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ECONOMIC REFORM PROGRAMME

OF

TURKEY
(2016-2018)

COMMISSION ASSESSMENT

Contents

1. EXECUTIVE SUMMARY

The Turkish economy has grown at an average annual rate of 3.3 % over the past four years. The Economic Reform Programme for 2016-2018 projects optimistically a strengthening of economic growth to 5 % supported by accelerating business investment and double-digit export growth. At the same time, the current account deficit is expected to narrow and inflation to recede. Overall, the projections appear more like policy targets than as a realistic forecast.

Turkey's economy continues to face two major macroeconomic challenges. On the external side, the current account shows a persistent deficit which corresponded to 4.5 % of GDP in 2015. This deficit has to be financed with capital inflows which tend to vary in response to changing risk sentiments and expectations regarding international yield differentials. Although the floating exchange rate absorbs much of this volatility, it can also result in – sometimes painful – macroeconomic adjustments. On the internal side, the economy is suffering from entrenched inflation in the high single digits. This is costly in terms of macroeconomic stability, resource allocation and redistributive effects. The Economic Reform Programme (ERP) projects a reduction in both of these imbalances in the course of the programme period, but without indicating how the macroeconomic policy mix will be adjusted to achieve this.

The ERP provides an account of public finances which have shown moderate deficits in recent years. The fiscal deficit of general government is projected to narrow as GDP growth increases without any move towards a more restrictive fiscal policy stance. Based on relatively modest fiscal deficits and high nominal GDP growth, the debt-to-GDP ratio of general government has trended downwards over the past six years to 32.9 % at the end of 2015. Although the sustainability of public debt is not in question, a more restrictive fiscal policy stance would be appropriate in view of the macroeconomic challenges, in particular the need to increase national saving.

Increasing macroeconomic stability and developing the economy's growth potential are Turkey's major economic policy challenges. Addressing the economy's internal and external imbalances by adjusting fiscal and monetary policies would lower the risk of sudden and severe macroeconomic adjustments. At the same time, implementing comprehensive structural reforms would help achieve the country's economic goals by increasing competitiveness, improving the business climate and raising potential growth. The main challenges are:

- **Domestic saving is too low in view of the need to reduce the internal and external imbalances.** This requires increased incentives for private saving, including significantly positive real interest rates on saving instruments. It also requires a contribution from the public sector by the pursuit of a sufficiently restrictive fiscal policy.
- **Domestic and foreign investors' confidence is likely to be significantly affected by the security and political developments in the country with negative repercussions on the Turkish economy.** The rule of law and the judiciary are being weakened particularly by decisions affecting private sector assets and by the encroachment on fundamental rights, including freedom of expression and of the media.
- **The narrowing of the current account deficit is held back by a slowdown in the structural reform process, which delays improvement of the economy´s**

export potential. In the context of the low spending level for research and development, the absence of a comprehensive strategy in support of research and development is a particular problem. Cooperation between research institutions and economic operators is weak. In some industries, the lack of exposure to international competition hinders productivity growth. The ERP addresses these challenges, but does not present an overall strategy to tackle them.

- **Turkey faces substantial labour market challenges.** This is reflected in low female participation and employment rates; a high number of young people not in employment, education and training; a high level of informal work; and a low qualification level of the workforce. These imbalances hamper the achievement of higher productivity and diversification of the economy, which should in turn also support more inclusive growth. The strong minimum wage increase and the influx of refugees risk further increasing informal employment.

Turkey's ERP was again submitted very late, which reflects negatively on the government's readiness to fully engage in the economic aspects of the pre-accession agenda. The ERP's macroeconomic projections are overly optimistic and not fully consistent internally. The programme features for the first time a dedicated section on structural reforms. The level of detail and comprehensiveness of this section is still uneven and it would benefit from a stronger focus on the diagnostic aspects and on a systematic cost analysis, budgeting and scheduling of reform measures.

Last year's policy guidance is generally not addressed. An exception was the introduction of the option of part-time work for parents, which should stimulate female labour force participation.

2. ECONOMIC OUTLOOK AND RISKS

Relative to the previous four years, the ERP's macroeconomic scenario provides an optimistic combination of faster growth and reduced underlying macroeconomic imbalances. Since the post-recessionary boom in 2010-2011, the Turkish economy has grown at a relatively moderate pace while inflation has remained in high single digits. Because of a rapidly expanding labour force, the unemployment rate has increased gradually despite significant employment growth. The current account has remained in deficit at a level which is unsustainable in the medium to longer term.

Economic output in the coming years is projected to accelerate and unemployment to decline. In 2015, GDP grew to 4.0% on the back of accelerating domestic demand. Consumer spending increased by 4.5% fuelled by the lower oil price and easy financial conditions. Private fixed investment achieved 2.7% growth after being close to stagnation for two years. Net exports, however, exerted a drag on growth as exports contracted while imports expanded. The ERP projects that GDP growth will increase to 4.5% in 2016 and still further to 5% in the subsequent two years. This seems optimistic given an average annual growth rate of 3.3% in 2012-2015. Potential growth is forecast to increase to 4.3% in 2018 from 4% currently, which is already above most independent estimates. Contrary to recent years, growth is expected to be consistently supported by strong investment activity and positive contributions from net exports. Private fixed investment is projected to accelerate from sluggish growth in recent years to 8% annually in 2016-2018. Exports are projected to increase at an average annual rate of 11.6%, which looks overly optimistic in view of an average annual growth rate of 5.7% over the past four years and subdued growth in Turkey's export market (about 4% annually in 2016-2017 in current Commission projections). The ERP's projections for investments, exports, and potential growth are explained by an acceleration of Turkey's structural reform programme which will serve to promote investments, particularly in the tradable sector, and increase international competitiveness and hence exports. In view of the slow pace in the implementing structural reforms in recent years and the time-lag between reform implementation and macroeconomic results, this scenario is questionable.

In the labour market, solid employment growth is projected to push the unemployment rate back below 10%. The unemployment rate would fall by 0.6 percentage points over the programme period based on 2.4 % annual employment growth and a significant slowdown in labour force growth. While the projected employment growth rate is in line with the recent trend, the decline in labour force growth (from more than 3% in recent years to around 2% in 2017 and 2018) is improbable in view of the structural trend towards higher labour force participation and a steady increase in the working age population. Assuming that the labour force continues to increase at a rate of 3%, the unemployment rate would also continue to increase by about half a percentage point per year as it did in 2012-2015. The ERP does not discuss the impact of the inflow of refugees and migrants on the labour market.

Average annual inflation is projected to decline gradually from 7.7% in 2015 to 5.8% in 2018, denoting a continued over-shooting of the official 5% year-end inflation target. Between December 2014 and December 2015, inflation increased by 0.6 percentage points to 8.8% despite the decline in oil prices. The projected disinflation in the programme period is difficult to reconcile with output growth in excess of its medium-term potential and a closed output gap by 2018, which normally implies rising domestic inflationary pressures. High single-digit inflation rates are problematic in terms of macro-economic stability, resource allocation and re-distributive effects, and have a negative effect on the economy's growth potential. The current level of inflation is so entrenched in the Turkish economy that sustained disinflation would require that price stability is made the clear focus of monetary policy, with other policy objectives being pursued with separate instruments.

The current account deficit is forecast to narrow from 4.5% of GDP in 2015 to 3.5% of GDP in 2018. However, if GDP accelerates as projected in the ERP, it is likely that the current account will worsen considering the historical correlation between the two variables. The oil price decline, which reduced the deficit by 1 percentage point of GDP in 2015, is not expected to continue. It is assumed that the oil price will increase from the long-time low in early 2016 to close to last year's average (52.5 USD/barrel) by 2018. Gross external debt has continued to trend higher, reaching EUR 366.5 billion (59.6 % of GDP) at the end of 2015. The current account deficit and the associated vulnerability can only be reduced by increasing national saving.

The external deficit makes the economy dependent on sustained capital inflows. Net foreign direct investment (net FDI) has declined significantly since the global financial crisis, covering only a modest share of the current account deficit in recent years. In 2015, there was a noticeable improvement in net FDI when it financed 36% of the external deficit. However, most of this is due to one-off factors, particularly large foreign investments in the financial sector. Portfolio investments saw a sharp swing from net inflows to net outflows in 2015, as global investor sentiment turned against Turkey and other emerging markets. This meant that the current account deficit was financed by the banking sector's foreign borrowing, a large drawdown in foreign exchange reserves and an (unexplained) surge in net errors & omissions in the balance-of-payments statistics. Future contributions from foreign exchange reserves to the financing of the external deficit will be constrained by the relatively small size of Turkey's net reserves. A large positive contribution from net errors & omissions is also unlikely to be sustained. For the programme period, the ERP expects some further strengthening of net FDI inflows and a return to large inflows of portfolio investments which would even permit a renewed accumulation of foreign exchange reserves. This presupposes a strong performance of the Turkish lira in the currency markets which has not been the case in recent years. However, the ERP's scenario for external deficit financing is not altogether implausible provided that growth, inflation and the current account develop as benignly as projected. The more likely scenario, where the overall economy develops less favourably than projected, is that the financing of the current account deficit will develop less smoothly. In addition, financing of the external deficit will be complicated by the reduced attractiveness of Turkish assets for foreign direct investors as a result of the recent worsening of the business environment, particularly with respect to security and the rule of law.

The banking sector is adequately capitalised and remains resilient. The sector's net profits increased by 5.9% in 2015, but the return on equity is relatively low at 11.3% considering the level of inflation and considerable credit risk. The capital adequacy ratio stood at 15.6% at the end of the year. This is well above the current regulatory minimum, but has to be seen in light of the introduction of Basel III which will require significantly higher capital buffers. Non-performing loans amounted to 3.2% of total loans at the end of 2015 and were well provisioned. However, banks remain very reliant on external wholesale funding and the relatively high foreign-currency exposure of their corporate customers poses a risk to their asset quality. Net foreign exchange liabilities of the non-financial corporate sector corresponded to around 24% of GDP at the end of 2015.

Table 1

Comparison of macroeconomic developments and forecasts										
	2014		2015		2016		2017		2018	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	2.9	**2.9**	3.1	**4.0**	3.4	**4.5**	3.6	**5.0**	n.a.	**5.0**
Contributions:										
- Final domestic demand	1.1	**1.1**	4.1	**5.2**	3.8	**4.7**	3.9	**4.9**	n.a.	**4.6**
- Change in inventories	0.2	**0.0**	-0.4	**-0.5**	0.2	**-0.3**	0.0	**-0.4**	n.a.	**-0.4**
- External balance of goods and services	1.6	**1.8**	-0.6	**-0.7**	-0.6	**0.2**	-0.3	**0.5**	n.a.	**0.8**
Employment (% change)	1.6	**5.4**	2.6	**2.8**	2.8	**2.4**	2.9	**2.5**	n.a.	**2.3**
Unemployment rate (%)	10.1	**9.9**	10.5	**10.2**	10.7	**10.2**	10.8	**9.9**	n.a.	**9.6**
GDP deflator (% change)	8.3	**8.3**	8.6	**8.0**	9.6	**7.6**	7.7	**7.4**	n.a.	**6.0**
CPI inflation (%)	8.9	**8.9**	7.7	**7.7**	9.0	**8.0**	8.5	**6.3**	n.a.	**5.8**
Current account balance (% of GDP)	-5.8	**-5.5**	-4.8	**-4.5**	-4.4	**-3.9**	-4.7	**-3.7**	n.a.	**-3.5**
General government balance* (% of GDP)	-1.5	**-1.3**	-1.4	**-0.6**	-1.7	**-1.3**	-1.6	**-0.9**	n.a.	**-0.6**
Government gross debt (% of GDP)	33.5	**33.5**	33.2	**32.6**	32.1	**31.7**	31.4	**30.5**	n.a.	**29.5**

** excluding privatisation revenues*

Sources: Economic Reform Program 2016 (ERP), Commission Winter 2016 forecast (COM)

3. PUBLIC FINANCE

In 2015, the central government's budget deficit declined slightly as a ratio of GDP. The deficit fell from 1.3% in 2014 to 1.2% of GDP which is slightly higher than originally planned (1.1%). Revenues and expenditures increased by 13.6% and 12.8%, respectively. According to the ERP, the fiscal deficit of general government (excluding privatisation revenues) decreased from 1.3% of GDP in 2014 to 0.6% in 2015. (The ERP's general government data are not fully aligned with the ESA2010 standard). The fiscal consolidation in 2015 is, however, much smaller when one uses the "program-defined" primary balance as yardstick. This measure only improved from 0.6% of GDP in 2014 to 0.8% in 2015 and fell clearly short of the target (1.2%) in the ERP for 2015-2017. According to yet another measure of fiscal performance, which is also presented in the ERP and excludes both privatisation receipts and one-off items, the general government deficit narrowed from 2.0% of GDP in 2014 to 1.5% in 2015. The ERP does not explain clearly why the various measures of fiscal performance yield different results. Overall, it seems that there has been some fiscal consolidation in 2015, but less than previously planned.

The budget deficit of central government is projected to increase slightly in 2016. Expenditure is budgeted to increase slightly faster than nominal GDP whereas revenue growth is set to increase slightly below it. This would raise the central government deficit by 0.1 percentage point to 1.3% of GDP, the same level as in 2014. The general government deficit is also projected to return to the 2014 level, i.e. 1.3% of GDP, because expenditure is set to increase significantly faster than revenues. Again, the difference between the general government and the central government budget is not fully explained, but seems to be related to the government's decision to take on part of the burden put on employers as a result of raising the minimum wage by 30% from 1 January 2016.

The fiscal stance in the final years of the programme provides little support for a much-needed increase in domestic savings. For 2017 and 2018, the general government deficit is projected to decline by 0.4 and 0.3, percentage points of GDP, respectively. This deficit reduction is more modest than what was projected in last year's ERP. Despite the declining deficit, the projection must be considered as an easing of the fiscal policy stance in view of the simultaneous change in the output gap from -1% of GDP in 2016 to +0.4% in 2018. Although the projected fiscal deficits are relatively small and there are no imminent risks to public finances, the fiscal policy stance is too accommodative given the macro-economic context.

Table 2

Composition of the budgetary adjustment (% of GDP)

	2014	2015	2016	2017	2018	Change: 2015-18
Revenues	38.9	40.1	40.3	39.7	39.3	-0.8
- Taxes and social security contributions	30.9	32.2	33.1	32.8	32.5	0.3
- Other (residual)	8.0	7.9	7.2	6.9	6.8	-1.1
Expenditure	40.2	40.7	41.6	40.7	39.9	-0.8
- Primary expenditure	37.2	37.9	39.0	38.2	37.5	-0.4
of which:						
Gross fixed capital formation	3.8	4.0	3.8	4.0	4.0	0.0
Consumption	18.0	18.1	18.4	17.9	17.6	-0.5
Social transfers & subsidies	8.9	9.0	9.7	9.5	9.4	0.4
Other (residual)	6.5	6.8	7.1	6.8	6.5	-0.3
- Interest payments	3.0	2.8	2.6	2.5	2.4	-0.4
Budget balance	-1.3	-0.6	-1.3	-1.0	-0.6	0.0
Structural balance	-1.7	-1.4	-1.7	-1.2	-0.9	0.5
Primary balance	1.7	2.2	1.3	1.5	1.8	-0.4
Gross debt level	33.5	32.6	31.7	30.5	29.5	-3.1

Sources: Economic Reform Program (ERP) 2016, ECFIN calculations, differences due to rounding

The programme includes a number of measures with potential fiscal implications for 2016-2018. Most of the measures remain, however, relatively vague and non-committal (e.g. broadening the tax base, raising tax compliance, simplifying tax legislation, reviewing tax exemptions and transaction taxes). With respect to the expenditure side, the information that wages for public employees will be increased twice in 2016 (5% in January followed by 5% in July) is precise but insufficient in itself for a deeper analysis of public finances in the medium term. It also remains unclear which policies are to increase the efficiency of social programmes and health spending. The programme does not specify the underlying policy measures which would support the significant reduction in current spending and transfers over 2017 and 2018 – by 0.8 and 1.2 percentage points of GDP respectively. The stated intention to move towards a more growth-enhancing budget is not convincingly explained in the fiscal strategy.

The debt-to-GDP ratio has been influenced by exchange rate developments. General government debt, defined in accordance with ESA2010, corresponded to 33.5% of GDP at the end of 2014 and declined to 32.9% at the end of 2015. The ERP's projection (32.6% for the end of 2015) does not seem to have taken full account of the Turkish lira's depreciation in the course of 2015. This has increased the value of the debt in lira terms since a large part of the debt stock is denominated in foreign currencies. For the programme period, the ERP projects a 3.1 percentage point decline in the debt ratio to 29.5% in 2018. If economic growth turns out to be significantly lower than projected in the ERP and fiscal deficits develop as projected by the Commission, the decline in the debt ratio will be less than that.

4. Structural reforms

Turkey´s reform process has stalled in recent years. The economy is diverse with particular strengths in white goods and machinery, as well as in services such as construction and tourism. The country has seen remarkable development since 2001 when the government began an economic and political reform process, which included a number of important structural reforms. However, in recent years the reform process has stalled and even reversed in some areas that are important for the investment climate, such as the rule of law.

The fact that exports have not benefitted much from the sharply decreasing external value of the currency points to the need for some structural reform. Besides the high foreign currency debt held by economic operators, persisting weaknesses in human capital formation and comparatively low investment in research and development are the main obstacles to increased productivity and a sustained high development rate. Considerable segments of the population, in particular women and youth, constitute untapped potential for the labour market. The high level of informality and poor working conditions hamper inclusive growth and perpetuate high rates of poverty and social exclusion.

The Economic Reform Programme 2016-2018 is the first to comprehensively address structural reform needs. There was only one structural reform recommendation adopted at the Economic and Financial Dialogue with the EU in May 2015. This one recommendation was partially addressed. Amendments to the Labour Law were adopted in January 2016 introducing the right to part-time work for parents, with specific rules for female civil servants to stimulate female labour force participation. Training provisions in VocTest Centres have been increased, which should contribute to improving the qualifications of low-skilled workers.

The ERP includes a discussion on key policy objectives in all relevant areas, but is weak on diagnostics and reform measure details. The ERP is closely based on Turkey´s 10th development plan (2014-2018), and sector strategies, as it should be. It aims to increase competitiveness through higher productivity and moving its industry up in the production chain, thus seeking to reduce the current account deficit and the resulting vulnerability to international portfolio investor sentiment. The programme also includes measures intended to support innovation and human capital. Nevertheless, it suffers from several weaknesses. By and large, it focuses more on reporting or expounding objectives than on analysing reform needs, strategic options and risks and does not make any link between strategies and budgetary costs. The distinction between supportive actions and sector reforms is unclear in most cases. Import substitution plays a central role in several sector policies, but is unlikely to achieve its objectives if it ends up protecting weak sectors more than encouraging promising ones. Space for such a policy is also limited under existing international obligations, including the Customs Union with the EU.

Public finance management

Turkey´s public finance management is comparatively strong in terms of institutions, processes and personnel for planning and executing the budget, but should improve on performance-based financial management. The ERP does not include comprehensive cost analysis, budgeting and scheduling of reform measures. This casts doubts on both the credibility of budget estimates and policy outcomes. Moreover, the external audit function and its parliamentary follow-up, which are not mentioned in the document, should be strengthened.

Infrastructure

There is a need to increase the efficiency and capacity of the transport sector – especially in rail and port services – starting with a comprehensive plan for a more balanced development of transport modes. In the energy sector, lack of effective price competition is the main challenge. While the ERP puts a particular focus on logistics, it does not reflect an integrated concept for sector development and linked reform measures. It notes that a liberalisation of railway transport has been initiated but does not mention a rationale for developing new rail interconnections, for example. With regard to energy, the adoption of pending key reforms on gas market liberalisation and the law on nuclear energy are mentioned, but not scheduled. In general, the ERP tends to report on past events rather than developing a future reform agenda.

Sector development

Agricultural sector development

Turkey lacks a comprehensive strategy on agriculture to identify and address shortcomings, including low productivity. Turkey´s agricultural market is fairly protected from international competition, and support for production appears to be on the rise. But the ERP does not include an analytical section on this sector; identification of the main problems and remedial measures to address them is, therefore, rather ad hoc and inconsistent with strengthening productivity. The planned measures to improve agricultural infrastructure are, however, relevant.

Industry sector development

The key obstacles to competitiveness and growth in the industrial sector are low productivity and the large share of low value-added products. The small-scale structure of industry (90% of firms are SMEs) results in small-scale production and does not sufficiently realise economies of scale. The uneven geographic distribution of larger industries is another problem. The ERP analyses these challenges well and outlines a sector strategy, but not in much detail, and thus does not distinguish sufficiently between support schemes and structural reforms. Turkey´s existing Priority Transformation Programme could be explained more comprehensively. Possible trade-offs between the import substitution policy for intermediate goods on the one hand and the objective of increasing productivity on the other hand are not addressed. Finally, the structural transformation programme for healthcare-related industries may favour a protectionist mind-set over one that would attract investment. Instead of seeking a blanket increase in productivity across all sectors, Turkey should consider focusing on sectors with comparative advantages that have more chance of integrating into global value chains.

Services sector development

Turkey has a comparatively strong services sector and comparative advantages particularly in tourism, health and educational services. However, tourism is vulnerable to political developments. The diagnostic and strategic analysis of sector opportunities and risks included in the ERP should be significantly strengthened. This is because the steps to increase service quality and competitiveness are not sufficiently addressed, while infrastructure, marketing and promotional activities seem overemphasised. Potential cross-linkages to labour and education are not explained.

Business environment, corporate governance and reduction of the informal economy

Turkey's weak performance in terms of judicial independence and the rule of law indicate a lack of predictability and stability, factors critical for drawing in and retaining investment. The transparency of the legislative process has diminished as a result of the proliferation of omnibus laws, which amalgamate several amendments to different laws in one package. In addition, frequent changes in technical legislation protecting non-viable companies or sectors, an increase in derogations granted in public procurement, the perception of politically motivated tax inspections and insufficient stakeholder consultation contribute to an atmosphere of legal uncertainty.

The ERP proposes actions to reduce the administrative burden and increase the efficiency of the judiciary, which could be considered as relevant reforms once achieved. However, the ERP does not adequately address the effects on the business environment of targeted actions against critical media and business people, through active use of the tax authority, the financial crimes unit and courts. The government has acquired active control of several media assets (Bugün, Habertürk, Zaman), companies (Koza-İpek group) and a bank (Bank Asia) through appointing trustees in their management.

Technological absorption and innovation

Turkey recognizes the importance of research and innovation as a driver for development. Despite improvements in recent years, the country faces a low, notably private, R&D spending intensity of 0.96% in 2014 (Eurostat), an ineffective venture capital market and a low ratio of R&D personnel in the total labour force (0.45% in 2014). In addition, deficient education in science, weak and scattered cooperation between academia and business, insufficient knowledge transfer mechanisms and low performance on innovation outputs, as reflected by the number of patents can be noted.

The diagnostic elements in this section of the ERP are generally plausible, albeit vague. The ERP presents no clear strategy as to the necessary reforms; the ERP provides insufficient details on implementation, notably on the cooperation between universities and public research institutions and businesses will be incentivised and how the effectiveness of measures will be assessed. While the proposed measures to stimulate R&D and innovation through public procurement could foster the creation of more knowledge-intensive products and services, this has to be done in full respect of competition rules. The instruments envisaged in Turkey´s ERP, notably price preferences and outright exemptions from the public procurement law, are an unlikely or even a counter-productive method of incentivising technological development. Moreover, supporting R&D activities with large procurement lots appears to disadvantage SMEs, in particular start-ups, which can be important drivers of new technology. Finally, stronger support for fundamental research and, in particular, better funding schemes for PhD students will be necessary to strengthen the science base.

Trade integration

Ad hoc barriers to trade and weak logistics infrastructure are key obstacles to the closer integration of Turkey in global value chains. The ERP lists trade liberalisation, better awareness of intellectual property rights, support for R&D activities in critical areas and support for waste recycling as measures that help international trade integration. The measures are aimed at reducing the current account deficit through export-oriented and competitive production. If implemented, they should have a positive impact on the competitiveness of the Turkish economy. However, the ERP also gives priority to reducing the undesirable impact of trade integration, including from the EU-

Turkey Customs Union. It remains unclear whether this means that Turkey will seek to conclude more FTAs with countries not having similar deals with the EU. Such a policy would constitute a breach of the Customs Union, and could risk undermining trade integration with Turkey´s single most important trading partner. Moreover, the measures relating to origin deviation appear to envisage defensive trade practices including technical barriers to trade. Instead, the ERP could have mentioned the planned strengthening of EU-Turkey trade relations by modernising the Customs Union.

Employment and labour markets

Turkey faces considerable labour market challenges, reflected in low female participation and employment rates, a high number of young people not in employment, education or training (NEET), and a high level of informal work. Poor working conditions, problems in providing safe and healthy work places and low workforce qualification levels hamper increased productivity, which is necessary for improving Turkey's competitiveness. The ERP touches upon these issues, with the exception of informal work which might be further exacerbated by the recent 30% increase of the minimum wage and the influx of refugees. Overall the ERP is not sufficiently forward looking and does not fully consider labour market challenges in the wider context of the structural reforms for growth and competitiveness included in the ERP.

Turkey has partly addressed the 2015 recommendations, but the ERP does not report on them. Amendments to the labour law were adopted in January 2016 introducing part-time work schemes for female civil servants with small children and a general right to part-time work for working parents with small children. Accompanying measures for stepping up child care and early childhood education provision are not brought forward though. To support implementation of part time work, an amendment to the labour law for introducing private employment agencies has been prepared, with the potential to improve labour market dynamics. The provision of training for low-skilled workers was further stepped up in 2015; however the number of training courses provided is insufficient for the needs.

The ERP identifies reform priorities for improving labour market effectiveness, basic and occupational skills, and attracting qualified workers, but some measures need to be more clearly described. An additional list includes 12 measures which broadly relate to the reform priorities. They lack details on the content, timing and budget of the measures; the multiannual actions listed under Section 4 are ongoing measures ending in 2016 or 2017.

The measures for improving labour market effectiveness focus on improving the scope and effectiveness of financial and other support to the unemployed, addressing labour market rigidities and gaps in workers' rights. However, informal work is not addressed in this context. The reform measures related to human capital rightly put a two-fold focus on raising basic and occupational skills in the lower/middle skills segment and on attracting highly qualified professionals including from abroad. A new youth employment strategy is announced, which could help to tap unused potential for raising labour market participation and productivity.

Fostering social inclusion, combatting poverty and promoting equal opportunities

Turkey faces significant social challenges in terms of poverty and income/wealth inequality which are structural in nature. The current system of providing social assistance appears to leave a large proportion of poor households outside its coverage; beneficiaries of social assistance represent only one sixth of individuals below the relative poverty rate. The link between social assistance and labour market activation measures is weak. Turkey's advanced economic status contrasts with its very low ranking in international indices on human development and gender equality. The country's commitment to education reforms has not yet delivered tangible improvements.

The two measures in this area rightly focus on improving the delivery and effectiveness of social support measures. The two measures differ in focus. The Family Social Support Programme is already in place and specifically addresses families. The measure on the Effective Social Transfer System aims at a thorough reform of the social protection system to transform it into a universal system. No details are provided about its design, timing and budget.

ANNEX 1: OVERALL ASSESSMENT OF PROGRAMME REQUIREMENTS

A draft version of Turkey's Economic Reform Programme for 2016-2018 was sent to the Commission on 4 March 2016. The final and formally approved ERP was submitted to the Commission on 13 April, more than two months after the deadline. The programme includes an enhanced description of structural reform priorities. However, the programme's structure does not follow the guidance note provided by the Commission.

Ownership and internal coordination

The ERP was centrally coordinated by the Ministry of Development, but does not provide information on which ministries contributed to the exercise. The ERP is closely based on Turkey´s 10th Development Plan (2014-2018).

Stakeholder consultation

There appears to have been no consultation with external stakeholders on the ERP, in contrast to the 10th Development Plan on which it is based; it therefore contains no written contributions. This should be improved next year.

Macro framework

The programme's medium-term projections are overly optimistic regarding the main macroeconomic indicators (growth, inflation, unemployment, current account). The projections are not all internally consistent. Some key challenges are not sufficiently addressed, particularly the sustainability of the current account deficit, the persistence of relatively high inflation, and the impact of the large inflow of refugees and migrants on the economy. The macro framework is drawn from the government's revised Medium Term Program 2016-2018 from January 2016.

Fiscal framework

Efforts are required to improve fiscal data at general government level on a unified accounting basis according to ESA/international standards. It remains difficult to assess Turkey's public finance situation properly in the absence of regular and consolidated general government budget reports. There is little information about the measures underlying the fiscal projections for the programme period, making it difficult to assess their soundness. Future programmes would benefit from more complete data and from a long-term analysis of public finance sustainability to gain an understanding of the main fiscal challenges in the future, in particular those stemming from demographic and labour market developments.

Structural reforms

The diagnostics per sector should generally be improved. Reform measures appear eclectic at times and the number of structural reforms is unclear. Section 4 does not contain an enumeration of measures. The summary of reform priorities in section 4.3 indicates 18 measures, while table 9 in the annex includes a list of 25 measures. The measures read more like objectives, and no concrete activities are presented. Tables 7 to 9 in the annex are not numbered in accordance with the guidance note and are not properly filled in. Table 7 only references five measures or areas and only contains budgetary information on four of them. Table 8 only contains information on eight of the measures and only a few include detailed timetables. Table 9 provides the only comprehensive summary of structural reforms of the ERP; however, it does not correspond to the information given in section 4 of the ERP.

ANNEX 2: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2015

2015 policy guidance for Turkey	Summary assessment
PG 1: Promote domestic saving in view of the persistently large current account deficit. Fiscal policy has an important role to play in this regard by following a sufficiently restrictive stance. Reducing the rigidity of public expenditures would help to make the fiscal policy stance more responsive to macroeconomic needs. The adoption of a fiscal rule would enhance budget transparency, provide an important fiscal anchor and enhance credibility.	Turkey has not addressed policy guidance 1.
PG 2: Continue to take consistent steps to reinforce the focus of monetary policy on the pursuit of price stability, with other policy objectives being pursued with separate measures, and thereby contribute to improving both the functioning and the credibility of the inflation targeting regime.	Turkey has not addressed policy guidance 2.
PG 3: Make sustained efforts to improve the business environment and Turkey's attractiveness as an investment destination, not least for foreign direct investments, in view of the continuing dependence on large capital inflows. This requires wide-ranging reforms, including strengthening the rule of law, making it easier to start businesses, and strengthening competition through continued liberalisation of product and service markets.	Turkey has not addressed policy guidance 3.
PG 4: Accelerate the implementation of a comprehensive structural reform programme. Overall, this is essential to improve the functioning of the markets for goods, services and labour which, in turn, would increase potential growth and international competitiveness on a sustainable basis. In particular, Turkey should upgrade and make better use of its human capital through the pursuit of the education agenda and the deepening and widening of labour market reforms. Specifically, the qualifications of low-skilled workers should be improved through training and female labour force participation should be stimulated through flexible working conditions.	Turkey has partially addressed policy guidance 4: • Amendments to the Labour Law were adopted in January 2016, introducing the right to part-time work for parents, with specific rules for female civil servants. • Training provisions in VocTest Centres were increased.