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ECONOMIC REFORM PROGRAMME

OF

TURKEY
(2020-2022)

COMMISSION ASSESSMENT

The Economic Reform Programmes (ERP) were submitted around end-January 2020 and the present Commission assessment was finalised shortly thereafter in February 2020, supported by a fact-finding mission in mid-February.

The Covid-19-related economic crisis has in the meantime rendered the macro-fiscal scenarios presented in the ERP and in the Commission assessment largely obsolete. The Commission will publish its updated macroeconomic and fiscal projections for candidate countries, reflecting the expected impact of the Covid-19 crisis, in its spring economic forecast in early May 2020.

While the short-term macro-fiscal outlook has profoundly changed, the present Commission assessment also identifies structural reform challenges and priorities, including in the area of fiscal governance, which remain largely valid. Addressing these structural issues will be essential to ensure a sustained economic recovery after the crisis. The Joint Conclusions to be adopted at the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey will accordingly focus this year on the short-term priorities to mitigate the socio-economic consequences of the Covid-19 crisis and on the medium-term priorities to strengthen the foundations of a sustained recovery thereafter. While the Commission assessment does not address weaknesses in the public health system and issues in the social protection system are assessed only as far as they are linked to the key structural challenges, these two areas will feature more prominently among the issues identified in the policy guidance.

Contents

1. EXECUTIVE SUMMARY

The economy recovered faster than expected from the 2018 recession but uncertainty remains high and policy space is limited. In 2019, the authorities implemented a sizable fiscal expansion and various measures to boost credit. Economic activity was bolstered further by an aggressive monetary policy which loosened in the second half of the year, facilitated by benign global financial conditions. Inflation slowed but, fuelled by de-anchored inflation expectations, remained well above the central bank's target. The depreciation of the Turkish lira and improved price competitiveness helped maintain export performance throughout the year, while an intense decline in domestic demand led to sharp import compression. Improved financing conditions, base effects, and pent-up demand should sustain a robust recovery over the short term. However, the Economic Reform Programme's 5% GDP growth target over the medium term seems optimistic. Policy space for further stimulus has been largely exhausted. Although uncertainty declined from its peak, it remains elevated, fuelled by geopolitical risks, unconventional domestic policies, and legacy issues like the need to restructure some companies' balance sheets and to reduce pressures on the exchange rate through tighter monetary policy. The banking sector proved resilient, but shifting the focus of financial policies from lending support to financial stability seems warranted.

The authorities' objective is to strengthen fiscal discipline in the face of mounting challenges. The 2019 budgetary outcome was worse than expected as revenue underperformed, expenditure increased strongly, and the underlying budget deficit (excluding one-off and temporary measures) reached nearly 6% of GDP. The Economic Reform Programme plans a frontloaded fiscal adjustment, which is supported by some tax measures in 2020 as well as a 3.5% of GDP reduction in primary expenditure between 2019 and 2022, mostly through significant cuts in government investment. However, as most of the structural adjustment compensates for lower one-off and temporary revenues, there is only a marginal reduction in the headline budget deficit. This creates challenges for the Economic Reform Programmes's plan to stabilise government debt. The consistency of the fiscal strategy is undermined by a culture of frequent, ad-hoc, and incoherent tax changes. Risks from quasi-fiscal activities and contingent liabilities are not systematically monitored. Fiscal transparency and governance remain weak and improving them could be an important step towards increasing credibility.

The main challenges for future economic policy are the following:

- **Strengthening monetary policy credibility and reorienting macro-prudential policies from lending support to financial stability.** In order to permanently lower inflation expectations and inflation the authorities would need a stronger policy stance, especially in view of rising domestic demand and continuing pressure on the lira.

- **Implementing the envisaged fiscal consolidation and improving the quality of public finance.** In view of the large budget deficit and high uncertainty, fiscal consolidation is a priority. This could be supported by measures to use the scarce budget resources in a more efficient way and to increase budgetary transparency.

- **Foreign and domestic investments have fallen to a low level due to the continued volatile business environment.** A lack of predictability and stability in the regulatory environment, in rule of law and contract enforcement are negatively affecting business operators' readiness to engage in new activities. At the same time, there is a lack of transparency in State aid and other incentives to the private sector.

- **The weakness of the labour market is a particular concern.** The unemployment rose and the employment rate fell with the economic downturn of 2019. Women and young people continue to face difficulties in accessing the labour market. A vast and expensive range of labour market incentives is in place, of which the impact is unclear, while training measures are largely inadequate for developing higher skills levels. Undeclared work remains at high levels and has further increased in 2019. Measures to reduce informality are not focused and comprehensive enough. Policy responses should *inter alia* address Syrian refugees under temporary protection**.**

- **The education system remains a key challenge and needs to be further developed**. To this end Turkey has launched the Education Vision 2023 which provides a comprehensive framework for the reform of the education system. This is a good policy measure but perceptible results can only be seen in the long term. The latest Programme for International Student Assessment (PISA) for Turkey shows positive developments but demonstrates as well that Turkey still lags behind the OECD average. The high NEET (not in education, employment or training) and youth unemployment rates are directly linked to the underperforming education system.

The policy guidance set out in the conclusions of the economic and financial dialogue of May 2019 has been implemented to a limited extent. The persistently low level of policy guidance implementation needs to be addressed. In view of the difficult economic situation and their focus on achieving short-term- growth, the authorities pursued expansionary fiscal policy and took various measures to further increase lending. There have been no steps to improve the transparency of fiscal policy or to introduce numerical fiscal rules and establish an independent fiscal body. Monetary policy was very tight until mid-2019 but has loosened rapidly since. No significant improvements in the rule of law and the business regulatory environment have been observed. The number of companies under trusteeship decreased but still remains significant. Some of the measures related to foreign currencies that were taken in 2018 to contain temporary financial market volatilities remain in place. The 2019 inspection programme for tackling informality was adopted with huge delay, and undeclared work increased even further during some months in 2019. The labour market participation of women and youth has been deteriorating. As regards the enrolment of 5 year olds and the reform of the vocational system, implementation is partial. The measures are being rolled out and need more than one year to show an impact.

Overall, the programme correctly identifies the main challenges facing the economy, but is overly optimistic and reform implementation remains uncertain. The Turkish authorities are aware of the numerous challenges and vulnerabilities facing the economy. While they have a number of reasonable ideas for reforms, specific proposals are often still lacking. The medium-term macro-fiscal scenario is optimistic and, despite the closing of the current account deficit, major imbalances persist. The implications of structural reforms for public finances have not been identified. Turkey has started to address the challenges in the area of education but the impact of the measures will show only in the following years. Evidence-based active labour market policies need to be further rolled out and the fight against informal employment, which increased in 2019, needs to be further stepped up. Structural bottlenecks, like the low labour market participation of women and young people, remain as relevant as before.

2. ECONOMIC OUTLOOK AND RISKS

The economy recovered faster than expected from the recession triggered by the 2018 currency turmoil because of continuous and strong policy stimulus and favourable external financing conditions. Real GDP increased by 0.9%, due largely to the strength of net exports. In the first half of 2019, the authorities reacted to the worsened credit conditions and to the sharp drop in private consumption and investment with a sizable fiscal expansion and a credit boost by state-owned banks. Economic activity was bolstered further by an aggressive monetary policy, which loosened in the second half of the year, facilitated by lower global interest rates and an accommodative stance by major central banks. The depreciation of the lira and improved price competitiveness helped export performance throughout the year, while a steep drop in domestic demand led to sharp import compression, which was reversed only in the last quarter of 2019.

The Economic Reform Programme (ERP) aims to further accelerate economic activity, although the output gap is estimated to remain negative even in 2022. The annual GDP growth forecast was revised upwards to 5% in every year of the programme period and is expected to be sustained largely by domestic demand. The programme views improved confidence and lower financial volatility as key factors supporting private consumption and investment, with pent-up demand boosting them further over the short-term. The contribution of net exports to GDP growth is projected to fall significantly from its high levels in the previous 2 years, turning negative in 2020 before rebounding again in 2021 and 2022 to close to zero. Economic recovery is expected to be widespread across sectors. Industrial activity, in particular, is forecast to grow strongly (6.8% on average), supported by special industrialisation and productivity-enhancing measures. However, total factor productivity's contribution to growth is estimated to remain rather marginal and growth to be driven mainly by capital accumulation and gains in employment.

The macroeconomic scenario is rather optimistic, especially in 2021 and 2022, in view of elevated uncertainty and limited policy space. Improved financing conditions, base effects, and delayed consumption and investment demand should sustain a robust recovery over the short term. However, as effects from these factors fade away, maintaining the envisaged pace of economic growth is likely to become more challenging. Policy space has been largely exhausted, with limited potential to further support expansionary policies. On the fiscal side, the authorities plan a moderate consolidation of the high budget deficit. Monetary policy accommodation advanced rapidly since last summer, and has also approached its limits. In addition, macro-prudential measures to further boost lending and micro-manage demand are likely to have diminishing returns, while undermining their purpose to safeguard financial stability.

The programme does not present an alternative macroeconomic scenario, which is a missed opportunity to deepen the analysis of the main challenges and risks. The lack of an alternative scenario is also unfortunate in view of the rather optimistic baseline, which is above the Commission Autumn Economic Forecast as well as the Consensus Forecast. Although uncertainty declined in 2019 from its peak in the recession, it remains elevated, fuelled by geopolitical risks, unconventional domestic policies, and legacy issues like the need to restructure some companies' balance sheets and to reduce recurring pressures on the exchange rate in a structural way. If these issues are not addressed and consumers' and investors' confidence does not improve, Turkey's expansionary policies and the pursuit of the baseline scenario's growth objective may lead to a reversal of the recent rebalancing of the economy and to renewed vulnerabilities.

Table:

Turkey - Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021		2022	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	2.8	**2.8**	0.3	**0.5**	3.1	**5.0**	3.5	**5.0**	n.a.	**5.0**
Contributions:										
- Final domestic demand	0.8	**0.7**	-2.2	**-2.2**	3.0	**5.7**	3.6	**4.6**	n.a.	**4.6**
- Change in inventories	-2.2	**-1.5**	-2.6	**-0.1**	0.0	**-0.1**	0.0	**0.0**	n.a.	**-0.1**
- External balance of goods and services	4.2	**3.6**	5.1	**2.8**	0.0	**-0.6**	0.0	**0.4**	n.a.	**0.5**
Employment (% change)	1.9	**1.9**	-1.8	**-1.6**	2.6	**3.7**	2.8	**4.0**	n.a.	**3.3**
Unemployment rate (%)	11.0	**11.0**	13.7	**12.9**	13.3	**11.8**	12.9	**10.6**	n.a.	**9.8**
GDP deflator (% change)	16.4	**16.4**	13.6	**14.1**	10.9	**8.7**	9.8	**7.2**	n.a.	**5.4**
CPI inflation (%)	16.3	**16.3**	15.3	**15.1**	10.3	**10.8**	9.3	**6.9**	n.a.	**4.9**
Current account balance (% of GDP)	-3.6	**-3.4**	-0.6	**0.1**	-0.7	**-1.2**	-1.0	**-0.8**	n.a.	**0.0**
General government balance (% of GDP)	-3.2	**-2.4**	-3.0	**-3.0**	-3.5	**-2.9**	-3.3	**-2.8**	n.a.	**-2.6**
Government gross debt (% of GDP)	30.1	**30.1**	31.4	**32.8**	33.0	**33.2**	34.3	**32.5**	n.a.	**32.3**

Sources: Economic Reform Programme (ERP) 2020, Commission Autumn 2019 forecast (COM).

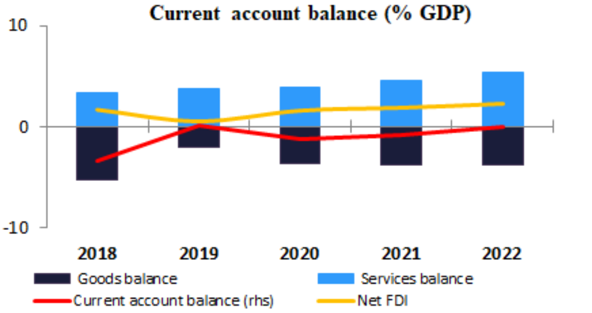
Achieving the ERP's ambitious disinflation path requires increased central bank credibility through a tighter and more transparent monetary policy stance. Driven by some stabilisation of the exchange rate, base effects and weak domestic demand, inflation declined rapidly from its peak of 25.2% in October 2018. However, it still remained elevated at double-digit levels in the first months of 2020. The central bank targets a disinflation path, expecting to bring inflation down to 8.2% at end-2020 and 5.4% at end-2021. However, it has missed its inflation target of 5% (±2 pps) for many years and as a result inflation expectations have become entrenched and high (above the central bank disinflation path). Inflation expectations made only a marginal contribution to the declining inflation in 2019 and they continue to be the main inflationary factor. In order to break their rigidness and reduce inflation in a permanent way, the authorities would need a stronger policy stance, especially in view of rising domestic demand and continuing pressure on the lira. More clarity on the central bank reaction function, after the steep reduction in the policy rate by 13.25 points since July 2019, may help lower policy uncertainty.

The significant external rebalancing represents a major turnaround, and preserving it is key to sustaining macroeconomic stability. In 2019, the current account deficit was in surplus for the first time in nearly two decades. This was largely due to import compression and price competitiveness gains because of the strong depreciation of the lira. Although the current account is forecast to turn into deficit in 2020, the programme acknowledges the importance of moderating it and aims for the current account to be balanced by 2022. The programme refers to policies aimed at boosting productivity and exports, counting in particular on higher tourism revenue and import substitution measures, which are designed to decrease the overall import dependency of the economy. While it may be premature to expect to see quick results from these measures – many of them are still in the planning phase – external imbalances may actually be kept in check by a competitive lira and limited external financing options. Turkey's gross external debt peaked in nominal terms in early 2018 but due to the depreciation of the lira it increased since then to close to 60% of GDP in the third quarter of 2019. Despite recent current account improvements, its elevated indebtedness and large gross external financing needs mean that Turkey's external position remains vulnerable to volatile capital flows, geopolitical uncertainty, a high country risk premium, and relatively low foreign reserves.

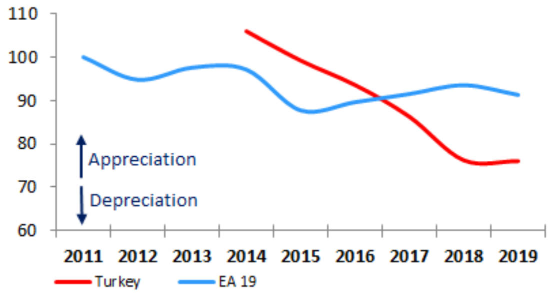
Low confidence and uncertainty supress external financial flows. Since the 2018 currency shock, net external financial inflows have declined precipitously. In 2019, portfolio and other investments both registered small net outflows, in a clear departure from the previous years' model of externally financed economic growth and despite generally benign global financial conditions in the second half of the year. The outflows were largely driven by banks' deleveraging but, in a sign of low confidence, also by a continuous build-up of foreign financial assets by banks and other sectors, mainly in the form of foreign currency and deposits. The nearly 40% decline in foreign direct investment inflows in 2019, to their lowest level in more than a decade, was another sign of investors' diminished confidence. In an environment of persistent pressure on the lira and scarce foreign finance, trade credit and advances expanded further to new highs. The programme does not present external financing assumptions, but net external financial inflows are likely to remain subdued unless the current high level of policy uncertainty subsides.

The unfinished corporate balance sheet restructuring remains a major vulnerability. The 2018 currency shock had a major effect on a significant number of companies with an open foreign exchange position. More than half of these companies' foreign exchange liabilities were with domestic banks. Although part of their loans were restructured and these companies deleveraged further, their net foreign exchange exposure remains significant at some 25% of GDP, making them vulnerable to further exchange rate depreciation and volatility. In addition, as restructured loans were classified with limited collectability or under close monitoring, the current level of non-performing loans may underestimate asset quality risks.

Graph: **Turkey - Evolution of the Current account balance (% GDP)**



Graph: **Turkey - Real effective exchange rate (CPI based, Index)**



The banking sector proved resilient but there is a need to shift the focus of macro-prudential policies from lending support to financial stability. Following a slump in the aftermath of the 2018 currency shock, bank lending, supported by strong policy measures, recovered and in early 2020 was growing in real terms. Macro-prudential measures and state-owned banks have been instrumental in boosting lending. State-owned banks acted as policy banks, taking a strong bet on the recovery of the economy, and expanded their portfolio, providing loans at below-market rates. They also significantly increased their holdings of government debt and have been active on the foreign exchange market in defending the lira. Although commercial banks' profitability declined, in particular in state-owned banks, their capital and liquidity indicators remained above regulatory requirements. The recent pickup in loan activity was largely channelled into consumer lending and consumption. In view of limited demand, it remains a challenge to reorient credit towards corporate and investment finance. Exchange rate volatility triggered increased dollarization, and the share of foreign currency deposits went up to nearly half of total deposits. Banks used part of their excess foreign currency liquidity to engage in derivative operations, while the central bank reduced its use of the one-week repo and now provides around two thirds of the daily market liquidity via the swap market.

Table: **Turkey - Financial sector indicators**	2015	2016	2017	2018	2019
Total assets of the banking system (EUR million	744	735	715	636	672
Foreign ownership of banking system (%)	30.8	30.0	28.2	26.8	26.0
Credit growth	20.7	16.7	20.9	16.0	10.9
Deposit growth	18.6	17.7	17.7	22.1	26.1
Loan-to-deposit ratio	1.13	1.12	1.15	1.08	0.95
Financial soundness indicators					
- non-performing loans	3.1	3.2	3.0	3.9	5.4
- net capital to risk-weighted assets	15.6	15.6	16.9	17.3	18.4
- liquid assets to total assets	6.4	8.1	8.0	10.7	10.0
- return on equity	9.9	12.5	15.9	14.7	11.7
- forex loans to total loans (%)	31.8	34.8	32.6	39.9	38.0

* including the impact of write-offs.
Sources: National Central Bank, Macrobond.

3. PUBLIC FINANCE

The 2019 budgetary outcome was worse than expected as revenue underperformed and expenditure increased strongly. The central government budget deficit increased by 70% year-on-year in nominal terms to 2.9% of GDP. Although the deficit was larger than the initially planned 1.8% of GDP, it was in line with the authorities' revised estimate. Weak domestic demand and strong import compression led to a significant shortfall in indirect tax revenue. Public spending on wages, current transfers, and on goods and services increased strongly in real terms. The government channelled additional resources, above initial appropriations, into some investment projects, some of which were carried over from the previous year. The difficult labour market situation created expenditure pressures as well. The general government deficit reportedly stood at 3.0% of GDP. However, in view of the authorities' use of significant one-off and other temporary measures (including exceptional receipts from the central bank) to the tune of 2.9% of GDP in 2019, the underlying deficit was actually nearly twice as high.

The programmes' objective is to strengthen fiscal discipline. To this end, it targets a 2 pps reduction in the structural budget balance over 2019-2022 and a decrease in the headline general government deficit from 3.0% of GDP in 2019 to 2.6% of GDP in 2022. Most of the structural adjustment compensates effects from lowering the use of one-off and other temporary measures and as a result there is only a marginal reduction of the headline budget deficit. The envisaged adjustment is frontloaded – more than half of it is planned for 2020 – and entirely driven by a 3.5% of GDP reduction in primary expenditure between 2019 and 2022. However, the planned further reduction of capital spending and transfers, beyond the already very low levels in 2019, seems unsustainable. Fiscal targets have been adjusted since last year's ERP, with higher deficit and debt levels, taking into account lower economic growth realisation in the last two years. Although the fiscal scenario is based on rather optimistic macroeconomic assumptions, its revenue estimates are prudent, irrespective of the fact that they are not backed by specific consolidation measures in the final 2 years of the programme.

The 2020 budget is a step towards consolidating public finance but remains under stress as economic recovery is still fragile. The general government revenue and expenditure are forecast to increase by 10.8% and 10.6% respectively, which is below nominal GDP growth.

The 2020 budget targets a broadly unchanged central government deficit level of 2.9% of GDP. It also keeps total spending on personal and current transfers largely unchanged as a share in GDP. Tax revenues are planned to increase by 0.5% of GDP which, together with significant cuts in capital spending and transfers, is expected to compensate for the large fall in non-tax, mostly one-off, revenue. Reflecting the strong increases in budget deficits in recent years, interest payments are forecast to reach 3.0% of GDP, up from 1.9% of GDP just 3 years ago. The underlying budgetary structure is, thus, under strong pressure as fiscal space is severely constrained. However, quasi-fiscal activities (public-private partnerships, state guarantees, state-owned banks) and the operation of the Sovereign Wealth Fund complicate the assessment of the fiscal stance.

The consolidation drive is supported by tax hikes and new taxes. The authorities introduced a number of new tax measures. It is unfortunate that the programme does not provide any information on them or estimates of their budgetary and economic impact. The new tax measures target increased progressivity and redistribution, and focus on activities with high turnover and liquidity such as telecommunications and tourism. As from 2020, there is a new digital services tax of 7.5% on revenue generated from digital activities and content, and a new personal income tax bracket of 40% for annual income over TL 500,000. Although the tourism sector has been declared a priority sector in the national development programme, a new tax was introduced on accommodation services: 1% of their total value (net of VAT) from 1 April 2020 and 2% from 2021. A new tax on residential houses with a value above TL 5 million was also proposed, although how it will be implemented and when it will start is not clear.

The budget for 2020

The draft budget for 2020 was presented to the Turkish Grand National Assembly on 18 October 2019 and approved on 21 December, within the 45-day deadline. The central government targets a budget deficit of 2.9% of GDP in 2020. It aims to counter increased interest payments and lower (one-off) non-tax revenues by increasing some taxes and cutting capital expenditure and transfers.

Main measures in the budget for 2020

Revenue measures*	**Expenditure measures****
• Higher tax revenues (+0.5% of GDP)	
• Lower (one-off) non-tax revenue (1.2% of GDP)	• Lower capital expenditure and transfers (-0.9% of GDP)

* Estimated impact on general government revenues.

** Estimated impact on general government expenditure.

Source: ERP

The fiscal strategy consistency is undermined by ad hoc measures. In parallel with the revenue-increasing drive, the authorities introduced temporary and targeted measures aimed at reducing inflationary pressures in the beginning of the year and helping certain sectors. These included cuts in the VAT rates on furniture sales and eggs. In addition, the government decided not to adjust tobacco and alcohol taxes in the first half of 2020 (these taxes are usually adjusted every January and July in line with the six-month change in the Producer price index). While the VAT measures most likely do not have a big revenue impact, tobacco and alcohol excises may be more damaging in terms of revenue losses.

Table:

Turkey - Composition of the budgetary adjustment (% of GDP)

	2018	2019	2020	2021	2022	Change: 2019-22
Revenues	33.3	33.3	32.4	31.3	30.7	-2.6
- Taxes and social security contributions	26.1	25.3	25.5	25.2	24.9	-0.4
- Other (residual)	7.2	8.1	6.9	6.1	5.8	-2.3
Expenditure	35.6	36.4	35.2	34.1	33.4	-3.0
- Primary expenditure	33.5	33.8	32.2	31.0	30.3	-3.5
of which:						
Gross fixed capital formation	3.8	2.7	2.1	2.1	2.1	-0.6
Consumption	16.0	16.6	16.0	15.2	14.8	-1.8
Transfers & subsidies	7.5	8.0	8.0	8.0	7.7	-0.3
Other (residual)	6.2	6.5	6.1	5.7	5.7	-0.8
- Interest payments	2.1	2.6	3.0	3.1	3.1	0.5
Budget balance	-2.4	-3.0	-2.9	-2.8	-2.6	0.4
- Cyclically adjusted	-2.6	-2.1	-2.3	-2.4	-2.4	-0.3
Primary balance	-0.3	-0.4	0.1	0.3	0.5	0.9
- Cyclically adjusted	-0.4	0.4	0.6	0.6	0.6	0.2
Gross debt level	30.1	32.8	33.2	32.5	32.3	-0.5

Sources: Economic Reform Programme (ERP) 2020.

Plans for stabilising the government debt ratio face sizable challenges. Government debt went up, driven by the recent expansion of budget deficits and the depreciation of the lira. The programme forecasts it to peak at 33.2% of GDP in 2020 before receding slowly to 32.3% of GDP in 2022. The government reacted to the tighter financing conditions and higher yields by shortening the maturity of new issuance. As a result, the average time to maturity of central government debt stock fell to 5.6 years. State-owned banks were active participants on the government bond market and increased their holdings of government debt to a quarter of the total. Discouraged by policy uncertainty and new restrictions on the foreign exchange swap market, non-residents reduced their exposure to around 10% of domestic debt. The share of domestic debt increased to above 55% of the total in 2019. The share of foreign currency-denominated debt increased further to nearly 50% (up 10 pps in 2 years), while the share of debt with fixed interest rate remained broadly unchanged at three quarters of the total. Turkish credit default swap spreads have come down since the 2018 currency shock, but they have been affected by geopolitical developments and so remain elevated and volatile. The country's sovereign rating remains below investment grade. Government debt is sensitive to exchange rate fluctuations and it may be a challenge to limit its further increase given persistent pressure on the lira, high risk premia due to elevated uncertainty, large contingent liabilities, and rather optimistic macroeconomic assumptions.

Debt dynamics

Inflation is expected to remain the main factor driving down the government debt-to-GDP ratio. Real economic growth is forecast to contribute steadily to lower debt, while the improving primary balance slowly catches up. Higher interest payments and (mainly exchange rate driven) stock-flow adjustments are to continue pushing debt upwards.

Table:

Turkey - Composition of changes in the debt ratio (% of GDP)

	2018	2019	2020	2021	2022
Gross debt ratio [1]	**30.1**	**32.8**	**33.2**	**32.5**	**32.3**
Change in the ratio	1.8	2.7	0.5	-0.8	-0.2
Contributions [2]:					
1. Primary balance	**0.3**	**0.4**	**-0.1**	**-0.3**	**-0.5**
2. "Snowball" effect	**-2.7**	**-1.3**	**-1.2**	**-0.7**	**-0.1**
Of which:					
Interest expenditure	2.1	2.6	3.0	3.1	3.1
Growth effect	-0.8	-0.1	-1.6	-1.6	-1.5
Inflation effect	-4.0	-3.7	-2.6	-2.2	-1.7
3. Stock-flow adjustment	**4.2**	**3.5**	**1.8**	**0.2**	**0.4**

[1] End of period.

[2] The snowball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator).

The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other effects.

Source: Economic Reform Programme (ERP) 2020, ECFIN calculations.

Challenges to the fiscal strategy are mounting. The programme devotes very little attention to the various risks to public finance. Despite some buffers on the revenue side, the fiscal scenario is built upon the assumption of favourable macroeconomic developments. In view of the current very high level of global uncertainty and domestic vulnerabilities, this assumption could be tested. In addition, switching from relying on one-off and temporary measures to more stable and permanent sources of revenue and financing may be difficult given weaknesses in the tax system. A culture of frequent, ad hoc, and incoherent tax changes needs to be addressed in order to improve predictability, efficiency, and resource allocation. The longstanding idea to simplify and reform the tax system is of high importance in view of rising fiscal pressures and the urgent need to improve revenue collection capacity. Government investment is planned at critically low levels; this may be unsustainable and puts upward pressure on expenditure and deficit targets. Risks from quasi-fiscal activities, excessive price controls, and contingent liabilities are longstanding issues that need to be addressed in a more systematic way.

Resolute reform measures are needed to improve the quality of public finances. Unfortunately, the programme does not devote sufficient attention to these issues. Some important steps have already been taken to improve public expenditure quality by strengthening the link between policies, strategic planning, and performance. The budget also includes a reserve appropriation fund to face unforeseen expenditure. A new unit has been set up in the Ministry of Treasury and Finance to work on structural reform issues in cooperation with line ministries. The authorities are also working on preparing a more holistic public-private partnerships (PPP) report and on new PPP legislation that would centralise projects' execution. However, further efforts are needed in multiple areas to improve public finance quality and policy coordination under the new presidential system. The structure of public spending is likely to worsen in view of the envisaged significant reduction in capital expenditure and transfers, and more focus is needed on increasing growth-enhancing expenditure in general.

Fiscal transparency remains weak and improving it could be an important step towards improving credibility. High-frequency data on budget execution at general government level are lacking and policy discussions continue to focus on fiscal targets at lower levels of government. Important policy decisions such as the latest tax changes have been taken without presenting publicly their estimated budgetary and economic impact. The budget system does not fully cover the whole government sector and needs to expand to include some revolving funds, special accounts and certain institutions like the Sovereign Wealth Fund. More efforts are also needed to improve the credibility and effectiveness of the medium-term budgetary framework. Anchoring some policies via fiscal rules and introducing an independent fiscal institution could also boost credibility and reduce uncertainty.

4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES

Turkey is endowed with a strategic geographic position, a strong and entrepreneurial business sector, a large domestic market and a young population. It also has privileged access to the EU market through the Customs Union with the EU. To provide jobs for the many new entrants to the labour market, since the early 2000's, the Turkish economy has relied on credit growth and foreign financing. As a consequence, structural imbalances exacerbated, amplifying the economy's vulnerability. Triggered by political tensions with the USA, this led to a currency crisis in August 2018. In addition, measures taken after the 2016 failed coup attempt and the 2018 currency shock, which had a profound negative impact on the business environment, are only slowly being unwound.

The Commission has conducted an independent analysis of the Turkish economy to identify the key structural challenges to boosting competitiveness and inclusive growth. Its analysis drew on the Turkish ERP itself, discussions with the authorities, as well as other sources. The analysis shows that Turkey is experiencing a number of structural weaknesses across many sectors. However, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) raising the performance level of the education system, (ii) improving transparency and predictability in the regulatory and institutional environment affecting businesses, and (iii) Increasing employment, in particular of women and young people, and reducing undeclared work.

Turkey needs to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for successfully transforming the economy. In its annual report on Turkey, the Commission is closely following the issues of strengthening the rule of law and fighting corruption.

Key challenge #1: Raising the performance level of the education system.

Education is key in developing a knowledge based economy. Turkey is an OECD and G20 member and aspires to become one of the 10 leading economies of the world. Half of its population is under 32 and hundreds of thousands of young people reach working age every year. At the same time, the economic transformation of the country from low to advanced technology requires sustained investment in human capital. High growth rates over the last nearly two decades had created an enabling environment for increasing employment and moderate unemployment rates. However, recent economic headwinds have added pressure on the employment of Turkey's youth. At the same time, digitalisation and automatisation is replacing physical labour in industry. This makes proper education a key factor for the economic development of the country.

Turkey has improved its PISA performance but remains below the OECD average. The results of the recent PISA 2018 assessment in Turkey suggest that the gap between Turkey and the OECD average has narrowed. The trajectory of results in mathematical and science skills went upwards between 2015 (mathematics score 420, science score 425) and 2018 (mathematics score 454, science score 468). Turkey has advanced from rank 50 in 2015 to rank 40 in 2018, out of the 79 participating countries. In addition, Turkey is one of the few countries that has managed to improve student achievement while increasing access to education. Over the past decade, significant investment and reform to Turkey's education system have enabled a major expansion in participation. However, there is no reason for complacency as there are still considerable challenges. Notably, the reading skills (score 466 in 2018) of the Turkish 15 year olds need to be improved. Only 3% of the students were top-performers in reading (OECD average 9%), whereas 26.1% were low performers (OECD average 23%). In view of this deficiency, Turkey has introduced *reform measure 17 (Increasing the reading culture)* in the ERP. This measure is in line with EU education targets. The Turkish Ministry of National Education has started with establishing Z-Libraries (enriched libraries) in schools at all levels of education. The aim of these Z-Libraries is to increase reading habits and to support social, cultural and artistic activities of the students. So far, 1,535 Z-Libraries have been established and the number will be increased to help Turkey reaching average OECD standards in reading skills. The education system should develop students' reading skills, their ability to understand and solve problems, and to make deductions. The proposed activities are a good initiative, but they need to be closely monitored. Guidance for teachers is very important in this respect.

Early childhood education and care services are limited in Turkey. Early childhood care is available on a pilot basis in big urban centres, but the enrolment rate for children up to the age of 2 years is less than 1% and not much higher at the age of 3 years. In the 2018/2019 school year, 50.42% of children aged 4-5 years have been enrolled in kindergartens and 68.3% of children aged 5-6 years were covered by preschool education. Full enrolment of 5 year olds in preschool education is planned for 2022. Hence, most childcare duties still lie primarily in the hands of mothers, limiting their opportunities to participate in economic life. Turkey plans to further increase the provision of preschool education. *Reform measure 16 of the ERP (Dissemination of pre-school education)* focusses on providing education through mobile schools, where no other schools are available, on access to education for disadvantaged children and on reducing the cost burden for parents. This measure is in line with EU education targets and will boost growth and competitiveness in the long term.

The enrolment rates in primary and secondary education leave room for improvement. The enrolment rate in primary the education was 95% and enrolment rate in secondary education was 83.6% in 2018. This means that 5% of children in the primary and 16.4% in the secondary school age group do not attend school as they should. In addition, there is a serious problem with early (school) leavers from education and training (18-24 year olds), which is at 31% considerably higher than the EU-28 average (10.5% in 2018). This leads equally to a high rate of people not in education employment or training (NEETs) in the age group 15-24 of 26% (2019) and an equally high rate of youth unemployment 25.4% (2019). Turkey is hosting the highest refugee population in the world. Around 4 million refugees live in the country, of which 3.6 million are Syrian refugees under temporary protection. Around 1.1 million are of school age (primary, lower and upper secondary education), which is an additional challenge for the education system.

Turkey responded to the to COVID-19 education system closure by launching distance learning through three channels provided by the state-run Turkish Radio and Television Corporation (TRT) and Education Informatics Network (EBA). The TRT-EBA TV airs school lessons for the primary, secondary and high school students through separate channels.

The vocational education and training (VET) system is being reformed. The current system requires the student to choose a field in their 10th grade, and focus during their 11th and 12th grade on their chosen branch. There are two types of VET schools: the regular one (with 10th and 11th grades in school and the 12th grade working) and the dual one. The dual system, where theoretical training in VET school alternates with practical training in companies, is proving to be well aligned with market needs. 82% of the students get a job after completing their training and 75% of the students are hired by the employer where they worked during their apprenticeship. Students, who go only to VET schools have greater difficulties in finding employment afterwards. Turkey participates in the European Alliances for Apprenticeship (EAfA), which promotes the increased involvement of the private sector in skills matching for all levels of education.

VET education in Turkey has potential for further development. VET education can alleviate to a certain degree the high NEET and youth unemployment rates. Unfortunately, VET participation rates have been decreasing in recent years. VET is not considered to be a prestigious alternative to tertiary education. To improve mobility and attractiveness, VET students are now able to obtain an official diploma (after following an extra course), and they are eligible to sit entrance exams to tertiary education and can subsequently undertake higher education studies. Turkey has included *reform measure 19 (Updating of curricula in vocational and technical education)* in its Economic Reform Programme. This measure is one of the important measures. In line with the competences required by the sector and national vocational standards, the vocational courses and the teaching material will be revised. This is necessary to make VET training more relevant. In addition, a credited modular system based on learning outcomes needs to be implemented. This is one of the basic parameters for the implementation of Turkish Qualifications Framework. Turkey has furthermore included the *reform measure 20*: *"Supporting applications for inventions, patents and utility models useful in vocational and technical education"* in its ERP. This measure covers increasing awareness and information on intellectual property law and the practicalities of protecting intellectual creations, which would encourage innovative thinking and help Turkey transform into a knowledge economy.

Employers face sometimes difficulties in finding employees with the right profile, as there is often a mismatch in cross-cutting skills. VET competences are often not the right ones. This is due to a lack of strategic direction in VET education. Public employment services have not yet established a coherent and analytical career guidance system, which matches people with labour market needs. Women, young people and refugees in particular do get no, or not appropriate, advice and support. Last, but not least, there is no link between initial VET training and further training on the job and adult learning. This is contrasting with the ambitious goals of economic transformation in Turkey. The high and increasing rate of youth unemployment, the skills mismatch of VET graduates and the integration of a large number of migrants into the working population, mainly operating in the informal economy, need to be addressed by policies that are more sharply focused and capable of producing results in short time. Turkey addresses partially this concern and has added *reform measure 23 (Vocational training and skills development cooperation protocol (MEGİP) Project*) in the 2020-2022 ERP (see key challenge #3).

Turkey participates in the EU programme Erasmus +. The country has access to actions in the field of higher education, youth, sport, vocational education and training (VET) as well as school and adult education projects for cooperation and mobility. Turkey can also cooperate with partners outside Europe under international projects. Turkey has also continuously shown a strong commitment to EU policies in the field of education and training, for example through participation in the ET2020 Working Groups, in the implementation and monitoring of the EU priorities for VET 2015– 2020 (Riga Council Conclusions), in its commitment and pledges to the European Alliance for Apprenticeships (EAfA). As far as far as skills mismatch in higher education is concerned, the business community observes a certain further horizontal skills mismatch, as MINT (maths, informatics, natural sciences and technics) faculties do not belong to the faculties most commonly chosen by Turkish students.

Turkey has launched the education strategy 2023 which provides a comprehensive political framework for education. This is a commendable exercise, but the commitments under the strategy need sustained follow up and financing in order to ensure the desired output. According to the strategy, student and teacher curricula will be revised, learning will become more inclusive, digital skills and contents will be strengthened, the evaluation system will be reviewed and a lifelong learning system will be established. Unfortunately, the strategy touches only briefly on lifelong learning, which would merit a more in depth analysis. Jobs in Turkey face a high risk of automation. According to the World Bank, around 55% of all occupations are at risk of computerisation in the near future. People need to be helped to develop the right skills to anticipate this trend. Re- and upskilling for new jobs are therefore a necessity for high employment levels. Nevertheless, Turkey lags significantly behind most EU countries in participation of adults in education and training (Turkey 2018: 6.2%, EU-28: 11.1%). The ERP *reform measure 24 (Courses Organized for Future Professions and On-the-job Training Programmes)* is a step in the right direction (see key challenge #3).

Turkey has until now failed to address appropriately its historical problem of an unskilled labour force. This aggravates another key problem: Informal employment, addressed under key challenge #3. Lack of skills, skill mismatch and precarious and informal employment caused by the lack of skills lead ultimately to weak social cohesion and poverty.

Key challenge #2: Improving transparency and predictability in the regulatory and institutional environment affecting businesses

Restoring the confidence of businesses and investors in the Turkish economy is key for ensuring a return to sustainable growth. Economic actors in Turkey have suffered from a volatile environment over the past years. In 2019, the level of investments reached a multi-year low. Restoring business confidence and creating a positive environment will be key to stimulating domestic and foreign investments that would support a longer-term and sustainable growth path. The regulatory and institutional environment has also been affected by the introduction of the presidential system, which changed not only decision-making procedures but also the set-up and independence of new institutions for supporting economic development.

Turkey's main economic policy documents recognise the need for action. The 11th Development Plan identified key features for improving the business environment and investment climate: strong legal infrastructure, compliance with international standards, and efficient public administration. Turkey's 2020-2022 New Economy Program (NEP) announced a set of relevant actions in the areas of jurisdiction, the notary system, electronic infrastructure for services to business and one-stop-shop services for investors. However, further details on the design and timelines of these actions are not yet available. Furthermore, a Business Environment Coordination Council chaired by the Vice-President has been set up to oversee the implementation of an annual agenda of measures mostly suggested by the private sector.

The predictability and stability of the regulatory environment are important factors for business operators. Early consultations with business organisations on legislative and regulatory initiatives affecting their operations would increase the transparency of legal changes. Conducting regulatory impact assessments, for which a legal framework is already in place, would also improve the regulatory environment. The operational structures in the new government system have led to delays in preparing decisions. For instance, a new 2019-2023 Strategy for Intellectual Property Rights was announced in the government's second 100-day-plan in 2018. The Strategy was prepared by February 2019 but has still not been approved, therefore delaying its implementation.

Effective measures to further strengthen the rule of law and ensure adequate and timely contract enforcement remain a key structural challenge to improving the business environment in Turkey. The NEP indicates that specialised jurisdictions will be established in fields such as finance, energy, environment and reconstruction, and that the professional specialisation of judges would be expanded, reflecting what was announced as part of the May 2019 Judicial Reform Strategy. The NEP also announced that the notary system will be reformed and expanded to cover non-contentious cases. Work is also under way to clarify the implementation of insolvency legislation, and a number of councils and committees have been set up to look into this.

An effective, efficient and independent judicial system is crucial for creating an investment- and business-friendly environment. The dismissal and forced removal of large numbers of judges in the aftermath of the failed coup attempt and subsequent new recruitments have led to a high share (around 60%) of staff in the judiciary having little relevant experience. Positions in specialised courts for commercial issues, which were occupied by specialised judges in the past, can now be filled with 'first class' judges having minimum 10 years of professional experience in any legal domain. This has a negative impact on civil cases, where proceedings take longer due to the need to obtain external expertise.

The introduction of alternative dispute resolution mechanisms for settling commercial disputes is considered as positive development. These mechanisms have the potential to reduce the duration of proceedings from the average 2 years currently taken at commercial courts. So far, an arbitration body has been established in Istanbul, and some local bodies have been set up by chambers of commerce in Anatolia. As announced in the Judicial Reform Strategy, there is a scope to advance further with the establishment of such mechanisms, also in view of attracting more foreign direct investment.

The risk for companies to be transferred to management under the trusteeship of the Savings Deposit Insurance Fund (TMSF) has decreased. In February 2020, 848 companies with a total asset value of €9.7 billion remained under the trusteeship of the Fund, compared to 1,008 companies in November 2018. However, there is no schedule for resolving the release of all companies from trusteeship. Furthermore there is no adequate, effective and timely means of legal redress in these cases.

Specific initiatives are planned to foster private sector investments. Despite its improved ranking in the World Bank's Doing Business Index in 2019, the level of foreign direct investment in Turkey was very low. In 2020, the benchmarks for foreign direct investment in selected sectors will be updated, and the results should inform the next steps for further improving the investment climate. As stated in the ERP *reform measure 10 (Preparing new legislation for easing private sector investments)*, a new Investment Framework Law is under preparation and should be finalised in June 2020. The Law should ensure transparency and predictability for investors and improve confidence in the economy, as it will pave the way for establishing an investment ombudsman system to help settle investment disputes between the public administration and investors. Indicators for monitoring the implementation of the Law will have to be developed. Furthermore, guidelines for investment procedures in various sectors will be established to facilitate bureaucratic procedures regarding investments and raise awareness among investors, as announced under ERP *reform measure 9 (Creating guidelines for investment procedures in various sectors).* It remains unclear how this measure relates to the action listed in the NEP to create one-stop-shop services in the investment support offices under the development agencies.

The transparency of State aid and other incentives to the private sector in Turkey needs to be improved. A new unit in the Ministry of Industry and Technology is tasked with evaluating the implementation of the support programmes for SMEs provided by TÜBITAK and KOSGEB. The first results are expected in 2-3 years. To support this, a database for monitoring projects during their full cycle of application and implementation is being introduced at KOSGEB. The data will start to be evaluated in October 2020. An SME guidance and counselling system as outlined under ERP *reform measure 8 (Establishment of SME Guidance and Counselling System)* will be established, and will involve a large number of technical consultants providing services to SMEs. The measure is rolled over from the previous ERP, and its implementation has not started yet. Its impact on the business environment could be useful, assuming that these consultants would be chosen transparently and merit-based.

Economic actors in Turkey continue to be constrained by rules affecting the free functioning of markets for utilities and products. In the energy sector, legislation on energy prices stipulates that industry and commercial clients can only buy electricity at freely negotiated prices if they have a minimum annual consumption, while those with lower consumption need to buy electricity from an assigned supplier at a price set by the regulatory authority. The legislation provides that the threshold is lowered every year, and therefore the room for phasing it out more quickly.

Key challenge #3: Increasing employment, in particular of women and young people, and reducing undeclared work

The high level of unemployment is of particular concern in the ongoing economic recovery. Despite some positive developments, the labour market has been under increased stress in the recent year, with the unemployment rate (15-64) reaching a new high of 14.0 % 2019, up from 10.9 % in the previous year. The main assumption in the ERP is that the expected economic recovery resulting in particular from an industrialisation strategy supporting domestic production and innovation will be strong enough to bring back unemployment to the pre-crisis period levels, i.e. below 10%. The priorities and actions set out in the NEP 2020-2022 focus on reducing rigidities, reducing undeclared work, making work arrangements more flexible, developing and matching skills, and helping the unemployed return to work. To some extent they are reflected in the measures presented in the ERP.

Unemployment llevels remained high in 2019. Between mid-2018 and December 2019, the non-seasonally adjusted unemployment rate increased from 10.2% (June 2018) to a first peak of 14.7% in February 2019 and a second peak of 14% in August 2019. The annual unemployment rate (15-64) stood as well at 14 % in 2019. More troubling still, the youth (15-24) unemployment rate climbed steadily from 16.9% in April 2018 to 25.4% in the year 2019.

The employment rate (15-64) fell by 1.7 pps in 2019 and stood at 50.3 % compared to 52 % in 2018. While around 1 million young people reached working age, only around 100.000 persons entered the labour market. At the same time there is an outbound labour migration. Some 250.000 people left Turkey only in 2017.

The labour market performance of women is better than the general labour market trend. In fact it improved despite the economic crisis. The 2019 data indicate a female labour force participation rate of 38.7%, compared to 38.3% a year earlier. The labour force participation rate of men decreased by 0.4 pps (78.6% in 2018 gainst 78.2 % in 2019).

Government expectations for employment recovery are above past growth patterns. It would be very optimistic to expect a continued reduction of unemployment at this pace over a longer period. The ERP forecast of 1.0 to 1.2 million new jobs per year in 2020-2022, which is above the maximal performance of Turkey's growth rates in recent years (average growth rate 4.2%, labour force/employment growth around 800 000 / 700 000 persons annually).

The main labour market policy in Turkey is demand side incentives. In total 18 different incentives schemes have been put in place in recent years, in which the state covers fully or partly the social security contribution and the contribution to the unemployment insurance fund. Only a few schemes are targeted at specific categories. Around 10 million workers have been supported by the five most common schemes, which is more than half of the registered work force. The total budget of these incentives in 2019 has been TL 28.8 billion (around € 4 billion). For 2020 an increase by 10.5% to TL 31.8 billion is planned. The funds are taken from the unemployment insurance fund. Additional support schemes without specific targeting were provided in 2019 to protect jobs and create new employment opportunities.

Specific support schemes are in place to prevent employment losses and cushion minimum wage increases. Their use strongly increased in 2019, with 105 396 people receiving the short term working allowance, equivalent to one third of all beneficiaries since 2005. The wage guarantee allowance was paid to 41.535 people (30% of all beneficiaries since 2005). Furthermore, new support schemes were introduced in January 2019 to mitigate the impact of the recession on the labour market. A minimum wage support provided TL 100 per worker per month to businesses with more than 500 registered workers. A wage premium support provided up to TL 4000 for new hires during the first 3 months of work and was paid to at least 250 000 workers. Turkey should step up these measures in order to mitigate the crisis induced by the Covid-19 pandemic.

Despite the considerable funds spent on providing employment incentives, no comprehensive evaluation has been conducted so far. In the best case scenario, incentives may have contributed to the creation of 8 million jobs between 2009 and 2018, but there is no evidence available for proving the causality. According to the 2020-2022 NEP an impact evaluation of employment incentives will be conducted in order to redesign them according to needs and impact. However, no concrete plans have been prepared so far, while the long-standing incentive schemes continue to be in place in 2020. The system of collecting contributions that are part of labour costs to fund schemes to reduce labour costs may call for a critical review.

Active measures for jobseekers are mostly short term vocational or on-the-job training. The Turkish Employment Agency (ISKUR) provides vocational training courses and on-the-job training of varying length (3-9 months) for job-seekers in general, for secondary and higher education students, young people under 30 years, and mothers, as well as entrepreneurship training. There are over 600 000 participants per year in these courses and trainings. These measures are mostly not tailor-made for beneficiaries. New types of training measures have been implemented through local cooperation protocols between ISKUR and the private sector (27 253 participants in 2019) or at workplaces linked to professions in technology and IT (1 557 participants). ISKUR has also started to offer longer training programmes of up to 24 months for jobs with higher skills levels, and 80% of those who followed the programme were able to take up paid work afterwards. A public works programme for stimulating university students' labour market attachment was introduced in 2019, providing work placements for up to 3 months with a monthly compensation of around EUR 160. The measure had 20 351 beneficiaries in the first year and will be continued. Most of these measures have not been evaluated.

The provision of training courses tailored to labour market demand will be continued. The ERP includes two measures in this respect. *Reform measure 23 (the vocational trainings and skills development cooperation protocol (MEGIP) project)* will continue the public–private partnership between ISKUR and the Union of Chambers and Commodity Exchanges of Turkey (TOBB) established in 2017. It is recommendable to set targets for a gender-balanced participation in the training courses. Training programmes for future professions under *reform measure 24 (courses organized for future professions and on-the-job training*

Programmes) will continue for the target group 18-29 years, which is justified given high youth unemployment and the digital affinity of younger people. However, if the project proves successful, it would be recommendable to expand such targeted re/trainings for Industry 4.0 professions and include jobseekers aged over 30, as mid-aged and older workers are the most exposed to skills obsolescence in digital and high technology economies. The number of beneficiaries is relatively modest and could be expanded if resources are available. Workers could be also targeted in future; and financial stimulus or other type of incentives could be granted to employers that invest in the skills development of their employees in the context of Industry 4.0.

Labour market reforms will be essential to achieve Turkey's policy objective of shifting to a higher productivity economy. The current configuration of the labour market and the types of support measures in place are not sufficient to unleash the potential of the Turkish economy and its workforce. The 2020-2022 NEP includes relevant proposals, which would have to be translated into policy reforms without delay. The long overdue reform of the severance pay system is a case in point, since the current system discourages mobility and limits employers' access to skills needed for business development. The government has already identified this reform as a priority and tasked the Treasury with coordinating work with line ministries. Incentivising employment in a targeted manner, training to help people develop higher levels of skills, and a review of taxes and benefits related to labour are to be considered as further potential reform areas.

There is also an urgent need to improve the functioning of labour market institutions, in particular social dialogue. Turkey continues to have a very low private sector trade union affiliation (13.8% of registered workers) and collective bargaining coverage (11% of registered workers). Structural obstacles to unionisation persist especially in new workplaces where employers do not welcome it. The existing extension rules for collective agreements do not work, even in situations where all conditions for applying extensions are present, as currently in the banking sector. The envisaged expansion of the industrial sector should provide the opportunity to strengthen the use of collective bargaining for wage-setting.

Given the high rate of undeclared work, measures to reduce informality should continue in a more focused and comprehensive way. The Turkish government has put in place a comprehensive Action Plan for reducing the informal economy. The action plan builds on information exchanges, an awareness-raising campaign, risk profiling of sectors and on increasing tax audit and labour inspection capacities. The government has set the target of reduction of undeclared work at 28.5% by 2023, which is ambitious given the stagnation at 33-34% in recent years. An increase in inspection capacities, with particular focus on non-agricultural employment especially in the construction and service sector, and the aforementioned evaluation of employment incentives in order to identify those which have proven most supportive of formalisation are important steps. The specific situation of Syrian refugees and migrants in undeclared work may require tailor-made policy responses. For the time being the large majority of the around 1 million Syrian refugees under temporary protection are working without any social protection. Only a small part of around 100.000 persons is in formal employment. For this reason, the action plan for reducing the informal economy would benefit from addressing the specific needs of the informally working Syrian refugees under temporary protection.

The Presidential Annual Programme for 2020 includes a considerable set of actions, such as increasing the number of social security controllers, audits based on risk analysis comparing business data from relevant sources, joint inspections with the Revenue Administration and roadside inspections. More attention will also be paid to identifying undeclared work. The ERP includes parts of this package in *reform measure 11 (Reducing unregistered employment by focusing on increasing audit capacity in non-agricultural sectors)*. The planned activities are relevant and feasible but they focus mainly on the technical infrastructure for auditing. No information is provided on the necessary training for newly recruited controllers, and result indicators are not clear.

The ERP includes also two measures rolled over from 2019, *reform measure 21 (job clubs) and reform measure 22 (mother at work and child care support)*. The expansion of Job Clubs is welcome since they are the key vehicle for delivering career guidance, including intensive coaching and support for groups further away from the labour market. The steps, timeline, targets and resources are well described, but the potential risk of not having sufficient counselling staff is probably not assessed sufficiently. This should be addressed since the number of job and vocational counsellors is low given the number of registered jobseekers and employers engaged in ISKUR's related activities. It is important to assess the impact of job clubs to increase their effectiveness. The result indicators are defined clearly, however, they should be gender-disaggregated since job clubs have a good potential to increase the number of women in work. Outreach activities to help NEETs to benefit from job clubs could also be considered.

The second measure for improving the skills of women (with children up to 15 years old) in certain industrial professions is an integrated measure which has established links with job clubs. Child care support (for mothers with children aged 2 to 5) is an appropriate mechanism to help them take up vocational courses and eventually enter employment. Although the total number of beneficiaries is low compared to overall needs and potential beneficiaries, the measure is welcome and well designed with a clear flow of services and support provided (counselling, re/training) to enable these women to get a job at the end of the programme (target: at least 50%). This is a good example of combined active and passive support (activation and employment services and social/childcare benefits), and if successful, could be upscaled in the overall employment and social assistance systems of Turkey.

Box: **Monitoring performance in light of the European Pillar of Social Rights**

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 key principles and rights on equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion for the benefit of citizens in the EU. Since the 20 principles are essential for countries if they are to achieve fair and well-functioning labour markets and welfare systems, they are equally relevant for candidate countries and potential candidates.

Turkey faces considerable challenges concerning the indicators of the Social Scoreboard[1] supporting the European Pillar of Social Rights. This is notably the case for equal opportunities and fair working conditions, especially for those in informal employment. Turkey has a high rate of early school leavers (31%) and young people not in employment, education or training (NEETs, 26% for age group 15-24). In 2019, the gender employment gap was at 36.1 pps, the highest among the enlargement countries. Both the at-risk-of-poverty-rate-or-social-inclusion rates (40.8% in 2018) and the income quintile ratio (8.68 in 2017) are higher than EU-28 averages. Social dialogue has been deteriorating in the recent years.

Low participation in the labour market applies in particular to women. The labour force participation rate of women is 38.7% in 2019. A significant part of the female population never enters the formal labour market. While between 2016 and 2018 unemployment rate was already high but largely stable, it increased further in 2019 to 14% (15-64). Enrolment figures for pre-primary and primary education were low but have improved le over the years. However, the quality of education remains an issue, as indicated in the results of PISA testing.

TURKEY		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Worse than EU average, improving
	Gender employment gap	Worse than EU average, improving
	Income quintile ratio (S80/S20)	Worse than EU average, no change
	At risk of poverty or social exclusion (in %)	Worse than EU average, no change
	Youth NEET (% of total population aged 15-24)	Worse than EU average, deteriorating
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-64)	Worse than EU average, deteriorating
	Unemployment rate (% of population aged 15-64)	Worse than EU average, deteriorating
	GDHI per capita growth	N/A
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	Worse than EU average, no change
	Children aged less than 3 years in formal childcare	Worse than EU average, low data availability
	Self-reported unmet need for medical care	Worse than EU average, improving
	Individuals' level of digital skills	Worse than EU average, improving

Skills mismatch and limited reskilling opportunities limit labour market integration and mobility. Overall, education outcomes remain low. While primary education is nearly universal, there are low enrolment and high dropout rates in secondary education. Teacher training and quality is another area which requires investment.

The impact of social transfers on poverty reduction is small. It accounts for only 8.64% (EU average 33.2%).

Turkey has a well-developed system for labour market and social statistics. The Turkish Statistical Institute (TurkStat) is the main producer and coordinator of Turkey's statistical system. TurkStat publishes the Labour Force Survey (LFS) quarterly and annually and the Survey on Income and Living Conditions (SILC) annually.

[1] The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance (https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators). The 12 indicators are also compared for the Western Balkans and Turkey, with one small adjustment for the age bracket for the unemployment rate (reducing the upper age bracket to 64 instead of 74 years) due to data availability. The assessment includes the country's performance in relation to the EU-28 average (performing worse/better/around the EU-28 average, generally 2018 data are used for this comparison) and a review of the trend for the indicator based on the latest available three-year period for the country (improving/deteriorating/no change). Data from 2016-2018 are used and can be found in Annex A.

5. Overview of the implementation of the policy guidance adopted at the Economic and Financial Dialogue in 2019

Overall: Limited implementation (23.5%)[2]	
2019 policy guidance	**Summary assessment**
PG 1: Promote domestic savings by following a sufficiently tight fiscal stance over the medium term and by reducing government credit guarantees and other incentives that increase the financial leverage of the corporate sector and strictly limit them to market failures. Further incentivise net savings of the household sector.	There was **limited implementation** of PG 1. 1) **No implementation:** The budget deficit increased significantly in 2019. While the (central government) primary deficit is planned to be reduced in 2020, the planned consolidation lacks sufficient detail, especially in the outer years of the programme. 2) **No implementation**: Government policies continued to provide various incentives to the financial sector to help boost credit. 3) **Limited implementation**: Under the 11th National Development Plan, the government aims to take steps to incentivise private sector pension schemes, but no specific measures have been implemented.
PG 2: Enhance the prudence and transparency of fiscal policy by publishing a comprehensive inventory of risks to public finances stemming from Public Private Partnerships and other contingent liabilities as part of the budgetary process. Limit the accumulation of new contingent liabilities from public-private partnerships by using strict cost-benefit analyses. Prepare an options paper on introducing numerical fiscal rules and establishing an independent fiscal body.	There was **limited implementation** of PG 2. 1) **Limited implementation:** There is no publicly available inventory of risks to public finance from public-private partnerships (PPP) and other contingent liabilities as part of the budgetary process. The authorities are working on preparing a more holistic PPP report and on a new PPP legislation that would centralise projects' execution. 2) **Limited implementation**: The 11th National Development Plan indicated that the government plans to introduce a new framework regulation to ensure cost efficiency and effectiveness in PPP applications. 3) **No implementation**: There has been no initiative to prepare an option paper for the introduction of numerical fiscal rules and the establishment of an independent fiscal body.
PG 3: Focus monetary policy on the pursuit of price stability and ensure that the monetary policy stance is sufficiently tight to bring inflation back to the target band, anchor inflation expectations and increase trust in the local currency.	There was **limited implementation** of PG 3. 1) **Limited implementation:** Turkey's monetary policy stance was reasonably tight only in the first half of the year (with a real interest rate of on average 5%), but turned too loose thereafter with the real interest rate falling into negative territory by year-end. Inflation, core inflation and inflation expectations have trended down, but remained well above the target range for inflation. Deposit dollarization has increased, indicating an erosion of trust in the local currency. Increased political pressure on monetary authorities to support credit activity, and the transfer of central bank contingency reserves to the fiscal authority, additionally undermined the independence and credibility of the central bank.

[2] For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's overview and country assessments of the 2017 Economic Reform Programmes available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

Publish the methodology and specific outcomes of the next asset quality review in a more transparent and detailed way in line with international standards. Ensure that no impediments to non-performing loan resolution exist to foster the clean-up of impaired assets, and explore potential further measures in order to address risks associated with corporate foreign currency borrowing.	2) **No implementation**: The authorities undertook an asset quality review in September 2019, but did not communicate the methodology used or more specific outcomes except for the headline ratios, which lacks transparency and did not help to restore confidence in the banking sector. 3) **Partial implementation**: Meaningful improvements to the financial restructuring legislation have been made, especially regarding taxation and embezzlement, and the restructuring framework agreement has been expanded to include smaller firms. However, there is still room for improvement, including by introducing alternative restructuring tools in addition to out-of-court debt restructurings such as write-offs and debt to equity swaps, and by easing foreign purchases of bad debt. Regarding foreign currency borrowing, in 2018 the authorities imposed restrictions on the use of foreign exchange loans for companies without foreign exchange income, and this regulation remained in place in 2019, although with additional exceptions.
PG 4: With the view to improving the business environment, strengthen the rule of law and stabilise the business regulatory environment, including by improving efforts to reduce the number of companies remaining under trusteeship without jeopardising lawful process; unwinding of the measures to contain temporary financial market volatilities that might hinder the free flow of foreign currency; and reducing the share of goods in the Consumer Price Index basket for which prices are directly or indirectly influenced by the government.	There was **limited implementation** of PG 4**.** 1) **Limited implementation:** The number of companies under the trusteeship of the Saving Deposit Insurance Fund of Turkey decreased from 919 in mid-May 2019 to 847 beginning of November 2019. 2) **Limited implementation:** In September 2018, the Ministry of Treasury and Finance adopted a temporary measure which obliges exporting companies to sell at least 80% of the foreign exchange earnings to a bank in Turkey within 180 days. This measure became permanent following publication of a Decree on 31 December 2019. Turkish companies are now required to repatriate their export revenue into the country within 180 days of the actual date of the transaction. However, they are no longer requested to convert revenues in foreign currencies into Turkish lira. The provisions introduced in 2018 restricting the use of foreign currency in high value transactions (car lease and real estate) are still in force. 3) **Limited implementation:** The weight of housing, water, electricity, gas and other fuels among consumer price index main groups has decreased from 15.16% to 14.34% in the 2020 consumer price index calculations.
PG 5: Further reduce informality in the labour market, including strengthening inspection capacities, and by evaluating the impact of social security and	There was **limited implementation** of PG5. 1) **Limited implementation:** Unregistered employment increased to 36% in 2019, after having hovered around 33% for several years, and non-agricultural unregistered employment has exceeded 23%. Although official figures are not available yet, it is expected that the number of inspections conducted by the labour inspection decreased in 2019 since the regular inspection programme has been adopted with huge delay, leaving limited time to implement it. The total number of social security inspectors (including assistants) increased to 507, with 30 assistant social security inspectors recruited in 2019. 2) **Limited implementation:** Turkey has announced

tax incentives aiming to strengthen the transition to formal employment.	it is working with the World Bank to evaluate such incentives, but no outcome is available.
PG 6: Ensure full enrolment for 5 year olds in mandatory preschool education.	There was **partial implementation** of PG 6. 1) **Partial implementation:** The government's 2023 Education Vision Strategy, announced in 2018, includes providing universal preschool education for 5-year olds. However, no date has been set yet for making preschool education mandatory. In the 2018-2019 school year, enrolment in preschool education among 5-year-old Turkish citizens had reached 68.30% (the figure excludes migrants, e.g. Syrians under temporary protection). Figures for 2019/2020 have not yet been announced.
Ensure full enrolment and improve curricula in secondary education, including the provision of vocational education and training.	2) **Partial implementation**: Turkey is far from achieving full enrolment in upper-secondary education level (grades 9-12). Despite upper-secondary education being compulsory since 2012, net enrolment in the 2018-2019 school year was 84.20%. By age group, 88.22% of 14-17 year olds were enrolled in school, compared to 87.64% a year earlier.
Incentivise female labour participation by providing public and private childcare facilities and tax and social security incentives for formal employment, especially in female-dominant sectors and for part-time work.	3) **Limited implementation**: Turkey lacks a comprehensive policy framework to promote female labour participation. No incentives exist for female-dominated sectors or to promote part-time work. Indeed, part-time work is in decline: 17.63% of women worked part-time in 2018, compared to 24% in 2013. About 2.7 million Turkish children aged 3-5 do not benefit from any form of centre-based early childhood education and care, with a wider gap in terms of service availability in large urban areas. To reach the OECD average, approximately 42,388 new childcare facilities would be needed at the current average rates of enrolment per facility in the country.

6. Assessment of the areas and structural reform measures included in the 2020-2022 ERP

Energy

The share of Turkey's renewable energy is significant. Some 34% of electricity was generated from renewable sources in 2019, and renewables accounted for 47% of the total installed power capacity in 2018. A Presidential Decree issued in 2019 introduced changes in the scope definition of renewable energy installations, rendering it impossible for renewable energy installations of capacity under 5 MW to receive state incentives, such as preferential feed-in-tariffs and some tax exemptions.

Measure 1: Increasing share of renewable energy regarding electricity generation

The reform measure has two main components: the preparation of new legislation for a renewable energy support mechanism modelled on the renewable energy resources zone (YEKA) in place so far; and its implementation with tenders in 2021 and 2022. The measure is relevant as such; however, without detailed information about the envisaged energy support mechanism, a precise assessment cannot be provided at this stage. Concerns remain regarding the local-content requirements applied so far, since they affect the EU and other international companies' access to tenders in the renewable energy sector in Turkey.

On energy efficiency, a new legal obligation was introduced by a decree requiring public buildings to save at least 15% of their energy bill compared to the building's calculated average consumption over the last 3 years. Turkey's policies on energy efficiency in buildings are well developed and aligned with EU directives. Any gaps are related mainly to insufficient detail as regards targets, standards and implementation methodologies. This applies in particular to green buildings, sustainable buildings and nearly zero-energy buildings.

Measure 2: Development of financial mechanisms regarding energy efficiency

The measure is relevant since it will support the ongoing implementation of the National Energy Efficiency Action Plan. The Plan has seen some progress, but a financing mechanism is still not in place. So far, international donor funding and concessional debt are still the main means of funding the urgently needed energy efficiency projects across the country.

Transport

Turkey's transport sector is heavily reliant on road transport, with little diversification in other transport modes such as rail. A large programme of track renewal and network modernisation is being completed after a long period of neglect. The rail sector liberalisation is ongoing.

Measure 3: Turkish railway transport liberalisation

The measure has been rolled over from the two previous years, with 2020 being the final year for implementation. The ERP fails to present in detail the scope of the measure and gives no information on the expected impact on competitiveness, on social outcomes (employment, poverty reduction, equality and gender) and on the environment. There is no information about the cost of the activities and the source of financing, or an assessment of potential risks and result indicators.

Agriculture

The ERP identifies the need to change the legislation on agriculture statistics in order to enable agricultural holdings to provide data on a mandatory basis rather than voluntary basis. In the EU's common agriculture policy, only participation and provision of data for the Farm Accountancy Data Network System (FADN) is voluntary, but not statistical data collection. The FADN system has been established in Turkey since 2009 and is currently used in 81 provinces. However, the data collected through FADN are used for different purposes, particularly for determining and monitoring the annual agricultural incomes of enterprises and measuring their performances, and they are confidential. The ERP refers to the need for a legislative change from a voluntary system to a mandatory one, however the FADN cannot be mandatory.

Measure 4: Improvement of data collection processes and increasing the capacity of evaluation in agriculture statistics

The measure aims to develop a new architecture and data collection and evaluation methodology together with Eurostat. This is as such fully relevant, and seems to continue the measure included in the previous ERP for "Agricultural statistics improvement in data collection processes and evaluation capacity enhancement". However it remains unclear whether the data collection methodology that was determined in 2019 is consistent with EU law. The main activity under the new measure is statistical and practical training for administration staff in headquarters and districts. The number of training sessions is indicated as one per year, which may not be sufficient.

Services

The further expansion and diversification of tourism in Turkey is one of the priorities of the 2020-2022 New Economic Programme for restoring sustainable growth and increasing employment. In spite of the already strong performance of the tourism sector, the average expenditure per person remains very low, and there is still a largely untapped potential in the tourism sector.

Measure 7: Increasing tourism market share and brand value

The measure is relevant and in line with policy priorities. This measure has been rolled over from the previous ERP, but its scope has improved significantly, with more detailed information on planned activities, result indicators and expected impacts. However, no resources have been allocated to it, claiming that implementation does not incur additional costs. Since the measure aims to diversify the types of tourism, it would also be important to develop a strategic approach to developing sustainable tourism, including an assessment of the expected impacts on the environment.

Research, development and innovation

Turkey's new Industry and Technology Strategy has set ambitious targets for increasing expenditure on R&D to 1.8% and for increasing full-time-equivalent staff in R&D to 300,000 by 2023. Although there was some progress in 2018, the gap between actual figures and the 2023 targets remains significant, as does the gap with the EU-28 averages.

Turkey remains a 'moderate innovator' according to the European Innovation Scoreboard for 2019. In 2018, there was as significant increase in innovation performance, mainly due to the number of innovators, the amounts invested by firms and an innovation-friendly environment. Structural challenges persist in the low share of employment in high-tech manufacturing and knowledge-intense services as well at the limited inflow of foreign direct investment. To raise the export capacity of Turkish SMEs, Turkish priorities would need to be aligned to concepts such as the digital single market and smart specialisation.

Measure 11: Supporting competent research infrastructures on a performance basis within the new legal framework

The measure is in line with the 11th Development Plan and the implementation has been started with four research centres, and further implementation should result in 13 research centres being supported in total. The measure is a welcome contribution to reaching the R&D targets.

Measure 12: Increasing the number and efficiency of business development, incubation and accelerator centres in order to support innovative entrepreneurship

The measure is in line with the latest Industry and Technology Strategy. One of the expected impacts of this measure is that enterprises will begin a digital transformation process. The measure does not propose mechanisms for financing SMEs' digital transformation.

Measures 13a and 13b: Enhancing the R&D and innovation activities of SMEs

The measure includes two sub-measures. The sub-measure for 'Prioritizing technological product investments to increase the technology level and export capacity of SMEs and supporting the commercialization of R&D projects' (M13a) is not clear as regards the indicator of 60 new medium-high and high technological products commercialised as of now. Although more target oriented policy tools and smart specialisation are referred in the analysis, the measure itself does not include anything specific on smart specialisation.

The sub-measure for 'Enhancing the R&D and innovation activities of SMEs; and the development and implementation of mechanisms to encourage and facilitate technology-based and innovative SMEs access to finance, participation in mentoring and cooperation networks' (M13b) is extended with the contribution of TÜBİTAK, which is welcome.

Digital economy

Digital technologies are the most important factor in future economic growth. Research shows that adoption of digital technologies will account for about 60% of potential productivity increase by 2030. This holds true for Turkey: automation, AI, and digital technologies have the potential to boost the country's economy. It is therefore important to understand the opportunities and challenges regarding the future of work and to prepare the Turkish workforce for the upcoming transformation.

Measure 6: Establishing model factories

The measure on SME competency and digital transformation centres and innovation centres aims to create 10,000 jobs by 2022 following the establishment of 14 model factories, which will be non-profit companies created through public-private partnerships. It is not clear from the presentation of the measure why and how non-profit model companies would create this number of jobs. The measure is considered to be gender-neutral, but there are various aspects with a gender dimension (such as equal access to education on digital skills, women's lower participation in digital professions, and opportunities from digital work for working from home).

Trade

Measure 15: Update of the Turkey-EU Customs Union

The ERP presents again the prospective modernisation of the Customs Union as a trade-related 'reform' measure. However, the purpose of the ERP is to present measures which Turkey will implement on its own.

Education and skills

Education and skills and the relevant reform measures 16, 17, 19, 20, 23 and 24 are analysed above in section 4 under key challenge #1.

Employment and the labour market

Employment and the labour market and the relevant reform measures 11, 21, 22, 23 and 24 are analysed above in section 4 under key challenge #3.

Social protection and inclusion

The risk of poverty and income inequalities have been increasing. According to the official Income and Living Conditions Survey for 2018, Gini coefficient was 0.408 with an increase of 0.003 points compared with the previous year. P80/P20 rate rose from 7.5 to 7.8. These two figures indicate that income inequality has slightly increased and remained structurally higher than the EU average. The at-risk-of-poverty-rate[3] was 21.2% with an increase of 1.1 pps. compared to 2017.

Measure 25: Increasing the scope of the Social Assistance Plus (+) and Family Social Support Program (ASDEP) and enhancing the accessibility of other programmes

The measure is designed to increase the social protection of poor people while establishing a link between social assistance and social protection services. However, it showed limited progress. It is relevant and important to provide supply driven social services, but this measure is so ambiguous that it seems to have a limited impact on poverty and social exclusion. The measure continues to reflect several deficiencies mentioned in last year's assessment, which explains very limited progress in the field of social services and assistance. The link between Social Assistance Plus (+) and ASDEP is not clear. The measure does not include any activity to increase the quality of services delivered by ASDEP staff. The measure does not include initiatives to address gender equality. The resources allocated and the indicators do not give the impression that this measure will contribute significantly to ensuring inclusive social protection and to reducing poverty.

Measure 26: Dissemination of family-oriented social services models

The measure, which aims at increasing the number of children benefiting from SED and foster care, should reduce poverty. However, the activities involved are not defined clearly. There is a need to provide social services for the beneficiaries of the SED, as mentioned in the 11th Development Programme; but it does not provide for any activity to achieve that aim. Providing only financial support is not enough to ensure social protection of children. The families of children could also benefit from active labour measures as well as social services. There is an urgent need to increase complementarity and cooperation between social assistance and social services for children. There is also a need to have an updated impact assessment of the SED programme to evaluate its aim, selection criteria and results. The link between the SED programme and ASDEP should be clear. The estimated cost has been indicated in the central budget.

[3] According to the poverty threshold set at 60% of median equalised household disposable income.

ANNEX A: OVERVIEW OF THE MAIN INDICATORS PER AREA/SECTOR OF THE ECONOMY

Area/Sector	2018	2017	2016	EU-28 Average
Energy				
Energy imports dependency (net imports /consumption, %)	N/A	77.2%	75.5%	55.1% (2017)
Energy intensity: Kilogrammes of oil equivalent (KGOE) per thousand euro GDP	159.58	166.57	166.30	117.69
Share of renewable energy sources (RES) in final energy consumption (%)	13.7%	12.8%	13.7%	17.98%
Transport				
Railway network density (meters of line per km^2 of land area)	N/A	N/A	13.3	49.9 (2016)
Motorization rate (passenger cars per 1000 inhabitants)	N/A	151	N/A	507 (2017)
Agriculture				
Share of gross value added (agriculture, forestry and fishing)	6.5%	6.9%	7.0%	1.6%
Share of employment (agriculture, forestry and fishing)	18.4%	19.4%	N/A	4.0%
Utilised agricultural area (% of total land area)	N/A	48.7%	N/A	40.0% (2017)
Industry				
Share of gross value added	24.9%	23.3%	22.3%	19.1%
Contribution to employment (% of total employment)	19.7%	19.1%	19.5%	17.3%
Services				
Share of gross value added	60.6%	60.1%	61.0%	73.8%
Contribution to employment (% of total employment)	54.9%	54.1%	53.7%	71.9%
Business environment				
Rank in WB Doing Business (Source: World Bank)	60	69	63	N/A
Rank in Global Competitiveness Index (Source: World Economic Forum)	61	53	51	N/A
Estimated share of informal economy in GDP (as % of GDP) (Source: IMF)	N/A	N/A	Up to 29.6%	
Research, development and innovation				
R&D intensity of GDP (R&D expenditure as % of GDP)	N/A	0.96%	0.94%	2,12%
R&D expenditure – EUR per inhabitant	N/A	90.8€	93.6€	656.5€
Digital economy (TBC)				
Percentage of broadband penetration (mobile and fixed) [NB: households]	82%	78%	73%	86%

Share of total population using internet [NB: population 16-74]	71%	65%	58%	85%
Trade				
Export of goods and services (as % of GDP)	29.5%	24.8%	22.0%	46.2%
Import of goods and services (as % of GDP)	30.6%	29.3%	24.9%	43.0%
Trade balance (as % of GDP)	-5.4%	-6.9%	-4.8%	
Education and skills				
Early leavers from education and training (% of population aged 18-24)	31.0%	32.5%	34.3%	10.5%
Youth NEET (% of population aged 15-24)	24.4%	24.2%	N/A	10.5%
Formal child care - children aged less than 3 years (% of total)	N/A	N/A	N/A	35.1%
Individuals' level of digital skills (% of individuals aged 16-74 who have basic or above basic overall digital skills by sex)	N/A	34%	28%	57% (2017)
Employment				
Employment Rate (% of population aged 20-64)	55.6%	55.3%	54.4%	73.2%
Unemployment rate (% of labour force aged 15-64)	11.1%	11.1%	11.1%	7.0%
Gender employment gap (difference between the employment rates of men and women aged 20-64)	40.8%	41.6%	42.3%	11.6%
Social protection system				
% of population at risk of poverty or social exclusion	N/A	41.3%	45.1%	21.9%
Impact of social transfers (other than pensions) on poverty reduction	N/A	8.64%	7.69%	33.2%
Self-reported unmet need for medical care (of people over 16)	N/A	2.6%	3.8%	2.0%
Income quintile share ratio S80/S20 for disposable income by sex and age group (comparison ratio of total income received by the 20% with the highest income to that received by the 20% with the lowest income)	N/A	8.68	8.65	5.17

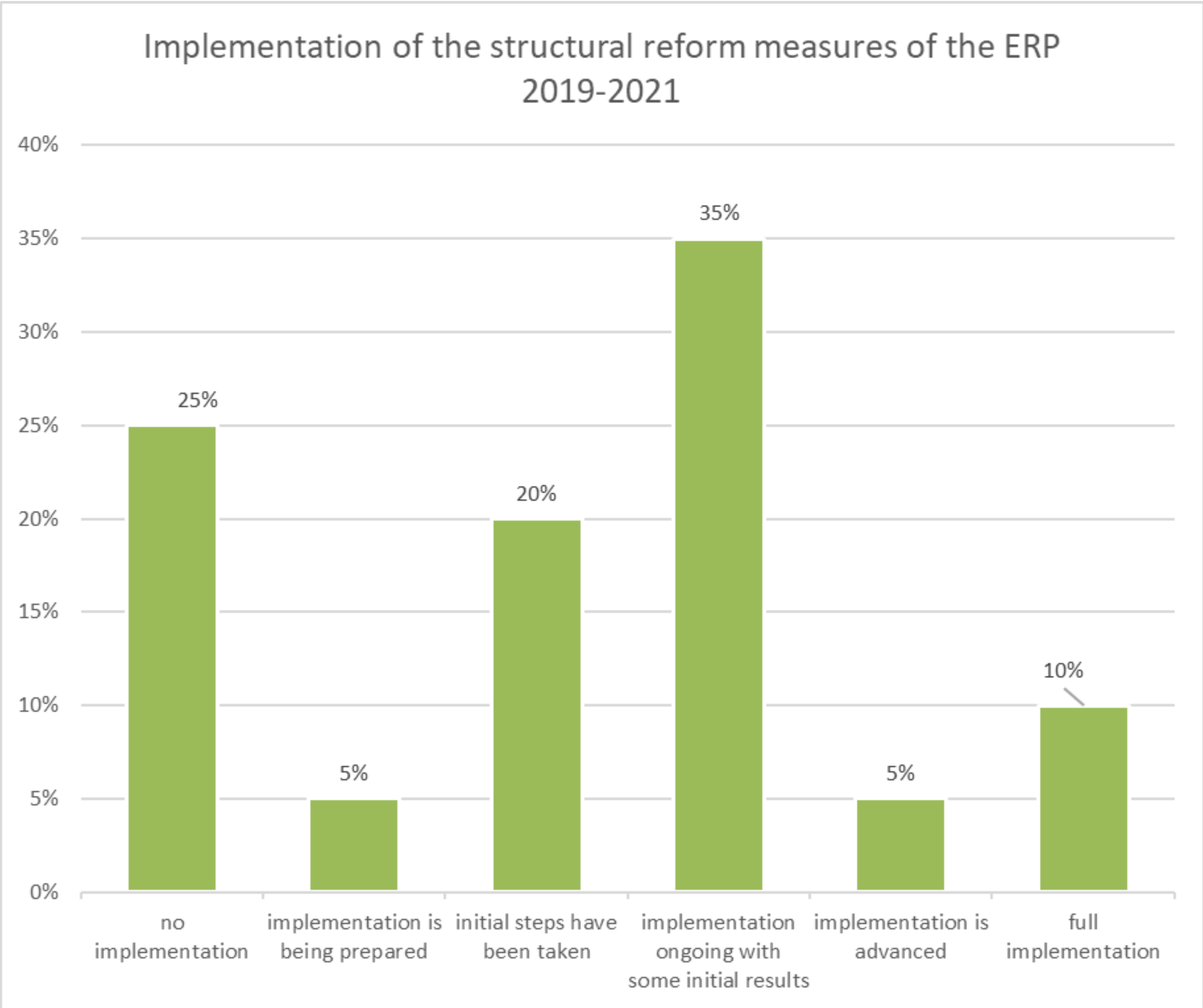
Source: EUROSTAT, unless otherwise indicated.

ANNEX B: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM THE 2019-2021 ERP

The average score for implementing the measures in 2019 is 2.0 out of 5. Since Turkey did not report on the implementation of measures in 2018, progress compared to the previous year has not been assessed. The score of 2.0 is impacted by the fact that Turkey abandoned 5 of the 20 measures included in the 2019-2021 ERP, because it considered them irrelevant and had not started implementing them.

Turkey's reporting on the activities carried out varies in detail and required further research by the Commission. As scores were missing for the five abandoned reforms, these have been calculated by the Commission. To provide a fair picture of the level of implementation, some adjustments to the scoring of activities were made for three other reforms, based on the description of the implementation and explanations presented in the ERP and the Commission's own research.

Implementation has been stronger for some measures, such as measure 3 on railway transport and measure 14 on supporting research infrastructure. Implementation has been weaker for other measures, such as measure 4 on improving agriculture statistics. Implementation was particularly weak for measure 20 on the Social Assistance Plus scheme.



ANNEX C: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The 2020-2022 Economic Reform Programme was formally submitted to the Commission on 10 February 2020 with one week's delay. Overall, adherence to the Commission Guidance Note has improved.

Inter-ministerial coordination

The central coordination of the ERP has been under the Presidency of Strategy and Budget since 2019. Each line ministry provided the respective ministry's inputs to the ERP coordinator. The proposed measures for the new ERP were discussed in a workshop held by the Presidency of Strategy and Budget with the ERP coordinators. Afterwards, the ERP coordinator, when deemed necessary, got in touch with the different line ministries and relevant institutions to request additional input. The preparation of the macroeconomic part of the ERP was led by the Presidency of Strategy and Budget on the basis of contributions from relevant institutions in the period December 2019 to January 2020.

Stakeholder consultation

The ERP is based on the 11th Development Plan (2019-2023) approved by the Turkish Parliament on 18 July 2019. Furthermore, it was prepared in line with the 2020-2022 New Economy Programme and the 2020 Presidential Annual Programme, which are both implemented upon Presidential Decision. The Development Plan was developed in a broad consultation process with stakeholders and experts, involving working groups and ad-hoc committees. However, the reports established by the working groups have not been made public. No specific consultation of external stakeholders on the draft ERP took place and no draft was made available to the public before its adoption.

Macroeconomic framework

The chapter on the macroeconomic framework broadly follows the outline of the guidance note. It succinctly covers nearly all of the required elements with one important exception – it does not present an alternative scenario. This omission is a major drawback, especially in view of the high domestic and global uncertainty. The macroeconomic section would have benefited from making stronger links to fiscal and monetary policy and macro-relevant structural reforms. The presentation, thus, could have been more coherent and convincing.

Fiscal framework

The structure of the chapter on the fiscal framework closely follows the guidance note. It covers nearly all major elements but fails to provide any detail on the major fiscal policy measures and their estimated budgetary and economic impact. The section on contingent liabilities does not cover all sources of liabilities in a systematic way. The section on public finance risks could be further developed and elaborated. The fiscal framework chapter also does not always present a sufficiently clear link with the macroeconomic scenario and with the major structural reforms agenda. The systematic use of budgetary statistics at different levels of government could be improved as well.

Structural reforms

The structural reform priorities section improved. Reform measures are better specified than last year, although the quality of these measures in terms of description, timeline, estimated impact and risks and key performance indicators could be improved. The maximum number of reforms (20) and the page limit (40) are not respected. Section 6 on budgetary implications of structural reforms is again completely missing. Table 1c in incomplete, tables 1f (external sector developments), 1g (sustainability indicators), 3 (general government expenditure by function), 7 (contingent liabilities) and 9 (selected employment and social indicators), as well as Annex 2 on the external contributions to the ERP were not submitted.

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