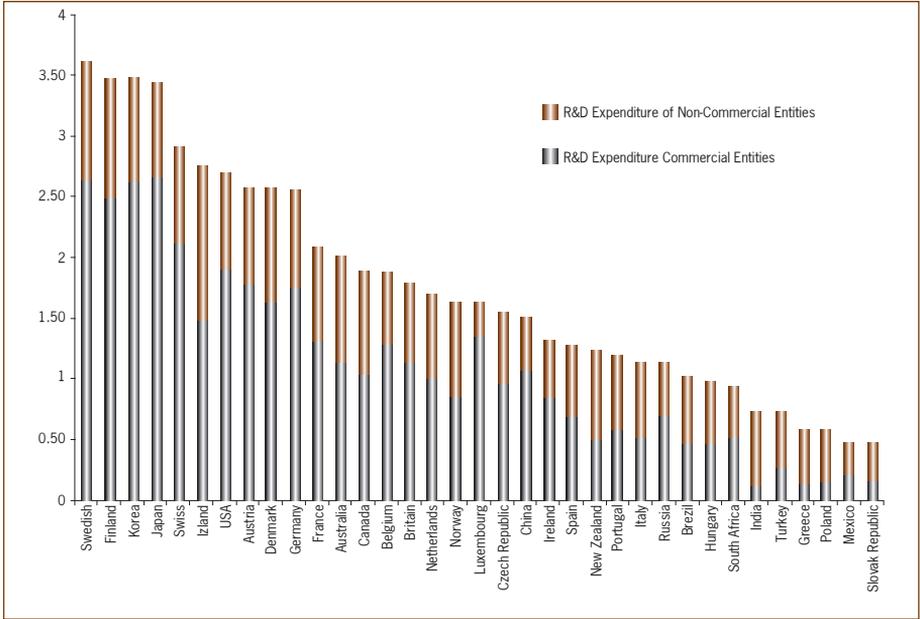


**Source:** Global Entrepreneurship Monitor, [www.gemconsortium.org](http://www.gemconsortium.org)

No matter how different developed countries may be from one another in terms of their culture of entrepreneurship, all of them share a certain element that supports their innovativeness and growth. That element is that they set aside resources for research and development and the commercialization of these processes. Unfortunately, our country lags behind many developed and developing countries in setting aside a portion of the gross domestic product to spend on research and development. In order for growth to be sustainable in the medium and long term and to create value, it is imperative that resources be channeled into research and development activity. Although the State supports such activities, it is also up to the private sector to mobilize itself to commercialize innovations and add them to the economy.

Progress with innovative initiatives can only be made when innovative ideas are matched to resources that can finance them. The parallel development of these two elements is necessary in order to be able

**Figure 1.8.** R & D Expenditure



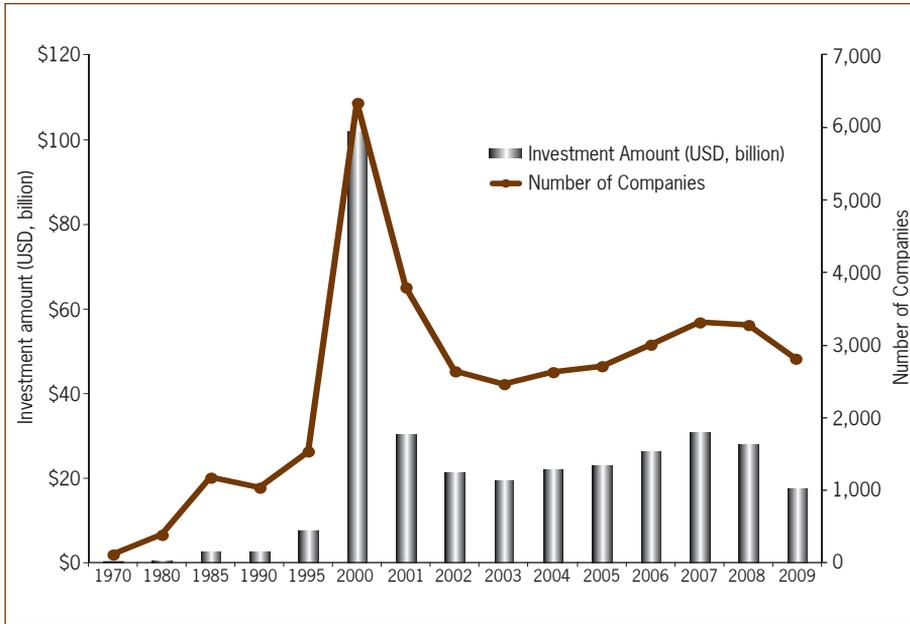
**Source:** OECD in Figures, 2009, [www.oecd.org](http://www.oecd.org)

to commercialize innovations and make them locomotives in the economy. The investments in research and development in the country as well as the steps taken to provide quality training in technical fields contribute to expanding the talents and opportunities that lie among our country’s young human resources. The aim of this report is to analyze the existence and development of the other element that will contribute to economic growth, which is financing resources.

Among the various financing sources that are important for entrepreneurial activities are individual sources, “angel investors,” venture capital, and state-supported programs. State-supported programs of the development agencies such as KOSGEB (SEEs Development and Support Administration), TÜBİTAK (Scientific and Technological Research Council of Turkey) assume a significant role in starting off innovative entrepreneurial activities in Turkey. The MÜSIAD reports on the economy in previous years as well as other research

publications have emphasized the importance of this matter. However, the most productive contributions of innovations to economic growth will be achieved through the activities of the private sector. In this context, the best opportunities for financing entrepreneurial activities are venture capital, which provides a means of financing new initiatives under the institutionalized umbrella of the private sector, and the network of angel investors that have been enhanced with a more institutional structure in recent years.

**Figure 1.9.** Venture Capital Investments in the US



**Source:** National Venture Capital Association, 2009, [www.pwcmoneytree.com](http://www.pwcmoneytree.com)

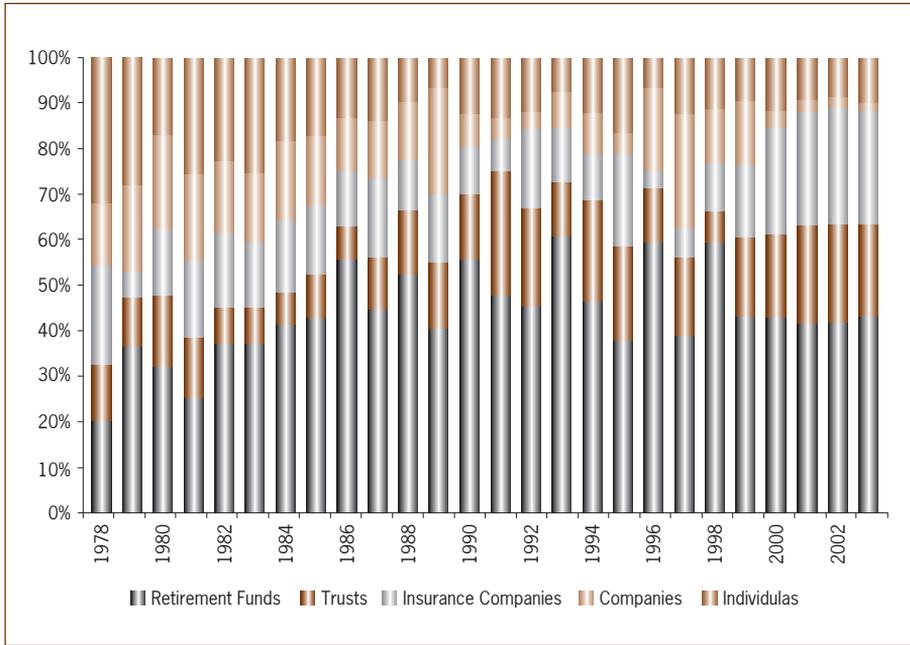
Capital for new ventures in Turkey is now regulated under the institutional structure of Venture-capital Trusts. These organizations are regulated and audited by the Capital Markets Board and are in the form of investment partnerships which trade on the stock exchange and are subject to the considerably inflexible rules and regulations of the CMB. Although organizations established with this status are few in number, the ones that are active are even fewer.

It would be useful at this point to examine the concept of venture capital companies in the country where they are the most successful, the United States. Venture capital firms in the US had also been structured as investment partnerships in the 1960s and 1970s. It was unfortunate that the structure of the system was not flexible enough to permit the success of these funds. Partnerships were subject to rigid regulations and therefore did not have the freedom of utilizing their funds in the way and at the time they wanted. By their very nature, venture capital movements need to make funds available when and whichever way necessary, independent of any given system. After these initial experiences, venture capital partnerships were structured as limited liability partnerships and the funds, as seen in the graph, were thus able to achieve the success they enjoy today.

The monetary resources for venture capital funds did not generally, as with angel investors, originate from individual resources but more from corporate investors. The tax advantages allowed the funds to be channeled to venture capital trusts by the corporations in Turkey constitute a very positive step in this context. However, to create a successful venture capital investment environment, investment funds must be given the flexibility such as in limited liability partnerships. Encouraging long-term corporate investors such as retirement funds and insurance companies to utilize their financial resources in venture funds will serve to channel monetary resources into new initiatives.

The lack of professional venture capital providing flexible terms in our country has attracted experienced international investment firms to this open market. In various examples in recent years, unfortunately, we have been witness to the innovative ideas developed by Turkish entrepreneurs being financed and incorporated abroad by international companies. The reluctance of financiers in Turkey to pick up on investment opportunities or their tendency to set forth unacceptable terms has left the stage open to experienced foreign companies that are interested in adopting and taking advantage of

**Figure 1.10.** Capital Resources for Venture Capital Funds



**Source:** National Venture Capital Association Yearbook, 2005

the new ideas. The facility with which many innovations, particularly products such as software in the field of technology, are allowed to leave the borders of Turkey to become incor

porated, and the liberal movement of ideas and capital beyond borders is creating an atmosphere where we will soon be losing the opportunities presented to us in our own country.

Of course, it is true that the reason countries like the US and the UK are more easily able to attract new companies is not just because of available monetary funds. These countries offer companies a wider scope of opportunities for sales and initial public offerings, not only during the process of establishment but even when the corporation's development has been completed. The advanced state of financial markets provides investors with every opportunity to implement their plans, especially in the case of venture capital.

Besides the ease with which incorporation is achieved, the facility provided to company bankruptcy and closure procedures are also elements that are important for new endeavors and their financing with foreign resources. Both organizations that extend loans as well as structures that acquire shares to be partners in venture capital firms need to follow a simple legal process to be able to liquidate the company whenever it becomes necessary. Facility of bankruptcy is of special importance for innovative ventures since a great portion of such companies do end in bankrupt. .

It is unfortunate that financial investors in our country lack the legal infrastructure that would provide smooth progress in required procedures. According to a survey conducted by the World Bank in 2009, among 181 countries, Turkey is 43rd in facility of establishing a new corporation, 68 in facility of accessing loans, and 118rd in facility of closing down business.<sup>2</sup> Such a legal structure is one of the factors that has caused years of delay in bankruptcy lawsuits, making the realization of financial investments difficult. Policymakers must change the legal infrastructure to accommodate and facilitate company incorporation and liquidation, which are after all the most natural elements of business life.

Based on the analysis above, we will now make some recommendations on how to facilitate the access of enterprises and innovative ventures to financial resources.

## 1.3. RECOMMENDATIONS

### 1.3.1. Generating Financing Resources

As stated above, capital inadequacies in our country and the shortcomings of the financial system make it difficult to finance sustainable growth. Because of the low costs of foreign loans, these loans

are suitable sources of financing. However, they should be directed toward the right investments in a way that will support growth. The recommendations below include suggestions as to the correct utilization of funds that enter the banking system by means of loans. Here, we will dwell upon achieving capital accumulation through increasing domestic savings.

We stated in the analysis above that private savings in Turkey are not at an adequate level. Recommendations as to policies that can be implemented to increase the percentages of household savings are as follows:

Work should be carried out to increase the level of individual financial literacy. Individuals that do not understand the importance of savings and are not aware of existing opportunities lean toward consumption and spend amounts beyond their level of income. Banks that provide investment services might be expected to provide education in this context as part of their social responsibility programs, with state banks acting as leaders in this effort.

Special care should be given to the education of women and to encouraging their participation in the workforce. Such services will increase productivity on an individual basis and will contribute to savings on a corporate level.

The recently established Individual Retirement System and the promotion of this program is an important marketing tool in establishing the savings habit. New savings instruments may also be developed and added to this product. Products such as trust funds, educational funds and the like for children may provide tax advantages.

There must be a complete and consistent legal infrastructure to support the development of financial markets. The recently revised Capital Markets Law is an important step in this direction. The problems of implementation and the needed regulations need to be analyzed and achieved.

The inequity in the tax rates applied to various financial instruments should be eliminated.

Increasing savings in companies depends upon their robust growth and profitability rates. Achieving this however in turn depends on accessing the right capital that will finance growth. The recommendations on financing made below will be of use in this context.

Tax exemptions for companies that channel resources into venture capital funds are a step in the right direction. Similar exemptions may be put into practice for company-based retirement funds.

High levels of savings are not by themselves an adequate condition for sustainable growth. Achieving productivity is also a propelling force for growth.<sup>3</sup> The recommendations below on utilizing financing resources correctly are aimed at ensuring this productivity.

### **1.3.2. Companies and Project Financing**

The various projects that companies have taken on over the years, particularly infrastructure and growth investments, have been financed with shareholders' equity or with loans secured from the commercial banks against collateral. Even when they found foreign-based financing, companies have used shareholders' equity as collateral for the loans they utilized. This general understanding has been helpful in keeping the risks of creditor organizations under control. On the other hand, it has caused an increase in company borrowing costs and risks. The matter of increasing capital through initial public offerings, a branch of company financing, was mentioned above. Corporate structures that have been reinforced with the new Turkish Commercial Code and the support given to initial public offerings by the new Capital Markets Law are part of the legal infrastructure that has been drawn up. Educating company owners and executives

<sup>3</sup> Dünya Bankası, "Türkiye Ülke Ekonomik Raporu, Yüksek Büyümenin Sürdürülebilirliği: Yurtiçi Tasarrufların Rolü" [World Bank, "Country Economic Report on Turkey, Sustainability of High Growth: the Role of Domestic Savings"]

about the various financial resources available and about the laws will encourage enterprises to conduct initial public offerings in the medium term. In the recommendations in this section, we will offer suggestions as to company investments and the financing of projects through loans.

For the last 20 years, the new approach adopted outside of the rigid system of guarantees has facilitated access to monetary resources under the name of project financing. The rigid requirement for security and collateral in the past has been replaced by easier access to capital markets and more flexible terms. The new structure made available for project financing will enable companies to close off their capital deficits without adding an extra load to their balance sheets. This structure is generally used for financing a single project or asset. The organization providing the financing accepts the asset or revenues from the project as security. This type of structure is currently being used in large infrastructure projects and in projects financed by the Public Private Partnerships (PPP). We recommend that the scope of this limited utilization be expanded to include private sector ventures.

Companies working with project financing find the opportunity to obtain financing without altering the structure of their balance sheets, without limiting their assets by offering them as security, thereby procuring the financing only on the basis of what the project is worth. We believe that these advantages will contribute to finding a solution for problems regarding private companies' access to loans, particularly by means of lightening the load of heavy security requirements. Beyond this, they will also cause investments geared for company growth to increase and enable enterprises to take on projects that they can finance with their own shareholders' equity, thereby lightening the burden of the issue of financing gaps and lighting up the path for productive growth.

The Loan Guarantee Fund (KGF), which currently provides state-backed security in Turkey for companies having difficulty in accessing loans, makes its assessments, not unlike the banks, on the basis of assets and shareholders' equity. Even if the project financing opportunities are used within the scope of this structure, however, if the amount of security provided by the State can be increased, an indirect benefit will have been achieved.

Project financing requires that the commercial banks in Turkey have knowledge and experience in project evaluation and risk analysis. Unfortunately the state of development of our financial sector is not adequate enough to achieve this. The state banks might take the lead in this and be examples for the private banks to follow in terms of company investment assessments and risk analysis. According to the Basel III criteria, if risks can be correctly assessed, project financing, which will bring about additional capital adequacy needs, will create profitability ratios that leave other investments behind, opening up new business corridors for banks with its risk-return ratio. That the banks are forfeiting profitability despite their conservative risk profiles indicates that this situation cannot be maintained in the long term. Banks that expand upon their know-how concerning project appraisals, risk management and project financing may be able to open up new business areas for themselves, taking knowledgeable risks while increasing profitability ratios.

The profitability currently offered by individual loans push the banks into being cautious in extending commercial loans. Efforts to enhance and deepen the competitive environment of the financial sector may cause loans to be directed toward more risky but profitable commercial customers. In this context, the sector might be expanded by providing international organizations that are experienced particularly in commercial and investment banking with new banking licenses.

As commercial and investment banks become more sophisticated, they should find effective ways of financing new initiatives with more advanced financial instruments that will include mezzanine bonds, hybrid borrowing products and asset-based securities. Such products need banks on the supply side and enterprises, new initiatives and venture capital companies on the demand side to be more knowledgeable about finance. As the Turkish financial system matures in the near future, our banks will be offering these products to firms that need them, thus allowing for a more effective distribution of risk.

The recommendations given above predominantly require that the banks develop themselves with respect to risk appraisal and structured financial instruments. In this way, the banks will no longer be passive service providers of the flow of financial resources, but will become active players in assessing risks and returns and effective capital utilization. We foresee that the services that the banks will thus offer will generate added value and increase their profitability levels.

### **1.3.3. Changing Banking from a System Giving Loans on Collateral to a System Granting Loans to Projects**

Our country does not have an adequate store of capital. Our savings ratios are also far away from providing the adequate capital needed for our goals for growth. Under the circumstances, in order to reach our goals for 2023, the obstacles impeding the growth of enterprises must be eliminated. There have been important advances in Turkey in terms of improving the investment environment. In this, the priority must be to provide investors with the peace of mind and atmosphere of trust they seek. With the political and financial stability achieved in recent years, this has been accomplished and it is foreseen that the “resolution process” will take the country to an even better point.

Besides this, the distance taken by the public sector in the areas of transportation infrastructure, logistics, etc. is very gratifying. From another perspective, investments are being appropriately encouraged on a geographical and sector basis with the New Incentive System. However, when the desired goals are considered, it can be seen that there is a need for additional investments and that the private sector, which will be undertaking a major part of these investments, needs adequate financing.

In the current banking system, enterprises seem only to be able to access loans when they prove they do not need them and then only if they can produce the collateral. This practice is one of the greatest obstacles standing in the way of the development and growth of particularly small and medium-size enterprises, which provide the motor power for the country's growth, and also of large enterprises of a certain dimension. The few and large-volume based projects are an exception to this rule and may be shown as a positive example. However, the access of enterprises to financing appears before us as one of the fundamental problems our country faces.

It is only natural for the banking system, like other commercial enterprises, to profit within the market economy. On the other hand, the repetition of circumstances that were experienced in the crisis of 2001 and the large amounts that took a plunge cannot be expected to be unfairly compensated for by all of the segments of society. It is also not feasible to expect that banks record losses as commercial enterprises.

It is a fact, however, that the system has come to the point where although each of them are commercial enterprises, the banks give loans on a no-risk basis, completely based on collateral, in fact providing credit to those in need of loans with the deposits they collect with expenses and profit added, based on a system of demanding excessive security; under the conditions of the market economy, this profile acts as a brake on growth.

At this point, it must be said that it is a matter of urgent necessity that a new system be created that is based on transparent balance sheets in the private sector, a system where the commercial risks of the banks and also the burdens carried by the real sector are both considered if we are to expect that the path to growth runs unimpeded.

In short, the most important item on the country's agenda in the next period is finding quality and rapid financing for projects that are correctly shaped on the basis of balanced income and cash-flow, with transparent balance sheets and reasonable security.

#### **1.3.4. State Projects That Can Be Financed**

Working with tenders on a smaller scale in public sector projects will not only make the projects easier to finance but will also open the tenders to a wider range of enterprises, thus reducing the public risk and contributing to the growth of small and medium-size enterprises. Some projects may be opened for bidding on a totality basis, sometimes because of the nature of the project and sometimes because of its economy of size. The breaking up, whenever possible, of billion-dollar projects into small bidding tenders will allow smaller sized enterprises to enter the bidding, reduce the risk of the public sector, and will in the long term prevent the financial resources of the country to be accumulated in a limited cluster of companies. At the same time, small-scale projects can be financed for less with shareholders' equity and with loans that are easier to procure and at lower cost.

The central government as well as local administrations should break up projects being opened for competitive bidding for infrastructure construction, service procurement, etc. to their smallest possible components. At the same time, preventing large-scale businesses from entering the bidding for small-scale tenders might also be considered. Such segmentation on the basis of size would contribute

to giving all sizes of enterprises the opportunity to provide public sector services with government resources and also to helping these resources grow. This in turn will prevent the unfair accumulation of capital at the top. A similar segmentation that was applied in the United States proved successful.

### **1.3.5. Venture Financing with a New Structure**

A company with an established structure is able to find loans from the commercial banks. It is much more difficult for new ventures. The financing of such risky ventures may only be possible through risk capital and shareholding. As discussed above, Turkey's venture capital trust structure does not provide the necessary flexibility for new ventures and ultimately, even ideas that need financing are captured by more flexible foreign competitors.

Legal preparation should be undertaken for institutionalizing the structure of venture capital by giving it limited liability. In this way, the trusts will be taking in a limited commitment on capital from shareholders and can put the needed capital together when the need for investment arises. Even if a fund being transacted on the stock exchange does not have the capacity for an investment, it will be required to keep its resources.

The establishment of new companies or the liquidation of companies through bankruptcy should be facilitated through process engineering efforts and the legal infrastructure should be updated accordingly. In Turkey, where establishing a company and going through bankruptcy necessitates quite an unproductive process, it is a challenge to institutionalize new ventures and find external financial partners. American laws are of a structure that eases the process of company incorporation and liquidation and an environment has been created where the ideas and financial accumulation of even foreigners can be brought together.

Venture capital investors should finally recognize that capital is in competition on a global scale for bright ideas and that financial resources may be offered under the same terms by more experienced international players. This awareness should also incorporate the sense that not every investment may be successful and that risks should be diversified in order to keep them under control.

### **1.3.6. Encouraging Project Financing in the Banking System**

In the current banking system's almost completely collateral-based model of financing, when it is considered that projects with appropriate feasibility and cash flow studies can find financing against reasonable security, it will be seen that the banking side too will have to share reasonable risks as a natural consequence of commercial business life. However, in a banking system that already has no problem with a demand for commercial loans, this model can only work if incentive is provided to the recommended system within market conditions. At this point, similar to the way in which angel investors provide entrepreneurs with capital, it is possible to encourage project financing with positive discrimination.

### **1.3.7. Ensuring That State Banks Focus As Much on Investment Banking As They Do on Deposit Banking**

In order to ensure a widespread and reasonable practice of project financing, besides providing the system with other incentives, it could also be possible to have state banks work within the market economy under suitable competitive terms.

The primary duty of the State is not to make commercial profit. In recent years, as a result of the heightened quality of management in the state banks, not only have the banks been able to be free of their traditional sickness of writing up losses, they have to the contrary made substantial profits. However, the principal behind the opera-

tion of state banks is of course not to suffer a loss; it is also at the same time not their priority to make a profit or indulge in profit competition with private sector banks.

In order to ensure that projects that balance income and expenditure and have a correctly formulated cash flow and a transparent balance sheet find quality and rapid financing against reasonable collateral, state banks should be guided--and correctly guided--into a system of profit optimization, something that is very important for the country but that has almost so far never been implemented. By becoming leaders in this context, the state banks can play a constructive and guiding role in the market. This is one of the principal duties of the State.

### **1.3.8. Making Public-Private Sector Partnerships More Effective**

In order to contribute to an adequate accumulation of capital so that Turkey can meet its medium and long term goals for growth, public-private sector partnerships must be made more effective in handling major investments as well as infrastructure projects with more reasonable dimensions that the private sector cannot tackle on its own. For this, the obstacles in the laws and regulations that hinder such collaboration must be eliminated and the entire process must be expedited.

### **1.3.9. Widening the Base in the Realization of Large-Scale Projects**

On the other hand, large-scale projects that are a source of pride for our country and are currently announced, implemented and realized in short periods of time should be undertaken not in large magnitude but broken up instead into smaller parts so that the number of outstanding companies in Turkey investing in such projects is expanded. This strategy will not only serve to create a more fair distribution of wealth but by broadening the investment base to include enterprises

that have reached a certain technological maturity yet do not have adequate funds to take on such projects, these enterprises will be able to enjoy a larger share in the economy. By increasing the number of structures that these enterprises can finance, growth can be achieved not by means of only a few enterprises undertaking a certain size of project, but through a more balanced base of investment.

At the same time, especially in the case of large-scale projects, giving more investors the capacity to undertake projects will also lead as a result to opening the way to their becoming recognized entities in the international arena. Allowing for only one partner in the consortium submitting a tender to be considered responsible for the completion of the project and permitting consortiums with a wider investor base to compete will also serve to spread wealth evenly. In addition, this strategy will reduce the risk involved in having growth dependent on a limited number of enterprises and is important in terms of permitting projects of lesser risk to be undertaken.

### **1.3.10. Opening the Way for Medium Sized Enterprises in Energy Investments**

It is expected that energy investments in Turkey will reach a level of approximately 150 billion dollars by 2023. The size of this investment potential, foreseen to ward off any crisis caused by an energy deficit, makes it imperative for the private sector to assume a bigger role in contributing to these investments. However, medium-sized enterprises are currently confronted with the obstacle of large-scale projects.

For example, in line with the understanding that was predominant up until recently concerning the privatization of particularly energy distribution and production facilities, small-scale power plants started to be put out for sale one by one and many new players were able to enter the market. The new approach is to combine medium and

large-scale power plants in terms of portfolios of several thousand MW to invite bigger investors. It is of the greatest importance to make sure that our medium sized investors are given equal opportunities and this requires that suitable portfolios are put together.

### **1.3.11. Gradual Implementation of Large-Scale Portfolio Privatization**

In the privatization of large-scale portfolios, the shares held by the public sector are sold by the block method. As an alternative to this, gradual sale and transfer of shares may be considered. This way, public-private sector partnerships can continue for a longer time. This practice is frequently seen in large privatization projects in the EU.

## Part 2

# RECOMMENDATIONS

### 2.1. MACRO POLICIES

The measures taken on a macro dimension in an economy to ensure the operation of the market, conditions of balance and stability must be achieved. In this context then, the monetary and fiscal policies to be implemented are of the greatest importance in order to avoid macroeconomic instability.

Many economic studies have shown that the most important factor in achieving productivity for sustainable growth is the adequacy of macroeconomic practices. In other words, a good macroeconomic policy is not sufficient for growth. However, since a poor macroeconomic policy will give way to worrisome results in the economy, the first condition of success is to draw up macro policies in a manner that is compatible with circumstances and goals.

Indeed, successful monetary and fiscal policies are the very foundation of the system. Also, financial regulations should be considered a part of macroeconomic policies.

### **2.1.1. Discreet Monetary Policies**

#### **Ensuring Price Stability**

The main goal of monetary policies is to ensure price stability. What is meant by price stability is not only that inflation should be kept low but that this can be sustained for long periods without serious fluctuations. The chronically high inflation that plagued Turkey for many years was finally successfully curbed in the last 10 years, achieving a drop to single-digit numbers as from 2004.

At the same time, when the difference between real inflation and targeted inflation gets wider and this becomes an accepted phenomenon, the credibility of the Turkish Central Bank may be adversely affected in the medium term. This in turn would be an indication of a loss of trust in targeted inflation as the impact of the global crisis lingers. For this reason, it is necessary to generate alternative strategies that will serve to ensure price stability.

#### **Continuing a Pro-active Role**

It must on the other hand be accepted that due to the financial difficulties in the EU and other global uncertainties, it will not be easy at the moment to set forth a monetary policy with a clear cut framework. This is because the deviation in targeted inflation is not unique to Turkey. Under these circumstances, it is important for the Turkish Central Bank to move forward with a flexible monetary policy that can be adjusted to prevailing conditions and for it to continue to play a pro-active role for the time being.

### **2.1.2. Prudent Financial Regulation**

As the Central Bank has said for some time, ensuring price stability is not sufficient in protecting macroeconomic balances. For example, circumstances such as the rising trend in foreign exchange rates or continuous variability lead to financial uncertainty and challenge the

economic decision-making process. In addition, such uncertainty also brings with it speculative movements, potentially making the situation even more serious. On the other hand, a high foreign exchange rate causes local currency to devalue, triggering inflation. For this and similar reasons, it becomes clear that within a macroeconomic framework, besides the classic targeting of inflation, there is also a need to create the conditions that will ensure financial stability.

### **Ensuring Financial Stability**

In this context, one of the matters that should be focused on is reducing fluctuations by deepening foreign exchange/TL markets (increasing the volume of transactions) and making sure that market actors have a more robust environment for their decision-making. With this aim, providing banks with advantages such as keeping required reserve ratios and prioritizing tenders will allow for quotations for significant amounts within defined margins, producing an effective method of keeping market prices within these margins. Especially by encouraging the ISE to collaborate with the world's most reputed stock exchanges, the obstacles hindering local investors from trading in foreign markets should be eliminated. This way, companies trading on the Istanbul Stock Exchange (ISE) should be encouraged to distribute dividends in order to ensure investor trust or regulations should be adopted whereby prolonged failure to distribute dividends is prevented.

Together with this, the credit lines that have been generated for the banks' foreign exchange stocks abroad should be closely monitored by the Banking Regulation and Supervision Agency (BRSA) and lowered if necessary.

In addition, interest rate cuts should be actively utilized to reduce the share of short-term speculative foreign investment funds in total foreign capital investments.

## Reducing Foreign Exchange Position Deficits

In economics open to the outside world, the difference between foreign currency assets and liabilities in sectors, or more specifically companies, is used as an important indicator in assessments. In Turkey, the net foreign exchange position of the companies in the real sector as of 2012 was recorded as 139.7 billion dollars. On the other hand, the short term net foreign exchange deficit stands at 13.4 billion dollars. This short term foreign exchange deficit, which is clearly not a low level, creates pressure on foreign exchange rates. Because of this, in terms of financial stability, it is important to conduct efforts to eliminate the deficit with medium term financing.

### 2.1.3. Disciplined Fiscal Policies

To avoid an economy crisis and/or be adversely affected by one, besides a prudent monetary policy and a cautious fiscal policy, wielding financial discipline is also an unquestionable must.

It can be seen in the light of the data for the period that after removing itself from the crisis, the Turkish economy, both in 2011 and in 2012, made no compromise in maintaining fiscal discipline. Indeed, the ratio of the fiscal deficit to national income in 2012 was around the level of 2 percent, below the Maastricht Criterion of 3 percent. It is for this reason that it remains clear that the government has been successful in its fiscal policies. In particular, while EU countries such as Greece and Spain were fighting the impact of the economic crisis, Turkey's refusal to compromise in the face of the crisis should be taken as a praiseworthy approach. What is important from this point on is that fiscal discipline can be continued into the future. To have a strong economy in the future, there needs to be a robust public economy.

## **Harmony with Monetary Policies**

To sustain fiscal discipline, it is necessary to follow discreet monetary policies and harmonious fiscal policies. In this context, the Turkish economy needs institutionalization so that monetary and fiscal policies can work in harmony.

## **Effectiveness in Public Expenditure**

Another important condition for a robust public economy is no doubt increasing the effectiveness of public expenditure. The importance given to performance-based expenditure management in 5018 in order to increase the effectiveness of public expenditure should be enhanced.

## **Additional Non-Tax Resources of Income**

As discussed above, investment is needed for growth and savings are needed for investment. In an economy where there are no savings, it would be impossible to speak of sustainable growth. This is because as the level of prosperity rises, the economy cannot be continuously based on borrowing. Therefore, the rate of savings in the Turkish economy must be raised. Savings are drawn from two resources—public and private. In this context, one of the main objectives of fiscal policy should be to increase public savings. This can be made possible by the creation of safe additional sources of income.

## **Fighting the Underground Economy**

Raising taxes is one of the most important factors in a strong budget. In 2011, as a result of the restructuring of tax debts and the increase in taxes owing to high levels of imports, the central administration budget exhibited a deficit that may be considered small, but with the fall of income from taxes, this deficit showed a partial increase in 2012. Measures must be taken to make sure that the fall in tax income and the increase in the budget deficit does not become continuous.

It is at this point that it is important to realize that fighting the underground economy can be used as a significant tool in maintaining tax income at high levels in the long term and not just in the current period. Among the foremost steps that need to be taken and not neglected in the fight against the underground economy are, besides audits and incentives, the simplification of regulations pertinent to business and working life, and a review of certain areas in the tax system. It is believed that efforts to gradually reduce the pressure of the employer on wages in enterprises in which the rate of employment is increasing will be an important step in the direction of reducing the underground labor force. This will not only cause an increase in employment because of its encouraging impact, but it will also bring down costs and increase competitive power, acting as an effective way of fighting the underground economy.

### **Lifting the Practice of Collecting Provisional Tax**

A measure left over from inflationary days, the government's practice of collecting provisional tax from the tax it will be collecting 16 months later as a precaution against high inflation-caused loss, is today no longer necessary since inflation is in the single-digit range and the downward trend is continuing. To ensure fairness in tax collection and to prevent enterprises from the unfair requirement of pre-financing, this type of tax practice should be lifted.

In markets where inflation has dropped to reasonable levels, sales terms are extended as much as working capital levels allow. In developed country economies, where inflation is low, long sales terms and borrowing opportunities are concrete examples of this. In Turkey as well, parallel to single-digit inflation levels and the economic stability that has been created, average sales terms in the markets have been extended, average terms going up to the 10-12 month level (in the method of progressive collection, an average term of 12 months matures 24 months after the last date of collection).

*However, according to the current implementation of advance tax:*

In actuality, sometimes provisional tax is paid on the basis of an unearned value perhaps twice, three times, and, depending upon the sector, even four times. This tax is a type of unfair pre-financing that is imposed upon enterprises.

Although tax is a value that is calculated annually, each advance tax period is perceived as if it is a separate period and in the next advance tax period, there is a psychological pressure stemming from the faulty perception that lesser income cannot be shown for the next period.

The approach of lifting the provisional tax practice does not imply any sort of tax deduction. As in the 3-year medium term plans of the public authorities, it is believed that income planning has reached a maturity where it may be adapted to new conditions.

If the provisional tax practice is continued, there can be lower percentages of profit at low levels of inflation such that, to compensate for this loss of profit, enterprises are pushed into the hidden economy.

In the same way, in view of the fact that income is determined at the end of a year's activity, there can be no talk of a fair provisional taxation method. Whichever method is used in a period, it is not possible to achieve justice in taxation. For this reason, it will be appropriate if the provisional tax method and practice is not considered one of the government's main methods to collect income.

### **VAT Payment Suitable to Collection Terms**

The matters discussed above with regard to the practice of provisional tax compare in principle with the problems experienced in VAT payments. It will therefore be appropriate to set up a system whereby VAT payments are compatible with collection terms. In keeping

with the principle that payment power will arise from collections, it is not appropriate to demand VAT payment from a taxpayer who as yet does not have the power to pay. On the other hand, accepting the existence of taxable activity before making a collection means that, if the collection is not made, the previously paid tax remains a burden for the taxpayer.

The developed infrastructure that the Revenues Administration Department has provided sufficient opportunity for access to all of the financial data of enterprises, their fund flows and other records. Under the circumstances, it can clearly be calculated what collections enterprises make and when. Thus a new VAT payment system can be made compatible with tax collection terms.

### **Lifting the Practice of KKDF (Resource Utilization Support Fund)**

Today, in this period where countries are experiencing credibility problems and are being challenged in their borrowings, Turkey's enterprises importing goods on term on the basis of their own credibility is a very positive and important indicator for the country.

On the other hand, while the CIF cost, which is even applied to imports on account for even one day was 3 percent at first, for a long time now, the CIF cost has been collected as 6 percent; it is recommended that this KKDF practice is lifted.

This cost, which all enterprises pay for products not produced in Turkey, for the import of investment and intermediary goods, is determined on the basis of foreign currency and is at a level that cannot even be compared with most interest rates on loans. As a matter of fact, this system causes some enterprises to cut corners on costs, leading them into the black economy. These tax rates, which must be borne on the basis of foreign currency, create serious problems for corporations.

The Demand for Registration Fees for Transactions in which the Commodity Exchange does not play an active role in the Sales Procedures

Article 32 of Law No. 5174 stipulates that “Those that engage in the buying and selling of goods included in the Commodity Exchange market quotations are required to be registered at the exchange of the district in which they are located. The registration of those who do not comply with this stipulation will be carried out by the Exchange ex officio and they will be notified of this.” As can be seen, although the provision of the law is very clear, the commodity exchanges exhibit a discriminatory attitude. Many companies who should be subject to the registration fee are not approached for collection and some are not even registered as members of the commodity exchange. Even when an investigation is made among the members of the commodity exchange board, it can be seen that registration fees are not collected from a great number of board members. The money collected from those that pay is much less than what is collected from competitors or other persons. Ultimately, the commodity exchanges register the companies they wish to and don’t register those they do not; they ask for registration fees from those of the registered companies that they wish but not from those that they do not care to ask. The commodity exchanges should put an end to this arbitrary practice, which is a violation of the principle of equality stated in the Constitution.

A revision should be made in Article 46 of Law No. 5174 on the Association of Turkish Chambers and Exchanges and the Chambers and Exchanges, which regulates this registration process, making it compatible with the principles of equality, justice and fairness stipulated by the Constitution.

#### **Article 46 (Current text)**

The Commodity Exchange should not have the right to demand registration fees in the case of transactions in which it does not play an

active role in the sales procedure. In addition, the registration fee should not be proportional; there should be a fixed rate to be collected equally from everyone.

Sales procedures carried out on the basis of minimum amounts of goods subject to the commodity exchange are required to be registered with the exchanges. Sales effected through electronic trade are within the scope of this regulation.

(...)

The registration fee rate is set at a maximum two per mille on the basis of the trading value of the good; this rate is determined by the Exchange. The ceiling for the registration fee to be collected per transaction cannot be less than ten percent of the annual dues ceiling or more than the full sum of this. The registration fee for the product certificate is set at a maximum five per ten mille of the trading value.

#### **Article 46 (Recommendation for Revision)**

The registration at the exchanges of sales procedures effected on the basis of the minimum amounts of goods subject to the exchange, is only possible when the exchange plays an active role in the sales procedure (upon the request of the seller, samples are displayed in the Exchange room and the sale is effected by bringing together the buyer and the seller).

(...)

The registration fee rate is set at a maximum two per mille on the basis of the trading value of the good; this rate is determined by the Exchange. The ceiling for the registration fee to be collected per transaction cannot be less than ten percent of the annual dues ceiling or more than the full sum of this. The registration fee for the product certificate is set at a maximum five per ten mille of the trading value.

## 2.2. MICRO POLICIES

Policies that are designed to provide markets, in other words, sectors and companies, with the competitive power to use their resources productively are micro policies. Because of how these policies encompass a great deal of dynamics in their essence, they are of critical importance in the development model to be adopted--from production to education, from the labor force to technology.

### 2.2.1. Production Policy

As stated above, exports must occupy a significant place in the growth model that Turkey will be adopting in the coming period. In targeting an increase of exports, a great contribution will be made to the country's development in terms of the income this will generate and also because of the positive externality that will be brought about by technology and investment.

There is no doubt that Turkey's current accounts deficit is a structural issue. Even if the deficit could be controlled with monetary policies, the solution to the problem lies in structural change.

### Production Incentives for Exports

In this context, providing incentives for exporting in Turkey, making sure that production supports exports is the primary objective to be considered. For this reason, increasing the incentives for exports, ensuring low-cost export financing, providing tax advantages for export income and other similar elements will make the field of exporting a more competitive arena.

Moreover, in order to add momentum to exports, efforts must be made from two different perspectives. The first of these is from the perspective of products, the other from the perspective of market diversity.

## **Product Diversity in Exports**

What is meant by product diversity is that products geared for export in the coming period are differentiated from the traditional and diversified, a goal that can be achieved by using technology and innovation.

The real goal with regard to foreign trade for 2013 and the upcoming period, therefore, should be aiming to compete in global markets and actually making a difference with the export of goods produced with a higher extent of technology and that signify added value, or with goods that boast of innovative qualities. This can be achieved with the adoption of technology policies, a heading that will be treated in a separate section.

## **Market Diversity in Exports**

Market diversity too is undoubtedly another important factor in increasing the volume of exports. For many years, Europe enjoyed about half of Turkey's export pie but this share steadily decreased due to the effects of the global crisis and the uncertainties that continued in the wake of the crisis. Despite however a drop to below 40 percent, nonetheless, exports exhibited an increase, a situation that resulted from the success achieved in alternative markets. In other words, in recent years, the gravitation of Turkish businessmen to markets outside of Europe produced positive results and the country's own region, its most important export partner, came to the rescue at a very tough time. In that case then, in a period such as this, where global uncertainty is rife, in order to ensure a robust stature for exports in the coming period, the success attained in the markets already penetrated must be sustained and the search for new markets must continue.

cess of spreading out. Parallel to this, trade with bordering countries should be strengthened, and particularly, the matter of using Turkish currency for trade at the country's borders should be considered.

In addition, markets should be restructured in line with Eximbank's priorities with respect to market and product diversity as well as branding since this is an important matter that must be treated in terms of providing export incentives.

Companies that will be participating in foreign fairs should definitely be helped in the matter of speaking the local language and in particular, translation services should be provided for the language of trade which is English. University students from schools where foreign languages are taught may be elicited to help in this. This will not only give students the opportunity to experience a commercial environment, where they can benefit from extra income, but it will also provide a chance to make use of idle capacities in this period before these students start on their business careers. Companies, meanwhile, will have solved the problem of communicating.

### **Solving the Structural Problems of Importing**

As it is known, because of the lack of rich resources, Turkey is dependent upon the external world, especially in the sense of intermediary goods. For this reason, in periods in which there is an upward trend in growth, imports climb up along with production. It is for this reason that imports, which form the basis of the problem with current accounts, constitute a structural problem for the Turkish economy. The objective of course is to ensure growth that does not bring about a current accounts deficit. In this context, to achieve the maximum growth with the minimum deficit, ensuring that the rate of exports increases while imports decrease should be the other aspect of the country's policy.

A review of the foreign trade data for 2011 shows that the biggest share in total imports belongs, at 25.4 percent, to fuels and oils. In

other words, the need for energy is the greatest component of our import problem. The scarcity in Turkey of resources such as petroleum and natural gas is known, and the share in imports of products made from these is at considerable levels. Therefore, for the purpose of at least ensuring the local manufacture of such products, it is believed that there would be great benefit in increasing the number of refineries in the country. Together with this, efforts to produce alternative energy should be accelerated. Recommendations on this subject will be made in more detail in the context of our sector recommendations.

Apart from this, other important imported items include machinery and boilers, iron and steel, motor land vehicles, electrical machinery and instruments. It is important that these products, some of them requiring technological advancement, be evaluated in terms of a logic of rational import substitution and from a relative advantage perspective within product strategies.

Although the Input Acquisition Strategy program (GİTES) is an important step in the right direction, it can be seen that the public sector factor is missing in the implementation. Because of this, in order for the program to be considered integrated and functional, the public sector leg of the GİTES program should not be neglected.

Again in this context, in the medium and long term, shifting the Turkish economy from a structure that produces labor-concentrated consumer goods to one that produces information-concentrated goods should be one of the fundamental goals of production policies.

### **Encouraging the Use of Locally Produced Goods for the Benefit of Local Production**

The circular put into effect through its publication in the September 6, 2011 issue of the Official Gazette on the use of locally produced

goods, encouraging a priority to be shown products produced in Turkey by public sector enterprises and organizations particularly in goods procurement is a very important and appropriate step in this context. Indeed, it is almost impossible for goods coming in from the Far East to compete in public sector tenders. In such an environment, the push to use locally-produced products will cut off the unfair competition in some sectors where goods of the Far East are widely found. At the same time, this kind of approach, which will also encourage foreign capital to manufacture in Turkey, should be effectively monitored, especially in the municipalities and government organizations.

### **2.2.2. Technology Policy**

Technology may be regarded as one of the most important tools to ensure a self-sufficient development with lasting results. In this context, the introduction of a serious technology policy will increase the efficiency of investments and allow for the production of export goods with high added value, therefore ensuring economic growth without increasing the current account deficit.

#### **Efficiency of R&D Grants**

Based on this fact, the importance of increasing R&D investment incentives and gradually implementing these within strategic planning is evident. Certain measures taken to achieve these objectives are already implemented. Examples include KOSGEB's R&D, Innovation and Industrial Application Grant Programs, Thematic Project Grant Programs and TUBITAK's R&D incentives. In this respect, the incentive program announced in April 2012 is another important, long-term step. Provision of these and similar instruments to companies should continue.

In the current situation, some portion of the grants is provided, without a rational cost-benefit analysis, to sectors or projects with vague

or long return times. In this context, a rational approach would be to channel more resources to fields that might provide a relative advantage with fast results, in order to increase competitiveness and effective use of resources. Moreover, to make the R&D process fast and efficient, incentives should be provided with a pre-paid model rather than progress payments.

However, incentives and grants provided should not be limited to only research and development stages, and should continue throughout other stages, such as marketing in particular for commercialization, in order to benefit from the resulting products. In fact, non-commercialized research and development activities create no value for the economy.

Of course, the extent of benefit provided by the support should be determined, in other words, measured. For this reason, in order to evaluate the effectiveness of incentives, a performance indicator model should be developed. For example, the performance of a firm provided with technology incentives might be evaluated using the ratio of incentive to international patents obtained by the firm and/or incentive given to the firm's contribution to exports. Accordingly, incentive support should be dropped from firms that have failed to obtain patents or contribute to the exports to prevent wasting resources.

### **Developing Technology Infrastructure**

Technopark physical infrastructure should be strengthened, and these parks should be turned into clusters of science-technology-production. In addition, the current conditions of study and management of these areas should be revised. Training and consulting services should also be also developed in these centers. Ideally, this new generation of technoparks would be established by the private sector, or under the umbrella of public-private partnerships. Therefore, making necessary arrangements to assign the management of

these parks to the private sector would play an important role in speeding up technological development.

On the other hand, the number of business incubators must be increased. In this context, it is considered to also include establishment costs of incubators in the incentives. In addition, extensive laboratories should be established in pilot universities to develop university-industry partnerships and to get better results.

### **Supporting Industrial Design and Implementing a Technology Hunters Model**

For stronger and more effective global competitiveness, the contribution of capital to production should be increased as much as possible. The way to economic growth and products with higher added value lies through technology and design. For this reason, SMEs work of innovative technology and industrial design, which create employment, should be supported both technically and financially. KOSGEB, Development Agencies and the Patent Institute should reinforce and provide this support with a process that allows for the evaluation of efficiency.

In addition to these evaluations, a “technology hunters” model should be developed. Many innovative products in Anatolia developed to in accordance with local needs have failed to see the light of day, because of ignorance or lack of resources. SMEs should develop a model, coordinated by all development agencies, to uncover such innovative approaches.

### **2.2.3. Employment Policy**

Turkey’s long-existing unemployment problem has remained stable until the recent years, even during the high growth period after 2001. In other words, there has been no employment-friendly growth until the global recession. However, due to various major reforms, the increase in economic activity in 2010 and 2011 has reflected on em-

ployment markets, and led to a noticeable decline in unemployment. In this regard, the unemployment rate has dropped to single digits in 2011 and continued this success in 2012 with 9.2 percent.

However, aside from reducing unemployment levels, the employment strategy for the coming period should focus on increasing labor force participation, efficiency in employment markets, and studies on factors compromising quality.

### **Increasing Labor Force Participation Rate**

One of the important indicators used for evaluating employment markets is the participation rate of the labor force. Labor force participation rate is the ratio between employed persons or persons looking for employment and the working age population. Although Turkey's labor force participation rate has shown some improvements compared to previous years, it remains quite low. In fact, in 2012, the rate stood at 50 percent. In other words, half of the working age population in our society is either working at a job or looking for work.

Comparatively, a study of the employment markets of developed countries show this rate to be around 70 or 80 percent. Therefore, Turkey has a relatively low rate of labor force participation, which means that the potential labor in the country remains dormant.

A study of the dynamics of this situation in Turkey shows that the main reason behind it is gender discrimination. In fact, in 2012, the labor force participation rate for men was 71 percent for men; while for women, it remained at 29.5 percent. Therefore, it is clear that the reason labor remains dormant in Turkey is based, in great part, in women preferring not to participate in the labor markets.

As a result of this analysis, it is of great importance to encourage women to participate in the labor market. Increasing the enrollment

rate of girls in schools might be one of the parts of this issue that might provide a long-term solution. At this point, activities should continue to focus on informing the public and creating awareness. As a short-term solution, women might be given priority in independent board memberships. Company boards of directors must be encouraged to employ women. In this way, women members of boards will work more efficiently in the employment of fellow women.

Another part of this problem is that the social culture of women in business life has not yet been fully embraced. In this regard, the idea that women contribute to the economy with their capabilities and productivity should be promoted with awareness-raising activities.

In addition, necessary measures must be taken to prevent gender discrimination against women in workplaces that might cause women to be alienated from the business market. In this connection, new incentives might be provided for employers who prioritize employment of women.

On the other hand, it would be beneficial to develop incentives for women who are discouraged from the business market due to long periods of unemployment.

### **Eliminating Rigidity in Labor Markets**

Another reason for unemployment, or the inability to use the full potential of existing human capacity, is the rigidities in labor markets. In other words, rules and costs associated with labor discourage employers from creating employment, and prevent the formation of a competitive market. Therefore, a revision of employment-related laws to make the existing structure more flexible is required.

In this context, one of the biggest problems for employers is the high non-wage costs of employment. Therefore, the reduction of social se-

curity contributions and taxes will help to increase employment rate. The advantages of the new incentive mechanism can be expanded particularly in this context. In addition, an incentive discount might be provided to employers who pay the SSI (Social Security Institution) premium of their employees on a regular basis.

Another factor that adversely affects employment is high dismissal costs. Employers, therefore, have to think twice before hiring a new employee. Therefore, it is mandatory to reach a solution on the subject of dismissal costs in a way that will not damage the rights of workers. Again in this context, the ability to record severance payments as expenses will serve as an important incentive for companies.

Another cause of rigidity in Turkish business markets is related to working hours. Terms of “part-time” employment must be revised to make it more widespread, as this model is known to provide important benefits, especially in periods of economic contraction, and would help to utilize a significant labor force in the current situation. In addition, it is important to implement a flexible working hours model, which is known to feature similar benefits.

### **Increasing Labor Force Efficiency**

The most important actor that plays a role in production is the overall efficiency of factors, which shows the performance of production. Factors in question here are capital, labor and technology. In this context, in terms of labor, employees’ efficiency, as well as their hourly production, is critical. Looking at the global productivity indices however, shows that productivity in Turkey’s labor market is, unfortunately, quite low.

Of course, the fundamental way to ensure efficiency and quality is, principally, education. As well as the education strategy discussed below, businesses should be provided with guidance, incentives and audits for the efficient production of goods and services.

## 2.2.4. Education Policy

As mentioned above, along with technology, a high quality and productive labor force is one of the requirements of a competitive market. Therefore, the main prerequisite for creating a qualified labor force is education. If a country's development is regarded as a pyramid, education forms the base, where it affects the above layers largely.

### Thinking-Based Education

Turkish education system, despite changing from time to time, has so far kept a generally rote-based and competitive structure. Elementary, middle and high school curriculums have been gradually renovated in the last seven years with a constructive approach to be more research oriented, productive, and with a higher participation of the families in mind. However, it has also become apparent that, in order to achieve the desired change in education, policies on training of teachers, one of the most important parameters of in education, must also be renewed at the same time.

It should be accepted by the public that, the purpose of neither elementary nor middle school education is to prepare students for Anatolian high schools or universities. The common perception of SBS and LYS placement exams as the sole indicators of success since 1st grade is in great contrast to the spirit of the changed curriculum. Thus, instead of relative changes, it has become essential to implement new medium and long-term policies, restructured to cover all aspects of the education system (curriculum, instruments, training of teachers, in-service education, culture and arts education, etc.).

### Continuous and Versatile Education

Training versatile thinking individual with a broad look on both social and business developments is one of the more important steps

to be taken towards becoming a developed country. For this reason, subjecting students, especially those in higher education, to an interdisciplinary training program is an issue that needs consideration.

On the other hand, the system to be developed should provide self-development opportunities for students that cover not just academic, but social and artistic events as well, since its earliest stages. In addition, in order to achieve a continuously improving society, life-long education programs should be intensified, encouraged, and supported.

### **Ensuring Education Adapts to Market Demands**

As our industry grows rapidly, many sub-sectors have an increasing need for technical personnel. Therefore, renewing the image and content of vocational schools to attract more students is an issue that must be addressed urgently. Again, in this context, social control mechanisms should be established and strategies should be determined to improve the quality of managers and educators of vocational schools.

However, given that economy development and sectoral growth is directly related to productivity, the meaning and importance of the concept of “productivity” should be taught from the earliest stages of education.

The role of the public sector in the development and direction of vocational education policies and practices, and the sharing of authority and responsibilities, should be revised to establish specific mechanisms that will allow the parties to participate effectively in the decision-making processes.

Social control mechanisms should be established and strategies should be determined to improve the quality of managers and educators of vocational schools. Vocational education institution mod-

els and practices are mainly adopted from other countries and institutionalized based on their regulations. However, a national and unique model for vocational education should be developed, based on Turkey's contemporary and local needs.

Life-long education counseling and guidance services in elementary, secondary and vocational education should be reinforced. All training tools and materials used in secondary and high schools should be diversified and to assist students in understanding business life and vocational education, and adapting to life.

The Fatih project should be turned into an opportunity, and with an awareness that the project is based on content rather than hardware, new content investments that support creativity in children, develop their intelligence, and cover the latest developments, from local to universal and from literature to all sciences.

### **2.2.5. Investment Policy**

Investments made by both public and private sector are among the most important factors driving growth. On the other hand, efforts should be stepped up to attract foreign direct investments, particularly for the long-term.

#### **Improving the Investment Climate**

Eliminating policy uncertainties and making regulations to prevent risk for investors are the main requirements for increasing investments.

On the other hand, certain financial benefits to be provided to investors are also important to make investments attractive. In this context, providing ease or flexibility in VAT payments for major Public-Private Partnership (PPP) projects that meet certain criteria would help increase public private contribution to these important investments.

However, one matter of urgency is removing the obstacles to investments. In this regard, regulations that discourage domestic and foreign investors alike should be revised. This holds true particularly for legal and tax purposes, where the existing bureaucracy could be reduced.

In parallel, the intellectual property rights should be developed for innovative products in particular in R&D, commercialization, investments, and similar activities, and entrepreneurs must be instilled with confidence in this regard.

### **Effective Promotions**

In addition to improving the investment climate, the country and sectors must be promoted effectively to attract foreign investors. Even in countries with poor resources and economy compared to Turkey manage to attract investors with a good and attractive promotion. Current promotional activities in Turkey, however, lack in content and fail to draw interest. In this context, a new approach is mandatory, with a special interest in promotion. A strong emphasis on the domestic market in Turkey would be one of the striking points.

On the other hand, development agencies and the Investment Promotion Agency should take a more performance-oriented manner, accompanied by a strategy based on a long-term vision.

### **Infrastructure Development**

As part of the Turkey's vision of great growth in 2023 and beyond, one critical factor to achieve the domestic income and export objectives is a strong infrastructure to serve this purpose.

In this context, a strong logistics system must be developed on countrywide basis, to support exports in particular. This is one major

shortcoming of the rapidly growing Turkey. For this reason, the issue of connecting the rail networks to provide an easier, faster, and more efficient transportation should be considered immediately. In short, rail systems should be expanded throughout the country. In addition, the establishment of an air logistics center should be treated in a separate project.

Also in the same context, a strategy should be developed to reduce transportation costs.

### **Modernizing and Activating Institutions**

Institutions play an important role in the development of a country. In the history of economy, many less developed countries have implemented the economic policies adopted by developed nations in order to achieve rapid development, only to fail achieving the success they expected. The main reason for this has been the difference in institutional structures between developed and developing nations. Institutions success in implementing policies creates differences in productivity.

In this regard, institutional development that will support medium and long-term sustainable growth is strategically as important as policies that create growth in the short term. Therefore, necessary conditions for a cultural transformation must be provided as soon as possible for the creation of high quality, modern and effective institutions. However, particularly in strategic areas such as technology, the efforts should also focus on inter-institutional coordination and accord.

### **Focusing on Regional Development**

Certain regions of Turkey are under-developed due to lack of infrastructure and capital, as well as low quality and inefficient labor.

Encouraging investments in these regions increases both production and employment rates. For this reason, the proven system of regional tax advantages and investment incentives should be continued in the medium term. It is also important to increase school enrollment rates and providing equal opportunities in primary education in these regions.

On the other hand, expanding of micro-finance programs to reduce poverty in these regions is a viable instrument of solution. This would allow reinserting unemployed population, and women in particular, to the regional economy. In this regard, especially in less developed regions, opening micro-credit branches will bring significant benefits in terms of regional development.

### **Promoting and Implementing Special Economic Zones**

Special Economic Zones (SEZ) is a method used in all developed and developing nations to improve the quality of opportunities provided by the state to the companies. The importance of company networks is an undeniable factor for the performance of companies. For this reason, the establishment of special economic zones allows performance to play a more important role in certain sectors and companies. Public-Private Partnership (PPP) approach should be prioritized while developing such zones. Private sector should provide management services while public administration provides effective supervision, therefore establishing an efficient balance mechanism.

In addition, these zones should focus on not only industrial production, but on trade activities as well, taking into account the domestic as well as export markets, and the sectors to be located in the zone should be determined strategically. The most important point is to implement an effective regulatory framework and rules proven throughout the world

## **Scheduling KOSGEB Grant Payments**

KOSGEB has achieved great efficiency and financed SMEs through many different programs in recent years. Previously supporting only the manufacturing industry, KOSGEB has now extended this support to the construction, energy, trade, tourism, communications, logistics and service sectors, a significant step in terms of businesses supported. However, this has led to an almost seven-fold increase in the target group, and consequently to problems in distribution and implementation of the support provided. The subject of paying the grants to businesses with approved projects in a reasonable timeframe must be included in the project financing agreement, thus allowing the recipient to know when and how much they are entitled to receive, and these schedules should be adhered to.

## **Establishing an Office to Manage the Procurement Processes for Major Public Projects**

Turkey has a large accumulation of infrastructure projects. Almost all ministries are offering world-scale projects that require significant investments. However, specification, procurement, financing and implementation processes for such large-scale projects are areas of expertise on their own. Completing such projects on a time and in cost-effective manner, is only possible through efficient management of all these. The problems encountered during procurement processes of major projects has created the need to establish a central unit for the infrastructure and superstructure tenders, which will be responsible for all processes from preparing the specifications to signing the contract. This will allow pooling the experience gathered from projects, and help the public administration to improve rapidly in this regard. In addition, this will also allow for more transparent procurement processes.

## **Increasing SMEs Access to Financing**

In Turkey, the number-one problem for almost all SMEs is access to a long-term and cost effective source of financing. Especially in a period when uncertainty in the EU, decreased credit appetite of banks has led to a noticeable decrease in loans provided to SMEs, the true backbones of the economy. However, in order for the expected impact of the New Law on Incentives, which was announced on April 5 and shared with the public in detail on June 8, 2012 to materialize, it is important to support the investors with different instruments. In such an important transition period for our economy, investors who will benefit from the opportunities created by the new law should be provided bank loans.

## **Banks Using Venture Capital Model**

The venture capital model, which aims to support the entrepreneurs of venture and investment projects, needs to be actively implemented by the banks. Project owners should be ensured financing, given that they can repay their loans and provide a cash flow with a capital profitability.

## **Preventing Bureaucracy to Replace Management**

Each ministry should make an internal bureaucracy inventory, listing the transactions in affiliated institutions per paper. This will allow eliminating redundant and repetitive activities to clear the way for investor and entrepreneurs. A strict bureaucratic structure discourages both current and potential investors of all sizes. Therefore, electronic inter-agency communications and delivering copies of correspondences to individuals and organizations with electronic signature will minimize the follow-up procedures as well as the costs in time.

## 2.2.6. Savings Policy

### Increasing Domestic Savings

As seen in the case of Turkey, current account deficits might be regarded as unimportant as long as financing can be maintained in the economy. However, this point of view, while true for the short term, is not valid for medium and long term. On the contrary, this approach is certain to lead to undesirable consequences, especially in today's world of liberalized capital movements, flexible exchange rate regimes and economic life rapidly reshaped by globalization. Today, the topic of whether the financial account is financing the current account or actually creating a current account deficit has become questionable. In particular, certain findings from developing countries show that financial account causes exchange rate appreciation, leading to current account deficit.

In this regard, one of the primary measures against current account deficit will be to increase domestic savings, because savings rate is quite low on Turkey and fails to meet the level of investments. This also brings about the need for external financing.

Savings should be increased in the public sector with non-tax methods, and encouraged in the private sector. One of the reasons for the decline in private savings in the recent years is the increasing availability of short-term credit. Therefore, it is obvious that this system, which triggers consumption and provides easily accessible credit opportunities, must be reorganized. Also in this context, a reasonable level of profit margin between the interest rates of savings and credits would be beneficial.

Moreover, rather than a financial structure that encourages consumption, the number of investment instruments and efforts to build confidence in financial systems have to be increased. These efforts should also serve to change the prevalent, real estate-oriented investment mentality in Turkey.

