**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

STRATEGY FOR TURKEY

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EXECUTIVE SUMMARY

Turkey is committed to the principles of multiparty democracy and pluralism in accordance with Article 1 of the Agreement Establishing the Bank. There has been progress in the application of these principles in some areas, whilst further efforts are needed in others.

Over the last strategy period Turkey has taken steps towards guaranteeing rights of its diverse communities, including by initiating a democratic opening with the Kurds, strengthened civil-military relations and improved state capacity to address human rights concerns. At the same time, additional steps are needed to further strengthen the independence of the judiciary, freedom of the media and the internet and reinforce the government's commitment to fight corruption.

Economic activity moderated to 2.9 per cent in 2014, and financial markets remained volatile and vulnerable to shifts in global sentiment. Nevertheless, drivers of growth have become more favourable, with net exports taking over as the main driver of growth following a sharp depreciation of the lira at the turn of 2014. In 2015, the positive impact of lower oil prices on growth will likely be offset by continuing weakness in external demand and developments in the euro-dollar exchange rate, affected by the diverging monetary policy between the Fed and the ECB. While higher cost of financing on the back of Fed tightening is likely to limit private consumption, net exports may benefit from better-than-expected growth in the Eurozone, resulting in economic growth of around 3 per cent in 2015 and 2016. In the years ahead, growth is expected to gradually recover towards an average of 4.5 per cent, reflecting a healthy long-term growth potential in Turkey. Nevertheless, sustaining these growth rates will necessitate continued and increasingly sophisticated structural changes and institutional improvements.

Structural reforms have been ongoing in several areas, but more needs to be done to reduce energy dependence, improve regional infrastructure and foster competitiveness in the corporate sector. The major part of the Turkish current account deficit comprises the energy import bill, which in 2014 stood at US$54.9 billion, or 6.9 per cent of GDP. The renewable energy sector has over recent years attracted intense policymaker and investor interest. Despite some initial delays, the electricity distribution grids are now fully privatised, but the public sector still has a share of 33.4 per cent in electricity generation. Meanwhile, regional economic disparities have highlighted the need for more regional investments coupled with fiscal decentralisation. Investment planning for local infrastructure (water and public transport) still remains highly centralised and delivery of capital investments is slow.

The uneven pace of reform and level of development across sectors and regions, together with Turkey's substantial infrastructure needs, and the country's systemic importance as a gateway between Europe, Central Asia and the Southern and Eastern Mediterranean, offer large opportunities for the Bank to deepen its engagement. Focusing on areas where there is most reform appetite and market demand, leveraging its core capabilities, further honed by in-country experience, and complementing other IFIs' activities, the Bank will seek to address the breadth and diversity of Turkey's pressing transition challenges through the following strategic priorities:

- **Enhancing energy security and sustainability by supporting sector reform, promoting energy efficiency and renewable energy:** With a rapidly growing economy, Turkey has become one of the fastest growing energy markets in the world, but the country remains highly dependent on energy imports, with 92 per cent of oil consumption and 98 per cent of gas consumption imported, mainly from Russia, Iran, and Azerbaijan. In order to strengthen the country's energy security, the authorities have sought to diversify energy routes and source countries, increase the share of renewables, as well as take bold measures to increase energy efficiency. Nevertheless, despite some notable progress toward liberalising the energy markets, attracting strategic investors to the renewable energy sector remains challenging. Improvements in institutional capacity and public awareness are also needed to further promote energy and resource efficiency. In that context, the Bank will continue to work with the authorities on enhancing the investment climate in the renewable sector and thus attract more private sector investment, particularly FDI. The Bank will also support further liberalisation in the power and natural gas sectors, and continue to support energy efficiency projects through direct and intermediated investments.

- **Improving the quality of infrastructure via commercialisation and private sector participation:** Around 70 per cent of Turkey's population lives in urban areas and this number is expected to grow to 80 per cent by 2030. However, lending to mid-sized and smaller municipalities remains difficult. Generally, those municipalities have not undertaken commercialisation and corporatisation-based reforms of their key utilities, and remain very dependent on concessional State finance. Therefore, the Bank will concentrate on creditworthy metropolitan municipalities, with a particular focus on second-tier metropolitan cities to support improvements in governance structures and financial management through its investments and policy dialogue. In larger metropolitan areas, the Bank will selectively promote corporatisation of municipal services and concessions. Outside the municipal sector, the sheer magnitude of Turkey's national infrastructure needs (US$350 billion between 2014 and 2018), coupled with the government's desire to limit its borrowing and debt, will require the increased utilisation of PPP structures. Where it is additional, the Bank will support the mobilisation of private capital for the development of motorways, ports, regional airports, hospitals, railways and other areas providing key utilities.

- **Scaling up private sector competitiveness through innovation and improved corporate governance:** Over the past decades, Turkey's competeveness has been mostly built on a relatively low cost of labour. As the country is now approaching the high income level, future competitiveness will have to be increasingly addressed through efficiency improvements stemming from better corporate governance and use of innovation. Turkey's business sector is highly fragmented, ranging from a myriad of micro, informal, low productivity firms to a growing segment of modern, high productivity enterprises. The productivity of MSMEs varies tremendously, and most of the labour force is concentrated in the low-productivity end with under-developed management skills and informal business practices. At the same time, there is still a great potential for medium-sized companies for further integration into global supply chains, which will require a more favourable business environment for FDI (at present, foreign investors often prefer to enter into joint ventures with local partners when entering the Turkish market). The Bank will therefore seek to support high-quality FDI, in particular projects enabling further integration into global value chains and technology transfer. Alongside this, support will be provided to local enterprises which have actively tapped the skills base in Turkish universities and in engineering companies in order to enhance levels of innovation and productivity. Through its investments, the Bank will also promote improvement in corporate governance, sustainability standards and operating practices. Lastly, the Bank will seek to support the ecosystem providing seed and growth capital to Turkish entrepreneurs.

- **Promoting regional and youth inclusion, as well as gender equality, to support long-run growth potential:** As a result of broad-based industrial development and massive job creation throughout the country, growth became more inclusive in the 2000s and income gaps between regions have narrowed. Nevertheless, there is still a lack of opportunities to move into formal salaried jobs in the poorer regions. In addition, female labour participation at 31 per cent remains one of the lowest in the OECD and the Bank's region of operations. Youth access to education, training opportunities and financial services continues to lag behind more developed economies. The high share of the informal sector (40 per cent of employment) contributes to entrenching inclusion issues, which in turn constrain the country's growth potential. The Bank will continue to invest in projects across sectors and pursue policy dialogues which promote inclusion and equal opportunities to access services, employment and finance for both men and women across the country with a particular focus on the more remote regions, and on youth. The Bank will be well positioned to scale up its activities in the southeast of the country with the 2014 opening of the new RO in Gaziantep.

- **Deepening capital and local currency money markets:** For some time Turkey has been experiencing a relatively low domestic savings rate which increases its dependence on foreign borrowings. This causes investment decision-making to be dependent to a degree on capital inflow cycles and external conditions, thus contributing to volatility of investment and GDP growth. Wider availability of equity capital and long term financing remain critical for Turkey's private sector development, as well as for the implementation of its ambitious infrastructure investment plans. The Bank will therefore continue to support long-term investors such as pension funds, asset management or insurance companies as well as fund managers in raising capital. Through investments in the bond and equity markets, the Bank will seek to demonstrate the benefits of capital market financing and support the introduction of new instruments, paying particular attention to facilitating access of SMEs and mid-caps to capital markets, and to act as a catalyst for international investors.

1 OVERVIEW OF THE BANK'S ACTIVITIES

1.1 The Bank's current portfolio

Private sector ratio: 96 per cent, as of 30 August 2015

Sector Group	Sector Team	Portfolio no of operations	Portfolio (€m)	% Portfolio	Op Assets	% Op Assets
Energy	Natural Resources	1	34	1%	17	0%
	Power and Energy	8	626	12%	263	7%
		9	**659**	**13%**	**280**	**8%**
Financial Institutions	Depository Credit (banks)	41	1,722	34%	1,465	39%
	Insurance, Pension, Mutual Funds	4	53	1%	53	1%
	Leasing Finance	2	106	2%	106	3%
	Non-depository Credit (non-bank)	11	276	5%	269	7%
		58	**2,157**	**43%**	**1,893**	**51%**
Industry, Commerce & Agribusiness	Agribusiness	15	285	6%	273	7%
	Equity Funds	19	234	5%	105	3%
	Information & Communications Technologies	6	128	3%	106	3%
	Manufacturing & Services	18	515	10%	515	14%
	Property and Tourism	0	0	0%	0	0%
		58	**1,162**	**23%**	**998**	**27%**
Infrastructure	Municipal & Environmental Infrastructure	11	514	10%	206	6%
	Transport	12	539	11%	348	9%
		23	**1,052**	**21%**	**554**	**15%**
Summary		**148**	**5,031**	**100%**	**3,726**	**100%**

Source: EBRD

1.2 Implementation of the previous strategic directions

In the current strategy period, the Bank has operated in Turkey on the basis of the Country Strategy approved in April 2012 (BDS/TK/12-1-Rev 2), with the following priorities:

- Support for the private sector participation in renewable energy and efficient power production as well as the development of energy efficiency instruments across economic sectors;
- Increasing availability of risk capital and long term funding to the micro, small and medium-sized (MSMEs) enterprise sector, especially in the less developed regions;
- Enhancement of the competitiveness of Turkish industry in a broad range of industrial and service sectors with a particular focus on agribusiness, energy efficiency, innovation and high value added industry, sector value chains and companies operating outside metropolitan areas;

- Promoting reform and supporting a secure and efficient delivery of vital utility services to the population and enterprises in the regions of Turkey on a non-sovereign basis; and
- Support for the Turkish government's privatisation programme in the enterprise and financial institutions sectors.

Since the start of operations in 2009, the Bank has signed 157 projects for a total value of €6.1 billion, including €4.2 billion through 111 projects during the 2012–2015 strategy period. As of end August 2015, the private sector share of EBRD investments accounted for 96 per cent of the total Turkey portfolio.

EBRD has had a strong impact in promoting sustainable energy financing, which represented 43 per cent of the Bank's business volume (2012-2014), through a variety of lending instruments and policy dialogues. The Bank supported several high profile renewable energy projects (in particular wind, hydro and geothermal) with the private sector. These include the two largest windfarms and largest geothermal plant in Turkey, as well as mid-size investments under a credit framework with selected commercial banks (MidSEFF, €1 billion disbursed). Additional projects in this area include the highly successful SME energy-efficiency and small scale renewable energy credit lines (TurSEFF I and TurSEFF II for an aggregate amount of €530 million mobilised), the new Residential Energy Efficiency Financing Facility (TuREEFF for €350 million), and a number of industrial energy efficiency projects. These projects have allowed Turkey to reduce its emissions by 5.6 million tonnes of CO_2 equivalent per year (1.5 per cent of Turkey's total emissions in 2011) and to save 1.5 million tonnes of oil equivalent per year (1.5 per cent of Turkey's primary energy supply in 2011). On the policy dialogue front, following the signing of the Turkish Sustainable Energy Action Plan (SEAP) between the Turkish Treasury and the EBRD in 2011, good progress has been achieved in numerous areas highlighted in the action plan as key priorities. For example, the Bank has developed in collaboration with the Ministry of Energy and Natural Resources (MoENR) a National Renewable Energy Action Plan (NREAP), published in February 2015, which harmonises relevant policies with European Union (EU) directives and outlines the long-term trajectory for the renewables market in Turkey, thereby providing investment and planning security. The Bank has also undertaken market assessments, provided to the Government for the purpose of policy making, covering the potential for bio-energy investment and geothermal power capacity development, which have been the base for EBRD financial products development.

Enhancing access to finance for MSMEs has remained one of the key strategic priorities for the Bank in Turkey. The Bank's additionality stems largely from the limited access local banks have to longer-term funding resources and from the EBRD's expertise in supporting SMEs and energy efficiency-related investment. EBRD designed several credit lines with commercial banks targeted at SMEs in the underserved regions and in agriculture, energy efficiency projects and women-led enterprises, each backed by tailor-made technical assistance programmes, funded mainly by the EU. Those financing frameworks have proved especially successful in encouraging partner banks to step up financing in previously underserved segments, in particular in agriculture and energy efficiency. Those lending products are now being mainstreamed in the banking sector. The Bank also invested in several regional and Turkey-dedicated private equity funds. Most of these are still in the early stage of their investment cycle with work to do before close assessments can be made of their success.

In the corporate sector, the Bank completed a large number of transactions, some with high profile clients (e.g. Ford Otosan, Şişecam, Keskinoğlu, Tiryaki), supporting technical innovation, resource efficiency investments, FDI-driven importing of expertise, enhanced corporate governance, more efficient production and logistics approaches in the agriculture and agribusiness sectors, as well as growth of mid-sized companies in the south and east of Turkey. Small Business Support (SBS) operations have been strengthened and continue to focus on the less-developed parts of central and eastern Anatolia, with the ability to deliver in this regard enhanced through the operation of the 2014-opened RO in Gaziantep. Ninety per cent of companies benefiting from SBS advice have increased their turnover, with a median increase of 25 per cent and 74 per cent having seen significant job creation.

In the infrastructure sector, the Bank had a significant impact in promoting innovative private sector-led solutions for infrastructure financing, through investment and policy dialogue. EBRD played a key role in highly visible projects with strong demonstration effects, such as the Eurasia Tunnel in Istanbul (Turkey's first Direct Agreement and Debt Assumption Agreement which has been used as a template for later Build–Operate–Transfer projects) and the Mersin International Port Eurobond, the first ever infrastructure bond in Turkey, which has attracted interest for other infrastructure investment in the country. The Bank also worked closely with the Ministry of Health to help refine its approach to contracting under public–private partnerships (PPPs) for the provision of public healthcare infrastructure, which successfully improved the bankability of future healthcare PPP projects and paved the way for further engagement by IFIs and other international banks.

Financing municipal projects continues to be challenging. Generally, the mid-sized and smaller municipalities have not undertaken commercialisation and corporatisation-based reforms of their key utilities. However, the Bank has played a key role in supporting and facilitating the privatisation of both gas and power distribution companies in mid-sized cities, in addition to supporting the introduction of energy efficient public transport systems. Substantial investment needs exist in Turkey's infrastructure sector, offering ample opportunities for the Bank to engage and promote sustainable and commercial financing solutions, including through support to foreign direct investment (FDI) with strong experience in infrastructure investment under PPP structures. Within the Government, financial and business communities, the Bank is now recognised as having strong expertise in infrastructure financing under private sector-led approaches.

1.3 Key lessons learnt

Six years of active engagement in Turkey have provided pointed lessons in the key differences between the operating environment in this new, large country of operation and the environments of the Bank's traditional countries of operations. Interactions with key government officials, as well as with other international financial institutions (IFIs) with much longer experience in Turkey, and with a business community that has been historically entrepreneurial-minded, have required an adjustment in the Bank's traditional approach. The relatively wider availability of commercial finance in Turkey and more competitive pricing environment relative to most of the Bank's other countries of operations have also been important challenges to business development. These initial years of operations have allowed banking teams to identify a broad range of areas where long-term finance is still lacking and to refine their communication of EBRD's value-added beyond its pricing and tenor, ensuring that projects brought forward have a clear additionality case and adequate risk-return terms. These adjustments have been made whilst, at the same time, continuing to educate the market on the Bank's distinctive principles of building a portfolio based on the key pillars of transition, sound banking standards and additionality.

The Bank's credibility for undertaking policy dialogue has taken time to develop, particularly given the long-standing engagement of IBRD, IFC, IMF and other institutions such as KfW and AFD in Turkey. However, leveraging those lessons learnt and the Bank's extended regional presence (including the recent relocation of EBRD's regional economic team to Istanbul and the Ankara and Gaziantep offices), EBRD is now well-placed to better support its investment activities through more intense and higher level policy dialogue, centred on sustainable energy, PPP regulatory frameworks, development of capital markets, institutional reforms in strengthening of infrastructure, and encouraging approaches toward a long-term rationalisation of agriculture incentives.

Equity investments represent a lower share of the portfolio than expected (currently 13 per cent of portfolio), in spite of the continued deployment of the Local Enterprise Facility (LEF) to support broad-based capability for developing and executing equity and quasi-equity investments. This can be partly explained by the underdeveloped culture for accepting outside equity, in particular within family-run businesses, in spite of the relatively advanced state of the corporate sector in Turkey. This is a challenge for both the Bank's direct investments and the private equity industry in general. Overcoming this challenge is critical, as bringing experienced outside equity investors is widely recognised as an effective channel for corporate governance improvements. Therefore, lessons learnt in this area – including the need for exhibiting clear demonstration effect of the value that can be added from the Bank's participation in the equity of a broad range of enterprises – need to be actively resourced and applied. In fact, the enhanced profile developed within the corporate sector by EBRD over recent years, the manner in which the Bank's private equity portfolio is developing and the publicity given to the Banks's acquisition of a minority stake in glass products manufacturer Paşabahçe during Q3 2014 have resulted in a significant growth in the current pipeline of equity investment projects. These elements, combined with the recent and ongoing strengthening of the equity investment resources and approaches Bank-wide, augur well for achieving strong transition impact as well as income-earning diversification from a much stronger equity portfolio.

Scaling up activities in south and east Anatolia has initially been challenging, and investment in those regions represents currently 14 per cent of the Bank's portfolio. Offices opened in Ankara in May 2012 and in Gaziantep in September 2014. During the new strategy period, EBRD's strengthened regional presence will help increase activity and impact in those regions, especially with MSMEs. A key lesson in engaging with MSMEs has been the importance of adding risk-sharing features which increase the appetite of commercial banks for participating in such facilities (e.g. the Women in Business Programme, credit lines for MSMEs in less developed regions).

The Bank has so far had mixed results in working on municipal projects in mid-sized and smaller cities, which depend largely on concessional state or EU finance. Based on this experience, the Bank will concentrate going forward on creditworthy metropolitan municipalities[1] with a particular focus on second-tier cities. The success of projects such as Gaziantep Urban Transport, Bursa Light Rail Transit and Bodrum Water has demonstrated the importance of first focusing on supporting commercialisation and corporatisation-based reforms of key utilities. Lastly, a key lesson for the Bank's future involvement in infrastructure PPPs has been the importance of early provision of appropriate technical assistance to public sector stakeholders to ensure timely capacity building (e.g. the Bank is currently in discussions with regard to technical assistance provision to Ministry of Education as it prepares to launch its facilities management PPP programme). The importance of this factor in Turkey confirms the Bank's experience in other countries of operations and demonstrates that the Bank is indeed additional in this sector in Turkey.

2 OPERATIONAL ENVIRONMENT

2.1 Political context

In 2014-2015 Turkey passed several political milestones which will shape its business environment and its economic policy-making for the years to come. On 10 August, Recep Tayyip Erdoğan – former Prime Minister and a founder of the ruling Justice and Development Party (AKP) – was elected President of Turkey in the first direct presidential elections. On 27 August, former Foreign Minister Ahmet Davutoğlu was elected the Chairman of AKP and later confirmed as the new Prime Minister. President Erdoğan retained strategic oversight over the government, relying on his strong mandate as directly elected leader. In the June 2015 parliamentary elections AKP received over 40 per cent of the votes, however falling short of the majority needed to form a single party government. The pro-Kurdish HDP secured 13 per cent of the vote and will be for the first time represented in the Parliament with 80 MPs. HDP achieved this result by effectively transforming itself from a narrow pro-Kurdish agenda towards a national leftist party defending civil liberties.

The Parliamentary elections were the last in the current election cycle. For the forthcoming Turkish government implementation of major political, social and economic reforms in Turkey will be the biggest challenge. Another priority includes continuation of the democratic opening process started in 2012 by the government aimed at bringing PKK terrorism to an end and finding a peaceful settlement of the Kurdish issue, which was welcomed by political parties in Turkey and by the international community. The process aims to eliminate terrorism, strengthen social inclusion, and enhance political participation for all communities in Turkey. However, many challenges remain.

Since the August 2014 elections, the new government took steps to revitalise its accession process with the EU. Turkey adopted a new EU Strategy and the National Action Plan for EU Accession, which outlines practical unilateral steps by Turkey to accelerate convergence with the EU acquis, including on chapters which remain blocked by the EU. A new EU Communication Strategy was also developed to help build public

[1] Special administrative status under which cities benefit from a higher borrowing capacity than other type of municipalities. In 2014, the list of metropolitan municipalities has been extended to 13 new cities, half of which are located in the eastern part of the country, bringing their total to 30.

support in Turkey and abroad for EU membership. In 2014, the EU Progress Report for Turkey was published. The report evaluated developments in Turkey in terms of the political and economic criteria for membership. In this framework, the report reflected positively the ongoing reform process in Turkey and also indicated a number of areas of concern, where progress is possible. These include the independence of the judiciary, separation of powers, the freedom of expression, right for assembly and the government's response to corruption allegations[2]. The Turkish authorities do not fully share this assessment by the EU. Lastly, on trade issues, Turkey is monitoring the potential impact from the Transatlantic Free Trade Agreement (TTIP) discussions on the EU - Turkey Customs Union, and requested to be included in the process.

Protracted conflict in Syria and the threat posed by ISIS/DAESH in both Syria and Iraq have imposed economic and security costs on Turkey. According to UN estimates, around 2 million refugees (1.8 million of whom being Syrians) from both conflicts have settled in Turkey with 260 thousands housed in refugee camps. Turkey has spent more than 5.6 billion US$ so far to address the needs of Syrians and Iraqis, while international support remained limited. The number of refugees is likely to increase further in the coming years, posing a threat to Turkey's border regions.

2.2 Macroeconomic context

Economic growth moderated recently, amidst continuing currency pressures. After growing 4.2 per cent in 2013, economic activity moderated to 2.9 per cent in 2014, albeit with more favourable growth drivers – net exports taking over as the main driver, thus helping to reduce the large current account deficit. Domestic demand was constrained by lower growth of private consumption, on the back of slowing household credit growth and a hike in interest rate in early 2014. A contraction in the agribusiness sector due to adverse weather conditions further contributed to the lower growth. The economy continued to grow at a modest rate of 3.8 per cent year-on-year in the second quarter of 2015, albeit with consumption taking over as the major driver of growth and net exports slowing down. Meanwhile, inflation remained persistently high, at 7.9 per cent as of September 2015, well above the central bank's target for the fourth consecutive year. High inflation was partly caused by a rise in food prices, as well as the continuing weakening of the lira in early 2015, following elevated political uncertainty and diverging monetary policies between the US and the Eurozone. The lira weakened 30.8 per cent to the dollar in January-September 2015, as expectations of US monetary policy tightening resulted in a reduction in capital inflows that finance Turkey's still large current account deficit of 5.8 per cent in 2014. But the weakening against the dollar did not lead to significant gains in trade competitiveness and net exports since Turkey's main trading partner is the Eurozone, and the lira weakened against the euro at a more moderate rate of 21 per cent, despite a sizeable inflation differential. Exports were further subdued due to continuing geopolitical tensions in the Middle East and recession in Russia.

Growth is expected to continue at a similar pace in 2015 and 2016 and gradually increase in the years ahead. The positive impact of lower global oil prices on growth will likely be offset by continuing weakness in external demand and developments in

[2] European Commission, Turkey Progress Report 2014 pp.2-4, 44-63

the euro-dollar exchange rate. Although inflation is expected to moderate somewhat due to falling food and oil prices, it will remain elevated above the central bank's target of 5 per cent, as the past and prospective currency weakening passes through to inflation. The higher than targeted inflation and moderation in global liquidity as the Fed tightens its policy will keep both lira and foreign currency cost of funding elevated throughout 2015 and 2016. This will constrain domestic demand and weigh on growth, which is expected to continue at 3 per cent in 2015 and 2016, below Turkey's long-term potential. In the years ahead, providing the country revives structural reforms and continues with institutional improvements, growth is expected to gradually recover towards its healthy long-term potential of 4.5 per cent.

Key risks to the economic outlook are shifts in domestic and global market sentiment. The volatility of capital inflows, as a consequence of both diverging monetary policies between the US and Eurozone and elevated domestic political uncertainty, is a key risk for the economic outlook in 2015 and 2016. Further risks may materialise if a recovery in the Eurozone does not take firm hold; if geopolitical tensions in the Middle East and Ukraine worsen further; or if business sentiment deteriorates due to perceived weakening of regulatory independence. On a positive note, the public finances of the country remain strong, with public debt less than 35 per cent of GDP in 2014, and the banking sector is well capitalised, with low NPL ratios of around 3 per cent.

2.3 Structural reform context

Structural reforms have been ongoing in several areas, but more needs to be done to reduce energy dependence, improve regional infrastructure and foster competitiveness in the corporate sector. Despite declining global oil prices, the major part of the Turkish current account deficit comprises the energy import bill, which in 2014 stood at US$54.9 billion, or 6.9 per cent of GDP. The renewable energy sector has over recent years attracted intense policy maker and investor interest. There was also recent progress in the policy framework, notably with the EBRD-supported National Renewable Energy Action Plan (NREAP), which was published in February 2015, and the development of a National Energy Efficiency Action Plan. Despite some initial delays, the electricity distribution grids are now fully privatised, but the public sector still has a share of 33.4 per cent in electricity generation. The authorities plan to privatise the remaining public sector power plants, with the exception of big hydroelectric power plants, in the coming years. Meanwhile, regional economic disparities have highlighted the need for more regional investments coupled with fiscal decentralisation. Investment planning for local infrastructure (water and public transport) still remains highly centralised and delivery of capital investments is slow. While large infrastructure projects continue to be developed (e.g. new rail and road crossings over the Bosphorus, the Gebze–Izmir highway, Ankara–Istanbul high-speed rail), strengthening regional and rural infrastructure remains a challenge. The National Assembly has passed a new railway law, which separates infrastructure and operations, grants third party access to infrastructure, and public service obligations based subsidies, but the secondary legislation is yet to be adopted. In the area of hospital infrastructure, PPP projects are set to accelerate, after a lengthy period during which the Ministry of Health amended the underlying legislation to enable bankability of the projects. Lessons learned during this work are likely to ensure more efficient implementation of PPP projects in other sectors going forward.

In the corporate sector, inefficiencies remain significant in the agribusiness segment, with notable lack of long-term tailored financing options, particularly for SMEs in the sector. The sector is highly protected, but the complex system of various protection measures distorts the environment for investment decision making, which opens opportunities for policy dialogue. Corporate sector competitiveness across various business segments remains hampered by corporate governance shortcomings and still limited use of innovation. Lately, innovation and its financing are attracting more focus of policy makers, and emerging amongst the main topics of Turkey's G20 presidency in 2015. Turkey has taken recent steps to encourage start-ups and improve innovation culture, by for example establishing guarantee funds for angel investors, or improving credit mechanisms to start-up companies. More broadly, the Capital Markets Board of Turkey (CMBT) has a comprehensive and proactive capital market development agenda. The regulatory framework around foreign capital market instruments, depositary receipts and foreign investment funds has recently been improved as part of Turkey's new Capital Markets Law.

2.4 Access to finance

Private sources of capital

Turkey has a well-developed financial system, which remained resilient during the financial crisis due to measures taken to strengthen the industry after the 2001 crisis. In 2013 further steps were taken to strengthen the financial sector and comply with the requirements of Basel III. In spite of its rapid growth (banks' balance sheets have more than doubled in TL terms since 2008, reaching 107.5 per cent of GDP at end-2014), the sector is broadly healthy, with a low share of non-performing loans at below 3 per cent. Capital adequacy ratios have declined somewhat but remain around 16 per cent, comfortably above regulatory requirement. This provides space for manoeuvre and should allow banks to increase their presence in riskier segments of the market and continue to develop more complex credit products. Nevertheless, the loan-to-deposit ratio has recently risen to more than 120 per cent in 2014 from around 106 per cent in 2012, as the banking sector is increasingly tapping into funding sources other than deposits. The Turkish corporate bond market is likely to experience significant growth and banks are increasing bond issuance in both offshore and local markets to access funding. SMEs account for almost 40 per cent of private sector loans and banks introduced new tools and credit options to increase the share of SMEs further. Access to finance remains a challenge however for women, young entrepreneurs and micro entities. Developing specific lending products, deepening dedicated markets and improving financial literacy through technical advisory services and training are needed to increase access to those underserved segments.

Although the banking sector remains the dominant source of finance, capital markets have grown and deepened somewhat during the past decade, benefiting from a growing reform momentum. Market capitalisation is now at 33 per cent of GDP in 2014, up from 26 per cent in 2011. However, the equity market remains dominated by a small number of large companies. Although the Treasury, CMBT and Ministry of Finance have been introducing equity incentive programmes to improve the environment for start-ups, the effects of these policies have been slow to filter down to the SME sector. The Treasury and CMBT have introduced angel investor programme and venture capital investment funds respectively. Both were supplemented by tax incentives. The government has also established a set of tax incentives for existing venture capital investment companies.

Pension funds' assets under management (AUM) have reached TL 35 billion, with 5.1 million participants in the system, after the introduction of more transparent tax incentives and management fee caps by both CMBT and the Treasury. Funds accumulated in the system have started to flow more into corporate bonds (9.95 per cent as of January 2015) in search of higher yields as competition in the market intensifies.

Non-financial corporations have also started to issue bonds as an alternative source of financing to bank loans in a very bank dominated economy, albeit at a slow pace. There is limited experience with corporations issuing bonds and the intermediary institutions marketing these instruments are also often part of larger banking groups that may not want to see their lending books eroded.

Multilateral and bilateral development bank finance

A number of multilateral development banks (MDBs) and bilateral financial institutions are active in Turkey, with varying investment levels and priorities.

Turkey is the **International Bank for Reconstruction and Development's** (IBRD or the World Bank) third-largest country of operations in terms of outstanding loans (US$13.64 billion). The portfolio is focused on the energy sector (43 per cent), financial and private sector development (34 per cent) and urban development (22 per cent). The IBRD financing envelope for the 2012–2016 strategy period is targeted at up to US$6.45 billion, and aiming principally at supporting competitiveness and employment. Over this period, IBRD expects to continue providing lines of credit through partner banks for SMEs and exporters, and to invest US$800 million in the financial sector. It will also seek to develop private sector participation in infrastructure, by increasing private sector investment in new electricity generation capacity, and enabling private sector operators to be licensed to operate on the Turkish State Railways (TCDD) infrastructure (the IBRD has been previously involved in TCDD restructuring and drafting of the Law on the Liberalisation of Railway Transport). In the areas of energy security and sustainable development, the World Bank has thus far provided policy-based loans for energy sector reform (especially for alignment with the EU *acquis*), technical assistance for sustainable resource management plans, energy efficiency credit lines to SMEs and financing to municipalities for the implementation of sustainable development plans. Moreover the World Bank is preparing to use EU IPA funds (of which EBRD is also a beneficiary) through a technical assistance operation to promote energy reform, energy efficiency, and renewable energy integration. On the policy side, the World Bank is also supporting the development of the National Employment Strategy, undertaking a review of the national competition policy framework with the Turkish Competition Authority (TCA) and seeking to encourage R&D through policy dialogue and technical assistance initiatives.

Turkey is the **International Finance Corporation**'s (IFC) second-largest client, with US$3.1 billion committed as of end-2013 and annual volumes of US$600–650 million expected for 2015 and 2016. IFC's goals under the country partnership strategy include supporting underserved parts of the economy (including women entrepreneurs and MSMEs), backing energy sector reform, and developing the Turkish corporate bond market through innovative structures. IFC launched the Banking on Women programme in late 2010, and has provided loans to three Turkish banks for on-lending to women-owned SMEs (Akbank, Fibabanka and Şekerbank). Those credit lines do not incorporate risk-sharing or technical cooperation components.

As an **EU** candidate county, Turkey benefits from financial assistance in the form of the **Instrument for Pre-Accession Assistance** (IPA). Priorities for the IPA II were set in the Indicative Strategy Paper for Turkey for 2014–2020 and the overall envelope amount for Turkey over this period is expected to be around €4.5 billion. Focus on the energy sector has been strengthened, and IPA II will seek to improve Turkey's integration with European electricity and gas markets, and to promote energy efficiency and renewable energies in line with the EU resource efficiency and climate targets. In the environment and climate sector, the Commission foresees continuing cooperation with IFIs (including the EBRD) and other partners to blend EU grants with loans. Furthermore, the Commission has explored the possibility of a Turkey Investment Programme (TIP) to increase the financing capacity for investments in key sectors. In transport, IPA II's main objective is to facilitate Turkey's integration with the European TEN-T rail network and to develop sustainable and efficient transport in line with EU standards. As for innovation, IPA II assistance will seek to improve the business environment and strengthen Turkey's research, technological development and innovation capacity. The EU is also greatly concerned with social policy, especially inclusion issues. IPA II will provide a sector support programme for the areas of employment, education and social policies, but investment support in this area will be limited.

The **European Investment Bank** (EIB) focuses on support for SMEs and infrastructure finance. Annual business volume in Turkey consistently hovers around €2 billion. SME lending accounted for 48 per cent of the total in 2013. EIB was active in the modernisation of the railways, lending €200 million to TCDD in 2013 for the Istanbul–Ankara high-speed rail line. EU IPA funds provided a further €120 million in grants. EIB lines of credit are often complemented by European Investment Fund (EIF) risk-sharing arrangements. Under the Greater Anatolia Guarantee Facility, EIF has jointly mobilised €937.5 million in finance to MSMEs in lesser developed regions of Turkey through its partner banks. The facility blends EIF portfolio guarantees with €51.9 million in IPA funds and €450 million of lending from the EIB.

The **Islamic Development Bank** (IDB) opened its first Turkish office in Ankara in September 2013, though its activities in Turkey long predate this. IDB has provided US$320 million in Islamic finance instruments (restricted *mudaraba*) to the Industrial Development Bank of Turkey (TSKB). However, there have been considerable delays in disbursing signed loans.

The **Black Sea Trade and Development Bank** has averaged one to two projects in Turkey in recent years, mostly focusing on financial institutions and infrastructure. Turkey is its largest beneficiary in terms of active operations.

KfW Group's development arm continues to work mainly with local banks to extend SME and energy efficiency credit lines (€300 million per year). It has also financed more than a dozen water and sanitation projects throughout Turkey. KfW is currently developing an Energy Efficiency in Public Buildings project with the Ministry of

Energy and Natural Resources, offering subsidised interest loans accompanied by technical assistance. Finally, **DEG** provides about €75 million per year in equity or loan financing to local corporates. In 2013, activities through **IPEX** – the arm providing project and export finance – more than doubled to €403 million and represented more than half of total KfW commitments.

The **Agence Française de Développement** (AFD) has increased its activities in the country over the last years, symbolised by its opening of a second office in October 2014 in Ankara. It is particularly active in energy efficiency and climate change, in which it has invested €350 million, and has provided SME energy efficiency credit lines through partner banks. AFD is currently implementing a credit line with DenizBank specifically for small- and medium-sized municipalities for investments such as public transport, water supply and sanitation and waste processing. **Proparco**, AFD's private-sector arm, has mainly invested in energy efficiency and renewables.

Finally, **FMO**, the Dutch development finance bank, is working exclusively with the private sector. Last year it invested about €60 million in sectors such as insurance, agribusiness and energy. FMO's total committed portfolio in Turkey amounts to €218.7 million, of which 60 per cent is directed to financial institutions.

2.5 Business environment and legal context

Progress on improving the business climate across sectors has been mixed. In the Doing Business 2015 report, Turkey ranked 55th amongst 189 countries, with particularly low scoring in dealing with construction permits and resolving insolvency procedures. In the Global Competitiveness 2014–15 Report, Turkey ranks 45th amongst 144 countries. Although it performs better than the average of emerging and developing Europe in most indicators, there are still notable barriers to doing business when it comes to inefficient government bureaucracy, policy instability, inadequately educated workforce, tax rates and access to finance. An amendment to the Public Procurement Law, which enforces a compulsory 15 per cent price advantage for medium and high-tech domestic products, has been criticised by the recent EU Progress Report. Nevertheless, some steps to improve the business climate have recently been taken. An omnibus bill, banning the reversal of privatisation transactions five years after the assets have been transferred to the private sector, has been adopted and should increase business confidence among foreign investors.

Unlike many EBRD countries of operations, Turkey has had an un-interrupted commercial law tradition since the 1920s. According to the EBRD assessments, **Turkish laws are advanced in a number of areas**, which was further strengthened when the new Commercial Code entered into force in 2012. In certain specific areas of law, which are of general relevance for supporting market activities, the system would still benefit from modernisation. For instance, taking security under Turkish law remains a fairly inflexible process, which lacks a uniform and modern all-encompassing system for taking non-possessory security over any type of movable property. Greater regulation of insolvency office holders is required, while the need for the existing postponement of bankruptcy procedure should be reviewed to limit the potential abuse by debtors, as well as bolster the creditors' rights to participate in restructuring process.

EBRD's reviews of local procurement practice in Turkey confirmed that local procurement capacity is almost matching the quality of the legal framework. Yet the integrity, transparency and uniformity of the legal framework could still be improved through, for example, the development of an eProcurement system, the provision of specific procurement rules for utilities, and the creation of an independent public procurement review and remedies body. PPP legislation is fairly comprehensive. However challenges remain for investors, such as the relative complexity of applicable laws, or the lack of single-piece legislation and a single authority in charge of coordinating, monitoring or supervising PPPs/concessions. On the energy side, relatively complicated bureaucratic and administrative procedures remain major barriers to the development of renewable energy and the realisation of Turkey's hydroelectric, geothermal, solar and wind resources. The Energy Efficiency Strategy Paper adopted in 2012 set a 20 per cent target for reducing energy intensity by 2023, however further work is required to set indicative energy savings targets per sector and identify relevant instruments to achieve those. Lastly, some shortcomings remain in the Turkish corporate governance legislation and practices, especially with regards to the composition and functioning of boards.

2.6 Social context

Despite Turkey's strong economic performance over the past years, the integration of women and youth into the labour market, and regional disparities persist as important transition challenges.

The Turkish labour market is characterised by an underutilisation of human resources, with less than half of the working age population economically active. In particular, the female labour force participation rate of below 30.8 per cent is amongst the lowest in the EBRD region (outside of the SEMED countries), against 71.5 per cent for men. In addition, women's employment rate in the informal sector, i.e. not registered for social security, is significantly higher than men's (50.7 per cent vs. 30.3 per cent). In urban areas, only 20.2 per cent of women participate in the labour market, whereas in rural regions women are often unpaid family workers. Turkey exhibits substantial barriers for women in relation to labour practices and access to finance, specifically in regard to collateral, skills and managerial capacity. The fact that Turkish women are less likely to own property affects their access to credit, as most commercial banks require collateral as a condition for loans. Men are still more than twice as likely to lead businesses as women or to hold a bank account that is used for business purposes. In addition, the OECD and UNESCO estimate that Turkey has the highest secondary school-level gender disparity in the OECD, East Europe and Central Asia regions, with particularly high disparities in less developed and socially conservative regions. The United Nations Development Programme's (UNDP) Human Development Index (HDI) placed Turkey 83rd in the world, ranking behind the Western Balkans.

Unemployment rates fell to 8.4 per cent in 2012 after peaking at 13.1 per cent in 2009, but are higher for women (11 per cent) and youth (17.5 per cent). Informal employment remains a concern at close to 35 per cent. Turkey has a high number of early school leavers at 43 per cent, a relatively high number of youth with no schooling at 6.5 per cent and a large group of young people not in employment, education or training at 25.5 per cent, well over the EBRD region average. This creates real challenges for the formal labour market and educational systems. The Ministry of Labour has updated its strategic framework to enhance employment and employability, specifically of women and youth, with a particular focus on vocational training. A national qualifications framework has recently been adopted and standards are being developed across a range of skills sectors. Social benefits also create disincentives for low-income groups to enter the labour force.

Large regional disparities exist, particularly in the south-eastern parts of Turkey. These are most pronounced in relation to the quality of local education and training, particularly vocational education. The availability of better quality vocational training that is based on specifications defined by employers is still limited in parts of the southeast. Furthermore, there are large regional labour market disparities, with few non-agricultural employment opportunities in rural areas. This, together with the comparatively high levels of informality, is a key challenge to the development of progression routes for young people from training into formal employment (particularly in the private sector). In addition, there are large regional gaps in relation to access to finance for SMEs, particularly those that are led by women, where access to saving and loans products[3] and availability of bank branches and ATMs is substantially lower in rural areas in regions 4–6[4] than in other parts of the country. Distinct regional disparities also exist in relation to health and other municipal infrastructure.

2.7 Sustainable energy and climate change context

Turkey's high dependency on fossil fuel imports, particularly natural gas from Russia, creates challenges to the country's energy security, macro-economic stability and environmental sustainability, in a context where energy demand is expected to nearly double by 2023. Although Turkey's primary energy intensity[5] and carbon intensity[6] are only slightly above the EU-28 average, these indicators are still far from global best performance and are likely to worsen in the absence of appropriate policies and sustainable energy investments, and in the context of the Government's plans to develop Turkey's indigenous lignite power production capacity. In terms of greenhouse gas emissions, Turkey's emissions rose by 123 per cent since 1990 to about 440 $mtCO_{2eq}$ in 2012, by far the highest growth among OECD countries.[7]

Turkey has limited domestic fossil fuel resources but does have strong renewable potential, including wind, hydro, solar and geothermal. The country aims to have 30 per cent of installed capacity from non-hydro renewables by 2023 and to reduce its energy intensity by 20 per cent as compared to 2008. These ambitious targets are being complemented by the Government's plans to foster the use of local fossil fuel resources, mostly lignite and hard coal, to meet increasing energy demand.

[3] Measured by loan density and savings deposit density as well as NPL/cash loans.
[4] Under Turkey's Regional Investment Incentives Scheme, the country's regions are classified in accordance with regional potential and the scale of the local economy, with greater support provided in less developed regions. Regions 4: Afyonkarahisar, Amasya, Artvin, Bartın, Çorum, Düzce, Elazığ, Erzincan, Hatay, Kastamonu, Kırıkkale, Kırşehir, Kütahya, Malatya, Nevşehir, Rize, Sivas. Regions 5: Adıyaman, Aksaray, Bayburt, Çankırı, Erzurum, Giresun, Gümüşhane, Kahramanmaraş, Kilis, Niğde, Ordu, Osmaniye, Sinop, Tokat, Tunceli, Yozgat. Regions 6: Ağrı, Ardahan, Batman, Bingöl, Bitlis, Diyarbakır, Hakkari, Iğdır, Kars, Mardin, Muş, Siirt, Şanlıurfa, Şırnak, Van, Bozcaada & Gökçeada.
[5] 0.12 toe/'000 US$2005ppp in 2012, a ratio in line with the EU-28 average (2012 IEA data).
[6] 0.3 $kgCO_2$/'000 US$2005ppp, a ratio 20 per cent higher than that of the EU-28 average (2012 IEA data).
[7] Organisation for Economic Co-operation and Development.

There are considerable opportunities for energy efficiency in the residential and corporate sectors, particularly on the back of the Government's Urban Rehabilitation Plan to reduce seismic risks. There is also a significant potential for municipal and SME resource efficiency. However, the limited credit availability for SMEs, lack of technical expertise and regulatory complexities in financing municipalities present serious barriers to the implementation of resource efficiency measures in those sectors.

Turkey officially ratified the Kyoto Protocol on 26 August 2009 but it is not included in Annex B of the agreement, thus requiring no binding emission targets in the medium term. Enhanced policies supporting cost-efficient technologies for carbon abatement are necessary to curb the current trend, as demonstrated by the Marginal Abatement Cost Curve commissioned by EBRD. On the policy dialogue front, following the signing of the Turkish Sustainable Energy Action Plan (SEAP) in 2011 between the Turkish Government and the EBRD, the Bank has continued its support to the Government to enhance sustainable energy investments across sectors. (Annex 7 provides a summary of key SEAP activities.)

The existing waste management infrastructure is largely insufficient to cover the country's needs and lags behind Turkey's EU neighbours. Hand in hand with the country's growing demand for goods, the level of waste generation has increased, recording a total of 25 million tonnes of municipal solid waste and 13.4 million tonnes of industrial solid waste in 2010. About half of the total population of 77 million does not have access to any waste disposal or recovery. Moreover, wastewater treatment service and collection rates are lower than in most EU countries, at an average of 84 per cent for municipal solid waste. Some regions of Turkey such as Konya are already experiencing severe water stress due to climatic factors and over-exploitation, and climate change is expected to exacerbate such problems.

3 STRATEGIC ORIENTATIONS

3.1 Strategic Directions

The uneven pace of reform and level of development across sectors and regions, together with Turkey's substantial infrastructure needs, and the country's systemic importance as a gateway between Europe, Central Asia and the Southern and Eastern Mediterranean, offer large opportunities for the Bank to deepen its engagement. Focusing on areas where there is most reform appetite and market demand, leveraging its core capabilities, further honed by the in-country experience, and complementing other IFIs' activities, the Bank will seek to address the breadth of Turkey's pressing transition challenges through the following strategic priorities:

- **Enhancing energy security and sustainability by supporting sector reform, promoting energy efficiency and renewable energy:** With a rapidly growing economy, Turkey has become one of the fastest growing energy markets in the world, but the country remains highly dependent on energy imports, with 92 per cent of its oil consumption and 98 per cent of gas consumption imported, mainly from Russia, Iran, and Azerbaijan. The large energy import bill (US$54.9 billion, or 6.9 per cent of GDP) remains the main contributor to Turkey's significant current account deficit (5.8 per cent of GDP in 2014). In order to strengthen the country's energy security, the Turkish authorities have sought to diversify energy routes, partly through increasing international interconnectivity capacity, as well as source countries. They also aim to increase the share of renewables (30 per cent target by 2023, currently 14 per cent), include nuclear in its energy mix, take bold measures to increase energy efficiency, as well as increase storage capacity to meet 20 per cent of annual consumption[8]. Nevertheless, despite some notable progress toward liberalising the energy markets, attracting strategic investors to the renewable energy sector remains challenging. In addition, improvements in institutional capacity and public awareness are needed to further promote energy and resource efficiency. In that context, the Bank will continue to work with the Turkish authorities on enhancing the investment climate in the renewable sector and thus attract more private sector investment, particularly FDI. The Bank will also support further liberalisation in the power and natural gas sectors, and continue to support energy efficiency projects through direct and intermediated investments.

- **Improving the quality of infrastructure via commercialisation and private sector participation:** Around 70 per cent of Turkey's population lives in urban areas and this number is expected to grow to 80 per cent by 2030. In addition, investments to implement the EU environmental *acquis* will place a substantial burden on Turkey's public sector finances given the current levels of underinvestment in sectors such as water, wastewater, with an investment need of around €15 billion until 2023[9], solid waste management and public transport. However, lending to mid-sized and smaller municipalities remains difficult. Generally, those municipalities have not undertaken commercialisation and corporatisation-based reforms of their key utilities, and remain very dependent on concessional State finance. Therefore, the Bank will concentrate on creditworthy metropolitan municipalities, with a particular focus on second-tier metropolitan cities to support improvements in governance structures and financial management through its investments and policy dialogue. In larger metropolitan cities, the Bank will selectively promote corporatisation of municipal services and concessions where it is additional and can achieve strong demonstration effects. Outside the municipal sector, the sheer magnitude of Turkey's national infrastructure needs (US$350 billion between 2014 and 2018), coupled with the government's desire to limit its borrowing and debt, will require the increased utilisation of PPP structures. The freight rail system is in great need of modernisation[10] and investment in key ports is needed to ensure competitiveness of enterprises in underserved regions, as well as supporting Turkey's status as a regional transit hub. Where it is additional, the Bank will support the mobilisation of private capital for the development of motorways, ports, regional airports, hospitals, railways and other areas providing key utilities.

[8] 2015-2019 Strategic Plan of the Ministry of Energy and Natural Resources.
[9] Water Resources Management and Security Special Expertise Commission Report of the 10th National Development Plan.
[10] 91 per cent of main routes are single line and only 9 per cent are double lines, 26 per cent of total lines are electrified and 33 per cent have signalisation according to the Logistics Special Expertise Commission Report of the 10th National Development Plan.

- **Scaling up private sector competitiveness through innovation and improved corporate governance:** Over the past decades, Turkey's competiveness has been mostly built on a relatively low cost of labour. As the country is now approaching the high income level, future competitiveness will have to be increasingly addressed through efficiency improvements stemming from better corporate governance and use of innovation. Turkey's business sector is highly fragmented, ranging from a myriad of micro, informal, low productivity firms to a growing segment of modern, high productivity enterprises. The productivity of MSMEs varies tremendously, and most of the labour force is concentrated in the low-productivity end with under-developed management skills and informal business practices. At the same time, there is still a great potential for medium-sized companies for further integration into global supply chains, which will require a more favourable business environment for FDI (at present, foreign investors often prefer to enter into joint ventures with local partners when entering the Turkish market). The Bank will therefore seek to support high-quality FDI, in particular projects enabling further integration into global value chains and technology transfers. Alongside this, support will be provided to local enterprises which have actively tapped the skills base in both Turkish universities and engineering companies in order to enhance levels of innovation and productivity, in line with the approach recommended by the Transition in Manufacturing Industries Special Expertise Commission Report of the 10th National Development Plan. Through its investments, the Bank will also promote improvement in corporate governance, sustainability standards and operating practices. Lastly, the Bank will seek to support the ecosystem providing seed and growth capital to Turkish entrepreneurs.

- **Promoting regional and youth inclusion, as well as gender equality, to support long-run growth potential:** As a result of broad-based industrial development and massive job creation throughout the country, growth became more inclusive in the 2000s and income gaps between regions have narrowed. Nevertheless, there is still a lack of opportunities to move into formal salaried jobs in the poorer regions, where both the employment rate of the working age population and the productivity of the employed are well below those of the more developed regions. In addition, female labour participation at 31 per cent remains one of the lowest in the OECD and the Bank's region of operations. Youth access to education, training opportunities and financial services continues to lag behind more developed economies. The high share of the informal sector (40 per cent of employment) contributes to entrenching inclusion issues, which in turn constrain the country's growth potential. To overcome these issues, several goals to increase the efficiency of labour market policies are identified in the recent Strategic Plan of the Ministry of Labour and Social Security, including increasing the labour force participation of disadvantaged groups, reducing child labour, combining labour market flexibility and job security, as well as lowering informal employment. The Bank will continue to invest in projects across sectors and pursue policy dialogues which promote inclusion, and equal opportunities to access services, employment and finance for both men and women across the country with a particular focus on the more remote regions, and on youth. The Bank will be well positioned to scale up its activities in the southeast of the country with the 2014 opening of the new RO in Gaziantep.

- **Deepening capital and local currency money markets:** For some time Turkey has been experiencing a relatively low domestic savings rate which increases its dependence on foreign borrowings. This causes investment decision-making to be dependent to a degree on capital inflow cycles and external conditions, thus contributing to volatility of investment and GDP growth. High corporate sector net FX exposure of US$172 billion, or 20 per cent of GDP, poses a risk to the economy given the volatility of the lira in the past few years. Wider availability of equity capital and long term financing remains critical for Turkey's private sector development, as well as for the implementation of its ambitious infrastructure investment plans. To meet these goals, the 2014-2018 Strategic Plan of the Undersecretariat of Treasury defined strengthening the financial system and stability through increasing the diversity of financial products and services, as well as the depth and width of financial markets, as strategic goals. The Bank will therefore continue to support long-term investors such as pension funds, asset management or insurance companies as well as fund managers in raising capital. Through investments in the bond and equity markets, the Bank will seek to demonstrate the benefits of capital market financing and support the introduction of new instruments, paying particular attention to facilitating access of SMEs and mid-caps to capital markets, and to act as a catalyst for international investors.

3.2 Key challenges and Bank activities

Theme 1: Enhancing energy security and sustainability by supporting sector reform, energy efficiency and renewable energy

<u>Transition challenges</u>

- Energy market liberalisation remains uncompleted. Competition in the natural gas markets is limited, and one of the key challenges is to reduce the Petroleum Pipeline Corporation's (BOTAŞ) market dominance and promote greater participation of private operators, especially in the midstream and upstream oil and gas sectors. Specific challenges in the natural resources sector include promoting oil and gas exploration activities by private companies; adopting enhanced environmental, health and safety standards; and supporting regional transmission of crude and natural gas pipelines for energy security of the country and of the EU. Transparent regulatory mechanisms should be established, including for the setting of oil and gas transport tariffs and for third party access to storage facilities.
- While some good progress has been achieved in liberalising the power sector, state-owned companies still make up a large share of the non-renewable electricity generation system. The Government is planning to introduce capacity payments to remunerate coal power plants, which may distort the wholesale market if implemented, as there is no pricing for CO_2 and fossil fuel technologies are already favoured.
- The use of renewable resources is already established (hydro, wind), though well below the country's potential capacity, in particular for non-conventional renewables (geothermal, biomass and solar). The law allows for a bonus

payment (a feed-in tariff) if the project uses locally-sourced content, which may create a distortionary effect in the market.

- Further improvement in energy efficiency institutional capacity is needed beyond the already existing law and basic institutions. Energy tariffs reflect operating costs and provide some incentive for low-cost efficiency measures, but still do not reflect fully environmental costs and uncertainties exist regarding longer-term tariff regimes. Improvements in energy efficiency standards are needed in the industrial and property sectors.

Operational response

- The Bank will contribute to the improvement of energy and resource efficiency in the private sector through investments across a range of sectors, including industrial, and also in support of urban renewal. EBRD will continue to implement and deploy dedicated credit lines through financial institutions under the Turkey Sustainable Energy Financing Facility (TurSEFF), the TSKB Resource Efficiency credit line and the approved Turkey Residential Energy Efficiency Financing Facility (TuREEFF). The Bank will also seek to further develop and implement Resource Efficiency credit lines for water, waste and materials efficiency investments.
- To support the diversification of energy supply sources, the Bank will seek to finance renewable energy projects in wind, solar, biogas and geo-thermal and, on a selected basis, hydro projects, with a particular focus on less developed regions including through the dedicated energy efficiency and renewable energy credit lines to the financial institutions under the Mid-size Sustainable Energy Financing Facility (MidSEFF).
- The Bank will seek to support the ongoing efforts of the Turkish authorities to liberalise the electricity generation market through financing of the privatisation tenders for the assets of the state-owned generator, EÜAŞ, particularly hydro.
- The Bank will continue to actively seek investment opportunities to finance post-privatisation modernisation programmes of power and gas distribution networks.

Policy dialogue

- The Bank will continue to implement the policy priorities outlined in the cross-sectoral Sustainable Energy Action Plan signed in 2011, in particular:
    - With the Ministry of Energy and Natural Resources, finalising the ongoing Renewable Energy Action Plan intended to harmonise relevant policies with EU directives and outline the long-term trajectory for the renewables market in Turkey, thereby providing investments and planning security.
    - Development of a National Energy Efficiency Action Plan to assess energy efficiency saving potential by sectors and defining a detailed path towards achievement of energy saving targets.
    - Depending on the outcome of the 21st session of the UN Climate Change Conference of Parties (COP21) due to take place in Paris in December 2015, EBRD could consider integrating mechanisms reflecting environmental externalities in selected operations if deemed feasible.

Results Framework for Theme 1:
Enhancing energy security and sustainability by supporting sector reform, promoting energy efficiency and renewable energy

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1	Energy market liberalisation incomplete, with still large share of state-owned companies in traditional electricity generation, and limited competition in natural resources markets	**Support increased private sector participation in the power and natural resources sectors**	• Financing bankable winning bidders in the privatisation tenders for state-owned generator EÜAŞ's assets, particularly hydro • Post-privatisation modernisation programmes of power and gas distribution • Support private competition in downstream oil & gas segments	• Evidence of increased market share of private operators / owners in the power and natural resources sectors, as a result of the Bank's activities *(Baseline 2013 – 63 per cent share of private ownership in the power generation, 2013; 0 per cent share of private ownership in electricity transmission)*
1.2	Further improvements in energy efficiency standards needed in the private sector, energy tariffs do not fully reflect relevant costs and uncertainties exist with regards to longer term tariff regimes	**Continue to promote reduction in energy intensity across all sectors and support improvements in institutional environment for energy efficiency**	• Direct investments and intermediated financing (TurSEFF, TuREEFF, Resource Efficiency) supporting energy efficiency and improved standards • Development of a National Energy Efficiency Action Plan (NEEAP)	• Volume of energy savings achieved based on EBRD methodology in tonnes of oil equivalent/year *(Baseline – 0)* • Evidence of material progress in harmonisation of Turkey's legislation with 2012 EU Energy Efficiency Directive, as a result of the NEEAP *(Baseline – N/A)*
1.3	The use of renewable resources remains well below the country's potential capacity	**Promote private sector investment in renewable energies, by acting as a catalyst investor and working on enhancing the investment climate in the sector**	• Direct and intermediated (MidSEFF) financing of renewable energy in wind, solar, biogas and geothermal and, on a selected basis, hydro projects, with a particular focus on less developed regions • Finalisation of National Renewable Energy Action Plan (NREAP)	• Change in capacity of renewable energy installed with Bank support (in MW and TWhpa) *(Baseline – 447.5MW / 1.9TWhpa since 2010)*, and qualitative account of replication where applicable *(Baseline – N/A)* • CO_2 emission reductions as result of the Bank's operations (in tCO_2e/year) *(Baseline – 0)* • Evidence of material progress in harmonisation of Turkey's legislation with EU Renewable Energy Directive, as result of NREAP *(Baseline – N/A)*
	Context indicator: Turkey's energy intensity *(Baseline – 0.12 toe/'000 US$2005ppp in 2012)*. Source: WDI/IEA.			

Theme 2: Improving quality of infrastructure via commercialisation and private sector participation

Transition challenges

- Municipal utilities remain integrated into municipality with limited financial and operational autonomy. There is a need for corporatisation and commercialisation of metropolitan municipalities' utilities operations through more specific governance structures and financial management approaches, as well as greater fiscal decentralisation, to reduce their financial dependence on state finance from Iller Bank.
- The existing solid waste management (SWM) and recycling infrastructure are largely insufficient to cover the country's needs. While much SWM legislation is already in place and its development is relatively well advanced and promising, the progress in monitoring and enforcement lags far behind. The small private waste sector suffers from lack of long-term contracts, limited number of price-setting off-takers, high fragmentation and difficulties in accessing long-term financing.
- The railway sector is underdeveloped by international standards despite some recent progress. National rail operator TCDD is a fully integrated railway with poor financial performance and continuous loss of freight traffic to the road sector. There are some very small private operations in various parts of the country, but they do not represent a challenge to the incumbent. New legislation is under preparation to liberalise rail transport sector, following a law which was drafted with IBRD assistance and which entered into force in 2013. When fully implemented this body of legislation will allow private companies to build railway infrastructure and to be designated operators. In addition, TCDD retains responsibility for some of Turkey's key ports, which the government may make a further attempt to privatise.
- The private sector needs to be tapped to enhance earthquake resilience of built infrastructure or under PPPs for public investment programmes and performance-based contracting for parts of the road networks coming up for maintenance.
- While many of Turkey's largest airports have been transferred to the private sector under concession arrangements, the sector reform needs to be completed by privatising and commercialising regional airports.
- Men and women face different challenges in accessing transport, water, solid waste or electricity services, particularly in rural areas of Turkey. Mobility constraints, safety issues, lower literacy levels and the role of social norms, as well as limited control over household resources, limit women's access to basic services and particularly so in rural areas of the country.

Operational response

- The Bank will invest in water, wastewater and public transport facilities in creditworthy metropolitan municipalities, with a particular focus on second-tier metropolitan municipalities, to support commercialisation. Most typically these will be sub-sovereign loan operations together with technical assistance supporting commercialisation, aimed at strengthening governance and financial management. However, as the use of PPPs grows for regional infrastructure, the

Bank will respond to bankable opportunities. In larger cities, including Istanbul, the Bank will selectively promote the corporatisation of municipal services where it can achieve strong demonstration effects on the benefits of operating municipal services through independent companies.

- Jointly with the World Bank, the Bank will support the modernisation of the railway infrastructure, with the view to promoting reform and wider access to the network by private operators. The Bank will seek to support private sector engagement where feasible (e.g. in locomotives and rolling stock).
- Further in the transport sector, the Bank will promote performance based road maintenance contracts, and will target opportunities in the privatisation of toll roads, as well as PPP structures in the road sector. The Bank will also support private sector participation in regional airports, as well as in intermodal/logistics centres, port privatisation and private ports, where it is additional.
- The Bank will continue its strong engagement in PPP structures in Turkey's national hospital investment programme, not only with infrastructure financing but also providing longer-term technical assistance. The Bank will use its experience gained in healthcare facilities management PPPs to support investments in a broad range of Turkey's utilities provision programmes.
- The Bank will promote inclusive stakeholder participation processes to ensure that men and women have equal opportunities to influence, access and benefit from utility and public transport services provided by EBRD projects, and will seek opportunities for the development of safe transport initiatives.

<u>Policy dialogue</u>

- The Bank will work with other IFIs to establish a more efficient PPP environment, including support in drafting a comprehensive and modern PPP Framework Law, develop centralised institutions and build implementation and monitoring capacity.
- The Bank will work with municipalities on corporatisation of utility services and increase the policy dialogue with the Ministry of Environment and Urban Planning to implement PPP structures in water, wastewater, waste management and urban transport.
- The Bank has already engaged with TCDD under an advisory approach and has found genuine openness for a policy dialogue to support detailed implementation of the 2013 Railways Liberalisation Law, developed with World Bank assistance. Effective secondary legislation should allow for further participation of private operators in the railway sector as well as assisting with the development of effective approaches for promoting private sector involvement.
- The Bank will continue to engage with the Turkish authorities regarding the introduction of a nationwide glass recycling scheme with the view to expanding into other waste recycling sub-sectors, such as metals, paper and plastic.

Results Framework for Theme 2:
Improving the quality of infrastructure via commercialisation and private sector participation

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
2.1	Metropolitan municipalities' utilities do not operate on an efficient and commercial basis and depend excessively on state finance from İller Bank, in particular second-tier cities	**Improve efficiency and quality of municipal infrastructure services, through commercialisation, and on a selective basis corporatisation, of utilities**	• Investment in water, wastewater and public transport facilities in creditworthy metropolitan municipalities, with a particular focus on second-tier cities, and promotion of commercialisation through loan conditionalities and TC-supported policy dialogue • Selective promotion in larger cities, of corporatisation of municipal services	• Number of successful projects *(Baseline – 0)* and qualitative account of improvements in efficiency and service delivery at client level, with a focus on efficiency measures (e.g. labour productivity, profitability, formalised collection systems) *(Baseline – established at projects approval)*
2.2	The private sector needs to be tapped on a larger scale to finance Turkey's ambitious infrastructure plan	**Increase use of innovative private sector-led solutions to enable sustainable funding of infrastructure projects**	• Financing for modernisation of the railway infrastructure, linked to wider access to the network by private operators • Support to PPP, privatisation and private sector operators in road, airports, ports and logistic • Finance for PPP structures in national hospital programme and other utilities provision • With other IFIs, policy dialogue on developing comprehensive and modern PPP Framework Law	• Evidence (number of successful projects and qualitative account) of infrastructure services successfully outsourced to private sector (e.g. concession, PPP (BOT), lease of assets, management contracts) *(Baseline – 0)* • Evidence of successful improvements in PPP environment, as a result of the Bank's policy dialogue (incl. development of PPP Framework Law, creation of centralised institutions, and building of implementation and monitoring capacity) *(Baseline – N/A)*
	Context indicator: Δ in ATC scores of relevant sectors *(Baselines 2014– Infrastructure: Large/Medium; Urban Transport: Medium/Medium)*			

Theme 3: Scaling up private sector competitiveness through innovation and improved corporate governance

Transition challenges

- The low level of foreign investments flowing into Turkey and the resultant limited transfer of technology and skills deprives the country of an important source of innovation for productivity and employment growth. FDI inflows finance only around 17 per cent of the country's current account deficit, with 70 per cent of FDI flowing into the service sector, which reflects the relatively uncompetitive situation of Turkey's tradable sectors, as well as the preference of Turkish manufacturing businesses to retain control of business, often within family-run structures.
- Improvements in corporate governance remain significant challenges among corporates, in particular in family-run businesses and companies located outside of the metropolitan areas. There is still little acceptance of private equity funds amongst the family-run mid-sized corporates.
- In the Global Competitiveness Report, Turkey ranked 56th amongst 144 countries in innovation, scoring worse than average of its total competitiveness ranking. The number of World Intellectual Property Organisation (WIPO) patents in the country has risen in the past decade, but remains low relative to developed countries, especially given the relatively large number of people with PhDs in science and engineering from Western universities. R&D investment in 2012 stood at 0.93 per cent of GDP (vs. the OECD average of 2.3 per cent). There is scope for improved collaboration between higher educational establishments and the private sector to improve the effectiveness of R&D activities.
- Inefficiencies remain significant in many sectors. In the agricultural sector, standards still fall short of meeting international benchmarks regarding hygiene and quality (in terms of traceability of products). In the health sector, service delivery remain far below international standards, and less than 4 per cent of hospitals in Turkey are accredited to ensure "international standards" of quality and patient safety. Improvements in energy efficiency standards remain significant challenges across sectors.

Operational response

- The Bank will continue to support corporates' competitiveness and governance improvements, in particular in the manufacturing, services and agribusiness sectors, through debt and equity investments with strong demonstration effects. This includes private health services, with a focus on projects contributing to higher quality standards. With regard to SMEs, the Bank will seek to provide targeted credit lines and direct financing with advisory services through Small Business Support to improve corporate governance standards and operating practices.
- The Bank will actively support in-bound FDI and cross-border investments of Turkish companies with pronounced technology and skills transfer element and enhancing the role of local players in the global value chain.
- The Bank will seek to support innovative firms (e.g. software, electronic, payments etc.) through direct investments, financial intermediation or via

venture capital. The Bank will also nurture the start-up ecosystem by exploring opportunities to support business incubators.

- The Bank will broaden and institutionalise further the private equity industry by supporting nascent funds (growth funds, venture capital, and infrastructure) with the view to develop them into sustainable sources of equity capital to Turkish companies, while also supporting follow-on private equity funds in order to ensure adequate liquidity and depth of the market as well as the transfer of governance and operational expertise to the underlying investee companies.

Policy dialogue

- Building on its enhanced profile developed in the corporate and the private equity sector, as a result of its growing equity portfolio as a direct investor and a limited partner, the Bank will promote corporate and institutional awareness of the benefits of equity financing and improved corporate governance practices.
- The Bank will continue to promote the adoption of corporate best practices in the area of human resource management to support the development of Equal Opportunities policies and practices to improve women's participation and women's career development as well as diversity in the workforce. In addition to improving corporate practices, by focusing on high-visibility industry leaders, this is expected to have a demonstration effect and contribute to address gender gaps in employment in Turkey.

Results Framework for Theme 3:
Scaling up private sector competitiveness through innovation and improved corporate governance

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
3.1	Turkey is below its innovation potential and inefficiencies remain in several sectors	**Foster innovation and efficiency by supporting assets and processes upgrades, facilitating technology and skills transfers, and supporting development of an ecosystem conducive to innovation**	• Debt and equity investments to support corporates' efficiency and innovation improvements, in particular in manufacturing, services and agribusiness sectors • Credit lines and business advisory (through SBS) for SMEs, to support improved operating practices • Co-financing of in-bound and out-bound FDI, with a focus on technology and skills transfer • Investments in venture capital and private equity	• Evidence (number of successful projects and qualitative account) of introduction of higher value products, through skill transfer and introduction of new product, along existing corporate sector value chains as a result of Bank investments *(Baseline – 0)* • Number and qualitative account of successful operation of innovative companies supported directly or indirectly by the Bank, including through venture and private equity *(Baseline – 0)*
3.2	Weak corporate governance and standards short of meeting international levels, especially among family-run businesses and companies located outside of the metropolitan areas, hinder firms' growth and their ability to attract capital, in particular FDI	**Promote best corporate governance practices and support upgrades in business and operating standards**	• Seek corporate governance improvements and introduction of better standards as part of equity direct investments and debt financings, where applicable • Business advisory to SMEs on corporate governance and standards improvements • Investments in reputable venture and private equity funds, to enable transfer of governance and operational expertise to portfolio companies • Development of Equal opportunity/ diversity projects with clients promoting international best practice	• Number of successful projects *(Baseline – 0)* and qualitative account of improvement of corporate governance and business standards by clients, including (as applicable) equal opportunities practices and policies *(Baseline – N/A)*
	Context indicator: Δ Business sophistication score and ranking *(Baseline – score: 4.3; ranking: 50th out of 144, 2014-15). Source: Global Competitiveness Index (World Economic Forum).*			

Theme 4: Promoting regional and youth inclusion, as well as gender equality, to support long-run growth potential

Transition challenges

- In addition to structural gaps in human capital, Turkey's rigid regulatory framework translates into a relative high cost of doing business for formal enterprises. As a result, almost 40 per cent of all companies in Turkey still operate in the informal sector, weighing on the country's competitiveness and contributing to entrenchment of inclusion issues. Lack of financial transparency limits the informal sector's access to debt and equity finance. Informality hinders social mobility and progression of youth from training into formal employment.
- The Turkish economy is characterised by pronounced regional disparities, especially in relation to quality and length of local education, access to productive employment opportunities, health and other municipal services, as well as access to finance. South Eastern regions in particular continue to lag behind the rest of the country in those dimensions.
- The agriculture sector remains an important channel for promoting regional development and inclusion. However, the lack of proper irrigation, the relatively small and uneconomic size of individual family-owned farms, land fragmentation as a result of inheritance law, and the undersupply of capital and skills for the employment of modern production inputs, techniques and machinery prevent the country from realising its full agricultural potential in the regions. These sector inefficiencies, combined with a convoluted system of protection measures, are contributing to volatility of food prices in Turkey. Given that food prices make up more than 30 per cent of the consumer price index, their instability translates into volatility of inflation and interest rates.
- Women still face disproportionate obstacles to accessing economic opportunities, with large gender gaps in relation to equal opportunity labour practices, employment, firm ownership and management, in particular in the eastern part of the country. The female labour force participation rate in Turkey is lower than in most of EBRD's countries of operation. In addition, female entrepreneurs tend to find it more difficult to access finance than their male counterparts.
- More than a quarter of young labour market entrants, particularly young women, are not in employment, education or training. This is partly a result of the education system, social norms and expectations about women's role in society, a persistent skills mismatch, as well as an inflexible labour market structure which tends to protect incumbents over new entrants. Taken together, these inclusion issues constitute a substantial loss of human capital and weigh on the country's long-term growth potential.

Operational response

- The Bank will continue to provide long term MSME credit lines to commercial banks, to broaden access to finance to underserved regions and economic participants. In particular, the Bank will continue to roll out the highly visible and innovative Women in Business Programme across the country, which combines access to finance and business advisory services for women-led

SMEs. The Bank will also support access to finance, leasing and factoring for SMEs in disadvantaged regions and promote cash-flow based lending by integrating specific trainings in its credit lines to commercial banks.

- The Bank will actively pursue commercially viable investment projects that help build competitive advantages in less-developed regions and promote local employment and skills transfer, particularly for young labour market entrants and women.
- The Bank's new RO in Gaziantep will strengthen the coverage of local firms in the south-east of the country with a focus on supporting SMEs through direct financing and advisory services. This shall help to demonstrate to SMEs the benefit of formality in order to access finance, including through the provision of financial transparency programmes. The Bank will explore with donors the creation of funded risk-sharing facilities in the regions.
- The Bank will support agribusinesses of various sizes, an important lever for economic inclusion in underserved regions, through both direct investments and the Turkey Agribusiness SME Financing Facility (TurAFF).
- Where feasible, the Bank will continue to support projects in metropolitan municipalities in underserved regions, by introducing better governance methods and more efficient operating practices, as well as improve employment and training opportunities particularly for young job seekers, and seek to improve service delivery for women in utility and public transport.

Policy dialogue

- In the context of its Women in Business (WiB) Programme, the Bank will continue to engage with relevant Ministries and stakeholders, to address the barriers women face in becoming self-employed and to access finance. Policy dialogue on the regulatory framework and taking into account the gender dimensions of investment climate reform will complement the investment side of the WiB in Turkey.
- The Bank will engage with the Ministry of Labour and other relevant public and private sector stakeholders to identify the obstacles faced by women in accessing employment, building on the experience from the Bank's investments. This might relate to legal restrictions that currently prevent women from pursuing careers in a number of occupations in heavy industries; addressing issues to support women balance work with their family responsibilities, including their re-entry into the work place after maternity leave; as well as ways to roll out and build on good initiatives that currently exist such as the Equality at Work Platform or the FEM KADIGER scheme.
- The Bank will seek to support the development of sustainable partnerships between private sector clients and schools or universities to offer high quality vocational and technical training for young people that meets employer needs to achieve local skills transfer. This will build on the Bank's initial experience in the area of vocational training in other countries of operation and on the needs of an existing pipeline of clients in Turkey. The Bank will work in partnership with the European Training Foundation (ETF) to harness the strong complementarity between the Bank's strong private sector focus and ETF's expertise on structural reform in relation to vocational training in Turkey. In addition, the Bank will explore opportunities to engage with the Union of Chambers and Commodity Exchanges (TOBB) to support the Skills 10 programme, which develops

regionally-based vocational training programmes for youth based on demand surveys from the private sector. The Bank will seek to build on this model, adding a stronger focus on offering higher quality work-based learning models and expanding into new sectors.

- The Bank will engage with the Ministry of Agriculture on tariff policies and mapping the various existing protection measures, with the aim to demonstrate the potential effects of their rationalisation on reducing food price volatility.
- The Bank will engage with the Ministry of Agriculture and the Treasury in order to explore best instruments for widening access to finance for agricultural producers in less developed areas.

Results Framework for Theme 4:
Promoting regional and youth inclusion, as well as gender equality, to support long-run growth potential

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
4.1	The economy is characterised by pronounced regional disparities (in particular in the southeast), in relation to access to productive employment opportunities, finance and health, education and municipal services	**Promote inclusive economic development in the regions by supporting private firms, with a particular focus on agribusinesses**	• Direct / indirect (incl. potentially with risk sharing) investments in agribusiness, SMEs and projects building competitive advantage in underserved regions • Business advisory for SMEs on financial literacy / transparency, management practices, productivity and quality standards • Investment in municipal infrastructure in metropolitan municipalities in underserved regions • Policy dialogue with Min. of Agriculture on tariff policies and access to finance	• Volume and share of total loans extended by client banks to SMEs in the south-eastern regions *(TL 21.1bn, 2.8% of total portfolio*[11]*))*
4.2	Women face disproportionate obstacles to accessing economic opportunities. More than a quarter of young labour market entrants, particularly young women, are not in employment, education or training. These inclusion issues constitute a substantial loss of human capital	**Increase economic opportunities for women and young labour market entrants, via the Bank's projects and policy dialogue**	• Women in Business Programme (access to finance, business advisory services. networking for women entrepreneurs, policy dialogue) • Service delivery improvements for women in utility and public transport • Training partnerships between private sector clients and educational institutions, and policy dialogue with the Ministry for Labour and TOBB to expand Skills 10 programme	• Number and volume of total loans extended by client banks to women-owned or -led businesses *(Baseline – established at project's approval)* • Evidence of improvement in the institutional environment supporting women's participation in the labour force and their opportunities for career development (e.g. revision of legislation, public information campaigns, new directives), as a result of the Bank's policy dialogue *(Baseline – N/A)* • Number of women and youth accessing training to acquire skills due to Bank's support *(Baseline – 0)* and qualitative account of sustainable training mechanisms created (e.g. number of new apprenticeship, internship or traineeship places created, number of formal partnerships between educational institutions and private sector employers) *(Baseline – N/A)*
	Context indicators: Δ ATC Inclusion scores for Region *(Baseline 2014 – Labour markets: Medium)*, Youth *(Baseline 2014 – Opportunities for youth: Large)* and Gender *(Baseline 2014 – Women's access to finance: Large)*			

[11] Estimated using total banking loans in Regions 4, 5 and 6, partner banks market share and SME share of loans in partner banks' portfolios

Theme 5: Deepening capital and local currency money markets

Transition challenges

- The capital markets' as well as the banking sector's ability to provide long-term Turkish lira (TL) debt financing to a productive corporate sector or infrastructure projects remains constrained, leaving the corporate sector largely exposed to exchange rate volatility (the corporate sector's net FX exposure is US$172 billion, or 20 per cent of GDP).
- Debt finance remains largely sourced through the banking sector and the domestic corporate bond market is still at an early stage of development. Issuances are mostly dominated by banks or a few large conglomerates with well-known brands, and tend to be for short tenors. This is due to a current lack of long-term savings instruments and reflects the early stage of development of the life insurance and private pension sectors.
- The institutional investor base capable of providing long term local currency funding is growing rapidly but is still small, and constrains the development of the market. Mutual funds are primarily invested in money market funds as a bank account substitute and therefore do not play any significant role as a provider of long-term capital. Insurance companies and mutual pension funds comprise only 4.7 per cent of the financial sector, while domestic infrastructure funds do not exist. Although many international funds include Turkey in their geographical scope, there is little local presence of specific Turkey-dedicated funds.
- The domestic equity market is relatively well established. However, market capitalisation, as well as turnover volume, is concentrated in a small number of stocks.

Operational focus

- The Bank will much more actively and with stronger resource seek equity positions in SMEs and mid-cap companies specifically with a view to exit via an IPO, in order to demonstrate to entrepreneurs and investors the benefits of public offerings.
- The Bank will help increase liquidity of the local currency capital market by supporting the issuance of TL corporate bonds and participating in public equity offerings with strong demonstration effects.
- The Bank will seek to broaden the financial product range by using and promoting instruments and financing structures not yet widely available in Turkey, in particular, for funding infrastructure development (e.g. infrastructure funds, infrastructure bonds, or other instruments) and sustainable energy projects (e.g. green bonds), as well as extending maturity profiles of banking and non-banking finance products (e.g. covered bonds, asset-backed securities).
- The Bank will seek investment opportunities fostering the long-term TL investor base (e.g. pension funds, asset management, insurance), including by supporting fund managers in raising capital.
- The Bank will seek to contribute, through policy dialogue and investment, to the development of the capital markets infrastructure in Turkey and support its potential role as a regional financial hub.

Policy dialogue

- The Bank will cooperate with the Capital Markets Board on strengthening implementation and monitoring of corporate governance code for Borsa Istanbul listed companies (including the Borsa Istanbul stated initiative to increase women on boards from 11 per cent to 25 per cent).
- In order to facilitate SME access to equity markets, the Bank will work with the Capital Markets Board on reviewing listing requirements and further develop the stock market infrastructures currently available for SMEs.

Results Framework for Theme 5:
Deepening capital and local currency money markets

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
5.1	Institutional investor base capable of providing long term local currency funding is still small and the range of capital market products limited	**Deepen investor base and broaden capital market products range, in order to improve capacity of capital markets to effectively complement bank finance**	• Promote innovative financial instruments and structures with strong demonstration effects (e.g. infrastructure funds, infrastructure bonds, green bonds, covered bonds, asset-backed securities) • Support long-term TL investors (e.g. pension funds, asset management, insurance)	• Evidence of new capital market instruments introduced in Turkey as a result of the Bank's projects and policy dialogues *(Baseline – 0*) and qualitative account of their demonstration effect *(Baseline – N/A*) • Evidence of sector-level improvement in institutional investor base (e.g. assets under management of institutional investors *(Baseline – NAV of mutual funds TL 35.8 billion, 2014; NAV of pension funds TL 38.0 billion, 2014; investment portfolio of insurance firms TL 12.7 billion, 2013)*, creation of specific Turkey-dedicated funds), and, as appropriate, attribution to the Bank's activities
5.2	Equity market capitalisation, as well as turnover volume, is concentrated in a small number of stocks. Equity culture is generally underdeveloped, in particular among family-run businesses	**Promote use of stock markets as an efficient channel for raising capital, in particular among SMEs and mid-cap companies**	• Equity positions in SMEs and mid-cap companies with exit via IPOs • Investment in IPOs with strong demonstration effects • Policy dialogue with Capital Markets Board on SME listing requirements • Policy dialogue with Borsa Istanbul on upgrade of corporate governance code	• Evidence of improvement in equity markets (e.g., number of new listings *(Baseline – 0)*, reduced market concentration *(Baseline 2014 – top-10 listed companies comprise 47.1 per cent of total market capitalisation*) and, as appropriate, attribution to the Bank's activities
	Context indicators: Δ ATC (Market Institutions) score for capital markets *(Baseline 2014 – Small)* / Market capitalisation as % of GDP: (*Baseline 2013: 28%);* Securities (bonds and stocks) traded as % of GDP: (*Baseline 2013: 78%)*			

3.3 Potential Risks to Country Strategy Implementation

The ability of the EBRD to deliver on its strategy in Turkey will be influenced by a number of factors outside of the Bank's control. The Republic of Turkey generally has a strong vision for its future (as can be discerned from the government-led Vision 2023), but political changes may affect the authorities' priorities and their ownership of the proposed strategy, while economic factors could impact demand for the Bank's products and the availability of sponsors. Where feasible, the Bank will work to address and mitigate these risks through proactive and sustained engagement with its clients, its international partners in the country and the Government.

Successful implementation of Theme 1 (Energy) will require commitment on the part of the Government to allow for liberalisation of energy markets. This includes greater private sector participation and clarity on the setting and duration of related tariffs. Given that such modifications can sometimes be unpopular, success in this area may be contingent on the pace of the energy reform generally. The Government, however, appears especially dedicated to increasing installed capacity of renewable resources. Special attention must be paid to the specific regulations and tariffs for renewable energy in order to promote commercialisation and diversification of sources.

In Theme 2 (Infrastructure), risks stem from the lack of enforcement of legislation encouraging commercialisation, private sector participation and resource efficiency. Furthermore, frequent legislative and regulatory changes regarding infrastructure may dampen investor interest. This includes the possibility of even recently-passed legislation still not reaching EU standards.

Appetite for reforms more generally could be linked to relations with the EU and the state of membership talks, which can be complicated and subject to change. The Government has, after a cooling in relations, renewed its commitment to EU membership through the "European Union Strategy" published in September 2014.

Political risk stemming from external conflicts involving Turkey's neighbours may have an effect on FDI inflows as well as on domestic investment, and thus the potential for competitiveness and innovation as set out in Theme 3 (Corporate Sector). Furthermore, the risk of political spillover may also influence inclusion aspects under Theme 4 (Inclusion).

Youth inclusion and vocational training support is a new area for the Bank. Progress on policy dialogues in this area will be dependent on the effectiveness of the Bank's external partnerships, as well as the readiness of private sector clients' to engage in those issues.

EBRD's ability to provide local currency finance as under Theme 5 (Capital Markets) will be conditioned on access to local currency funding. Slow progress in the development of local capital markets and/or an absence of market-based instruments such as currency swaps would pose risks to the delivery of part of EBRD's projects. Moreover, foreign exchange risk will affect the attractiveness of TL-denominated financing.

Globally, potential heightened market volatility and reduced investor appetite for emerging market risk could impact equity and debt issuances volumes, as well as availability of foreign sponsors, and therefore undermine the Bank's ability to meaningfully contribute to capital markets liquidity under Theme 5.

3.4 Environmental and Social Implications of Bank Proposed Activities

As an EU candidate country, Turkey is reviewing and revising environmental and social legislation to adopt the EU Directives. The European Commission 2014 Progress Report notes that Turkey has made progress in aligning legislation in the fields of environment, occupational health and safety and climate change with the EU legislation. However, there are still a few areas where Turkey is not yet aligned with related EU *acquis* including procedures for trans-boundary consultations, access to information, public participation and access to justice in environmental matters (related to the UNECE Aarhus Convention), directives on ambient air quality, national emissions ceilings and volatile organic compounds nature protection, the national biodiversity strategy and action plan; legislation to implement the Industrial Emissions Directive; and legislation to implement the Regulation on Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH).

Most occupational health and safety (OHS) legislation has been aligned with the EU OHS Directives; however, implementation of adopted legislation is still weak as there is little guidance on how to comply with the provisions, and enforcement remains weak. In addition, awareness among workers is low, inspection resources are insufficient and level of sanctions is low. Strategic planning, substantial investments and stronger administrative capacity are required to ensure effective execution of the legislations.

These issues will need to be reviewed in the context of individual project appraisal and in line with EBRD's Environmental and Social Policy and Performance Requirements, which will apply to all projects carried out in Turkey. Specific building of environmental and social risk management capacity through implementation of the Bank's projects will add to this process and will assist in the process of alignment with EU Directives and Turkey's achievement of the Millennium Development Goals.

Power and energy projects, such as wind farms and transmission corridors will need to review impacts to birds, as Turkey's location lies within the path of two major international bird migration corridors. Trans-boundary consultations on water issues with neighbouring countries are still at an early stage and therefore hydropower projects which involve neighbouring countries will need to carefully assess the consultation needs and procedures. The development of transport, hydropower, and municipal infrastructure may involve land acquisition or economic displacement for local populations. It will be important to identify any vulnerable populations, including ethnic minorities, that may be disproportionately affected by the projects and to ensure that stakeholder engagement activities include any marginalised groups. Infrastructure projects that involve construction will need to assess potential cultural heritage issues carefully.

Changes made to environmental impact assessment (EIA) regulations in November 2014 raise serious concerns as additional exemptions to the EIA including several large infrastructure projects have been introduced. This increases the risk of judicial actions against projects which are exempted from EIAs. Regardless of any granted exemptions, EBRD will continue to require environmental and social appraisals to be carried out in accordance with its Performance Requirements.

In the field of solid waste management, further work is needed particularly on waste reduction and recycling. Since 2013, EBRD has supported the Ministry of Environment and Urban Planning in developing a glass recycling roadmap for Turkey to achieve its 2023 targets. The Bank will continue to work on new projects, which aim to catalyse a transformational change in Turkey's material efficiency and waste management by systematically addressing existing barriers. Financing mechanisms will be developed to encourage early movers in developing SWM investments. Technical assistance will be provided to identify and develop SWM initiatives by the private sector, to support the implementation of Turkey's integrated waste management action plan, and to develop awareness and knowledge initiatives supporting SWM expansion throughout Turkey.

There is huge diversity in Turkey with respect to cultural norms, socioeconomic status and education, so this needs to be taken into account when planning for and implementing stakeholder engagement. This also needs to be considered when assessing any reform in tariffs related to the Bank's investments.

As mentioned in the previous section, while women have the same legal rights as men with respect to access to credit or bank loans, Turkish women are less likely to own property. This will need to be taken into consideration when mitigating for the impacts of any resettlement and/or land acquisition. In addition, as Turkey has the lowest female labour force participation rate among OECD countries, a full assessment of human resources and labour policies needs to be undertaken to ensure that there are no underlying discriminatory practices.

It is common for children to work on farms so an assessment of supply chains and risk of harmful child labour will need to be undertaken for certain sectors.

3.5 EBRD co-operation with the European Union, MDBs and other international partners

Donor coordination in Turkey is led by the Turkish Treasury, with the EU Delegation also organising regular donor meetings in Ankara. The Bank is closely engaged in all these processes and the opening of the Ankara Resident Office has allowed the Bank to enhance its coordination ability with a broad range of donors and multilateral institutions. The three dominant IFIs in Turkey are the EIB, World Bank Group and the EBRD, all working with different approaches which often complement each other, resulting in some cases in co-financing of investment projects. There is effective and frequent communication between the three entities, both in Ankara and Istanbul.

In key areas including energy, transport and inclusion, EBRD's operations reinforce those of the IBRD and the EIB, through supporting the detailed implementation of structural adjustment programmes and policy initiatives. For example, EBRD's work on infrastructure PPPs builds on the previous effort of the IBRD in that area. In the upcoming strategy period, EBRD will seek to build upon the World Bank's beneficial work with TCDD, exploring opportunities to jointly encourage commercialisation of the Turkish railway sector. In addition, as the World Bank and EBRD both utilise funding under the EU's IPA I technical assistance allocation for energy, there will be ample room for close cooperation in this important sector. The recent opening of an EIB office in Ankara should further strengthen cooperation on topics relevant to policy dialogue, such as private sector development and PPPs.

In other areas, the EIB, IFC and EIB are fully complementary through co-financing of complex projects. In the past strategy period, the Bank has co-financed several projects with EIB, including the Eurasia Tunnel in Istanbul and MidSEFF credit lines. EIB and EBRD cooperation is likely to continue to centre on infrastructure and larger projects. In the area of healthcare, EBRD is exploring co-financing arrangements with IFC and EIB for the various hospital PPP projects under a framework operation approved by the Board in September 2014. In addition, EBRD will continue to work with IFC to co-finance projects in other sectors. IFC and the Bank work in similar spaces and often with similar clients, making an ongoing exchange of views particularly vital. This is especially true in the financial sector, where there is overlap in the participating banks acting as financial intermediaries.

Lastly, in some areas of overlap, there are differences in underlying approaches. For example, the EBRD's operations with the financial sector are mainly with private sector banks with funding provided on commercial terms intended to support the development of sustainable funding bases. The IBRD and EIB on the other hand provide significant funding to state-owned banks on concessional terms, mainly for funding of SMEs and energy efficiency. In the municipal sector, IBRD and EIB also provide concessional finance through state-owned Iller Bank, while EBRD focuses on commercialisation through direct operations with creditworthy municipalities to achieve financial sustainability. The EIB often finances large infrastructure and energy projects indirectly through the Turkish banks with strong credit profiles, with the funding being provided to the banks at below market rates. In those sectors, the EBRD's approach is to fund the projects directly at commercial terms and on the basis of limited recourse project financing structures.

EBRD has been closely cooperating with the EU. The two institutions' priorities are well aligned, in particular in the areas of environment and climate, transport, energy, inclusion and innovation, and the Bank has been working to identify opportunities to leverage IPA II funding. In 2014, the EU and EBRD signed two major donor funding agreements, one on Women in Business (€38 million) and one in the energy sector (€24 million) and discussions are progressing well toward a funding agreement for supporting innovation within the SME sector.

In September 2013, the IDB opened an office in Ankara to manage public sector projects, mainly in infrastructure. Another office in Istanbul is expected to be established to focus on private sector projects. Given the increasing interest of the Turkish government in Islamic financial products and solutions, IDB could eventually play a role as a potential co-financing party for EBRD projects (with the Bank providing conventional finance and IDB Islamic finance).

Strong cooperation will also continue with bilateral development agencies, especially AFD and KfW, which both have strong sustainable development and energy portfolios.

ANNEX 1 – POLITICAL ASSESSMENT

Turkey is committed to the principles of multiparty democracy and pluralism in accordance with Article 1 of the Agreement Establishing the Bank. There has been progress in the application of these principles in some areas, whilst further efforts are needed in others.

Over the last strategy period Turkey has taken steps towards guaranteeing rights of its diverse communities, including by initiating a democratic opening with the Kurds, strengthened civil-military relations and improved state capacity to address human rights concerns. At the same time, additional steps are needed to further strengthen the independence of the judiciary, freedom of the media and the internet and reinforce the government's commitment to fight corruption. Political polarisation within Turkish society affects public trust in institutions and constrains opportunities for inclusive political participation.

Turkey has made progress in improving its competitiveness and reducing transition gaps. However, in order to improve its position among G20 economies and attract more foreign investment it needs to strengthen the rule of law, implement comprehensive anti-corruption policies and safeguard political independence of key economic institutions.

Free Elections and Representative Government

Turkey held mostly free and competitive elections since 1950, making it one of the longest functioning electoral democracies among EBRD countries of operations. The current Constitution dating back to 1982 guarantees separation of powers, but more needs to be done to strengthen democratic checks and balances in practice. In recent years separation of powers was affected by a comprehensive overhaul of the judiciary. In September 2013 the government unveiled a "democratisation package" of reforms and in March 2014 the parliament adopted legislative amendments concerning elections and political parties. Reforms permitted political campaigning in languages other than Turkish, legalised party co-chairmanship and eased the rules on local organisation of political parties.

Free, fair and competitive elections

The current Constitution and law provide citizens with the right to change their government peacefully, and in the recent strategy period citizens have exercised this right through periodic, free and competitive elections based on universal suffrage. The Law on the Parliamentary Elections of 1983 introduces a proportional representation system with a nationwide 10 per cent threshold for entry into parliament. This threshold, applied at the national level, was put to the scrutiny of the European Court of Human Rights (ECtHR) in 2007 and was found to be in line with the European Convention on Human Rights. The 10 per cent threshold is the highest among Council of Europe members and observers noted that this has a potential to limit representation of smaller political parties. However, in the June 2015 parliamentary elections four parties, which have exceeded the 10 per cent threshold, received between them over 95 per cent of votes (in contrast to just 55 per cent in the 2002 elections).

In August 2014 Turkey held the first direct presidential elections and, according to the OSCE/ODIHR observation report, “candidates were generally able to campaign freely [and] freedoms of assembly and association were respected.”[12] However, the report continued, the use of his official position as well as favourable media coverage gave the Prime Minister a distinct advantage over the other candidates. The March 2014 local elections, which followed a period of political turbulence, delivered a strong vote of confidence to AKP, which received the largest share of the vote (45.43 per cent of provincial council votes and 45.54 per cent of metropolitan municipalities). However, the elections were marred by allegations of irregularities, by both opposition and AKP candidates, leading to several re-runs.

The June 7, 2015 parliamentary elections took place amidst very high citizens’ participation. With twenty parties and 165 independent candidates taking part in the elections, voters enjoyed a wide and diverse choice. The International Elections Observation Mission (IEOM) consisting of ODIHR, OSCE PA and Council of Europe PA commended Turkey’s commitment to holding pluralistic democratic elections. At the same time the IEOM noted that “media freedom is an area of serious concern” and that “there were numerous serious incidents, some resulting in fatalities” during the election campaign”[13]. However, IEOM concluded that “fundamental freedoms were generally respected”.

Separation of powers and effective checks and balances

Under the current Constitution, state powers are separated. Turkey is a constitutional republic with a multiparty parliament and a president who is the Head of State, elected for five years by direct vote. The current President Recep Tayyip Erdoğan took his oath on 28 August. In practice it remains at the discretion of the President how extensively he/she decides to interpret the executive role alongside the prime minister, who holds the main executive power. The prime minister’s powerful role is underpinned by his status as the chairman of the largest party in parliament. The prime minister nominates the ministers, whose appointment is subject to the approval of the Turkish Grand National Assembly. The president has some executive powers including the right to occasionally chair meetings of the Council of Ministers. The Turkish Grand National Assembly can dismiss the cabinet by a vote of no confidence.

The 550-seat unicameral parliament (the Grand National Assembly), exercises legislative authority and is elected for a four year term under a system of proportional representation. The AKP introduced an extra-constitutional limit of three terms for its members of parliament. Recently, the parliament’s ability to perform its key functions of oversight of the executive was affected negatively by a lack of constructive dialogue and willingness to compromise among political parties.[14]

The Constitution provides for an independent judiciary and the independence of individual prosecutors. The Constitutional Court provided effective oversight over

[12] OSCE/ODIHR (2014): International Election Observation Mission, Republic of Turkey – Presidential Election, Statement of Preliminary Findings and Conclusions, p.1

[13] Statement of Preliminary Findings and Conclusions, Republic of Turkey – Parliamentary Elections 7 June 2015, p.1

[14] European Commission (2014): Turkey Progress Report 2014, p. 8

decisions by the government and by the parliamentary majority. The Government respected rulings of the Constitutional Court. However, in 2013-2014 allegations arose regarding attempts to influence the judiciary, particularly in the context of the reform of the High Council of Judges and Prosecutors (HSYK).

Effective power to govern of elected officials

Elected officials generally have effective power to govern. In recent years the AKP government and its parliamentary majority implemented several reforms which strengthened civilian control over the military. Recently there were allegations about the existence of a “parallel structure” operating within state institutions, controlled by the Islamic scholar Fethullah Gülen and his followers. Throughout 2014 thousands of suspected Gulenists were removed from their positions in the judiciary, police, media and civil service and some were arrested.

Civil Society, Media and Participation

Turkey has a well-developed civil society, which remains vocal in advocating views of different communities and groups in Turkey, including through street protests and use of social media. In practice, civil society organisations have limited opportunities for translating grassroots political activism into effective influence over government policy. At the same time, the recent democratisation package of reforms and the ongoing democratic opening created opportunities for peaceful integration and greater political participation of Kurdish and other communities at all levels of government. Turkey has a diverse and vibrant media, but recently concerns have been raised by some Turkish and international organisations regarding freedom of expression.

Scale and independence of civil society

Over 250,000 civil society organisations and associations are registered with the Turkish Ministry of Interior, with around 100,000 of them being active. State funding for NGOs increased significantly from TL 1 million in 2010 to TL 22 million in 2015, although public funding for civil society organisations is not sufficiently transparent. The system of private funding for NGOs is not fully developed which limit capacity of independent watchdog NGOs to provide oversight over government activities. Under the current law, persons organizing an association do not need to notify authorities before interacting with international organisations, but must provide notification before receiving financial support from abroad and must provide detailed documents on such activities. Numerous business associations play an important role in policy dialogue with the government, including in regard to democratic deficit and rule of law.

Independent pluralistic media that operates without censorship

Turkey has a long established, diverse and professional press and media. There are over 7000 newspapers and magazines published in Turkey and the total daily circulation of newspapers published at the national level is nearly 5 million. The print media in Turkey is privately owned. Hundreds of newspapers spanning the political spectrum are published in different languages, including Kurdish, Armenian, Arabic, English, and Farsi. The media is mostly owned by powerful conglomerates or holding companies.

In recent years some concerns have been raised about freedom of expression and there are reports about the emergence of a culture of self-censorship. In addition there were some cases of journalists' arrests, strict application of privacy laws and reports of critical journalists facing a range of serious obstacles, threatening their jobs. The International Election Observation Mission for the June 7 ,2015 elections noted in its report that "media critical of the ruling party faced increased pressure and intimidation by public figures and political actors during the campaign period."[15]

At the same time, the OSCE Representative on Freedom of the Media noted that in recent years there was a substantial decrease of imprisoned journalists in Turkey. An annual survey commissioned by the Representative's Office showed that 95 Turkish journalists were imprisoned in 2011, which fell to around 20 in 2014[16]. Several journalists who had spent extended periods in detention awaiting trials were released following the adoption of the judicial reform package. The government maintains following its own investigation of the evidence that journalists were detained due to reasons unrelated to their journalistic activity.

Turkish citizens are among the most active users of the internet among EBRD countries of operations. The law on the internet was amended several times in 2014, with a view, according to the Government, to balance freedom of expression and protection of privacy and personal rights. These changes introduced the concept of proportional website bans and eliminated prison sentences for hosting service providers and access providers. In October 2014, the Constitutional Court annulled provisions which had been introduced in September in the law on the internet and which, notably, had extended the Telecommunications Communication Presidency (TIB) powers regarding blocking of websites and retention of data, which were criticized by several international media watchdog organisations. In 2013-2014 the freedom of the internet has been constrained by several temporary bans on websites and social media platforms, such as Twitter and YouTube for refusing to enforce Turkish court rulings on removing content. The Constitutional Court overturned these bans.

Multiple channels of civic and political participation

The Constitution grants Turkish citizens with many access points for participation in political decision-making. Turnout at national and local elections remains consistently above 70 per cent. Citizens have a right to launch individual cases with the Constitutional Court. Many government ministries are making efforts to consult civil society, but these remain ad hoc. Turkey would benefit from a more structured participatory mechanism whereby civil society organisations are able to take an active part in legislative and policymaking processes.

Opposition groups on some occasions resorted to public protests in order to express their political views. Several large protests took place across Turkey in 2013. Police responded to some instances of violence with disproportionate use of force, as noted by the Ombudsman's report. In other cases the authorities responded positively to demands, including by stopping the Gezi park demolition and taking steps to address

[15] International Election Observation Mission, Republic of Turkey, Parliamentary elections, 7 June 2015. Statement of Preliminary Findings and Conclusions p.3
[16] http://www.osce.org/fom/131896

concerns of ethnic and religious communities. The UN Special Rapporteur urged the authorities to ensure that no one is criminalised for the peaceful exercise of the rights to freedom of peaceful assembly and of association.[17]

Freedom to form political parties and existence of organised opposition

Turkey has a competitive multiparty system, however the opposition has weak public support and is unable to effectively challenge the established political dominance of the ruling AKP, which enjoys favourable media coverage and better access to administrative and financial resources.

While political parties and candidates could freely declare their candidacy and run for election, the chief prosecutor of the Court of Appeals can seek to close political parties for unconstitutional activities by bringing a case before the Constitutional Court.

According to a report by the Council of Europe's Group of States against corruption (GRECO), Turkey is yet to comply with its recommendations in assuring transparency of Party Funding[18]. OSCE/ODIHR report on recent elections noted concerns relating to transparency and accountability in funding for political parties and election campaigns.[19] On January 14, 2015 Prime Minister Ahmet Davutoğlu announced a legislative package aimed at instituting transparency in public life. It contains a number of measures concerning financing of political parties and elections.

Rule of Law and Access to Justice

Turkey has a well-developed functioning legal system, professional judges and an extensive body of laws. The Constitution guarantees all Turkish citizens the right to a fair trial. Six judicial reform packages were adopted as part of the Judicial Reform Strategy in the last few years. Further steps are needed to achieve the full independence of the judiciary and to ensure that all its citizens enjoy the right to a fair trial in practice. Under the AKP government significant progress has been achieved in both areas first by limiting the jurisdiction of military courts and later by abolishing Specially Authorised Courts. Moreover, the third and the fourth judicial reform packages adopted in 2012 and 2013 led to an improvement in access to justice for all citizens and helped to reduce number of cases filed by Turkish citizens in the ECHR.

Supremacy of the law

The Constitution guarantees all Turkish citizens the right to a fair trial. In the past there were some shortcomings in implementation. Between 2012 and 2014 the parliament adopted several judicial reform packages which were specifically targeted at reducing pre-trial detention. As a result the number of detained persons has decreased significantly during that period. In February 2014 an Omnibus Law (amending the anti-terror law, the criminal procedure code and various other laws) abolished all remaining specially authorised courts, which had posed the key obstacle because of extensive

[17] UN Human Rights Council (2013): Report by the Special Rapporteur on the rights to freedom of peaceful assembly and of association, p. 56
[18] GRECO (2014) Third Evaluation Round – Second Compliance Report on Turkey p.21f
[19] Final Report of Limited Election Observation Mission – Presidential Elections 2014, p. 15f.

powers to authorise long pre-trial detention regimes, limitations on the right of defence, excessively long indictments and the slow pace of judicial proceedings. The introduction of individual application procedures to the Constitutional Court, which came into force in 2012, has made a significant improvement in access to justice for many Turkish citizens with over 32,000 applications filed over the past three years.

Independence of the judiciary

According to the Constitution, the judiciary is independent from the legislative and executive powers. No organ, authority, office or individual may give orders or instructions to courts or judges relating to the exercise of judicial power or make recommendations or suggestion. With the introduction of the individual application mechanism to the Constitutional Court, and the recent judgements of the Constitutional Court, the independent role of the judiciary in terms of the protection of rights and freedoms has been demonstrated.

Throughout 2014 a number of judicial reforms that could potentially limit the independence of the judiciary were initiated. Amendments to the Law on High Council of Judges and Prosecutors (HSYK) and the Law on the Justice Academy were adopted within a very short period of time and without comprehensive stakeholder consultation. These changes provided for the transfer of some powers from the plenary to the Ministry of Justice, raising concerns over separation of powers[20]. The Constitutional Court subsequently ruled a number of provisions of the new HSYK law to be unconstitutional, including the decision to replace some of its members. However, some areas of concern remained[21].

Government and citizens equally subject to the law

Generally, the state and society hold civil servants accountable and conflicts of interest are punished. The Members of Parliament have immunity from prosecution for certain offences. Four Ministers resigned from Government after being embroiled in graft investigations which surfaced in December 2013. The response to corruption allegations, which were perceived by some as interference of the executive into the independence, impartiality and efficiency of the judiciary, raised concerns in the international community.[22]

Effective policies and institutions to prevent corruption

In recent years there has been some progress in the fight against corruption, notably by increasing transparency in the public administration. In 2010 the Government adopted a Strategy for Enhancing Transparency and Strengthening the Fight Against Corruption for a four year period and set up a Commission charged with implementing the strategy which is headed by the Deputy Prime Minister. On January 2014 the Commission approved proposals submitted by working groups with specific anti-corruption measures. Some measures, such as the establishment of the institution of ombudsman,

[20] European Commission (2014): Turkey Progress Report 2014, p. 44
[21] Consultative Council of European Prosecutors (CCPE) Declaration concerning recent developments in Turkey as regards some amendments to the national legislation on the judicial system, 6 June 2014
[22] European Commission (2014): Turkey Progress Report 2014, p. 10

have been implemented, while others relating to transparency in financing of political parties and adopting the law on General Administrative Procedure and Improving the State Procurement system are still in the process of implementation.

The 2014 EU progress report for Turkey notes insufficient control over and verification of assets declared by elected public officials, appointed public officials and political figures. It recommends that in line with Art. 20 of the United Nations' Convention Against Corruption, Turkey should consider criminalising illicit enrichment[23]. OECD Working Group on implementing anti-bribery convention noted that that political interference may impact foreign bribery investigations and prosecutions remain a serious concern.[24]

The GRECO 2014 Compliance Report welcomed the fact that Turkey has taken into account several concerns expressed in the Compliance Report in the reform process which led to the adoption of a new legal framework for the criminalisation of corruption offenses and took note of the relevant provisions which have been overhauled in order to comply with the requirements of GRECO's recommendations and that more comprehensive corruption provisions are now in place. However, several shortcomings in the relevant provisions of the Turkish Penal Code, as compared with the standards established by the Convention, have also been noted in the GRECO 2014 Compliance Report.[25] Transparency International downgraded Turkey from 50 to 45 (with 100 being the highest achievable score) in its 2014 Corruption Perception Index, referring to "endemic corruption at the highest levels of Turkey's businesses and government", and noted that the government's anti-corruption campaign targets mainly political enemies rather than those responsible for corrupt practices.[26]The Turkish authorities have rejected these claims.

Civil and Political Rights

The Turkish Constitution guarantees all key fundamental rights, however other laws, in particular the Anti-terrorism Law, impose limitations on the freedom of speech, assembly and association. Turkey has implemented a comprehensive reform of its human rights protection institutions with the view to reduce the number of cases in the European Court for Human Rights (ECHR). In the last two years, the number of new applications went sharply down, with most of them concerning the right to a fair trial.

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

Freedom of expression and freedom of press are safeguarded by the Constitution and other laws. In recent years six Judicial Reform Packages further improved freedom of expression. The democratisation package of reforms allowed Turkish citizens to carry

[23] European Commission (2014): Turkey Progress Report 2014, p. 48
[24] Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Turkey, October 2014 p.11 http://www.oecd.org/daf/anti-bribery/TurkeyPhase3ReportEN.pdf
[25] GRECO (2014): Third Evaluation Round – Second Compliance Report on Turkey, p. 21
[26] Transparency International (2014): Press release under: http://blog.transparency.org/2014/12/03/europe-central-asia-and-the-state-of-corruption-in-2014-the-gold-standard/

out a political campaign in any language or dialect that they prefer and to learn their mother language in private schools without any limitation. There was a decrease in the number of ECHR applications is a result of the introduction of new domestic remedies such as the Human Rights Compensation Commission which saw the scope of its jurisdiction expanded in February 2014. The 'Action Plan for the Prevention of Violations of the European Convention on Human Rights', adopted in March 2014 , represent a significant step towards bringing Turkey's legal framework in line with ECHR case-law. The Action Plan envisages the revision of some provisions of the Turkish Criminal Code that restrict freedom of expression and freedom of the press in the areas where the ECHR found Turkey to be in violation of the European Convention on Human Rights. Further steps are needed to ensure that implementation of provisions of the Criminal Code and other laws are not being used to limit freedom of expression.

The Ombudsman Institution, established in June 2012, operates on behalf of the parliament as an independent complaint mechanism to investigate, research, and make suggestions regarding practices and actions of the public administration, particularly in regards to human rights issues. The EU progress report assessed that the Ombudsman Institution had yet to gain the full trust of civil society, that it should have more authority to make spot checks on its own initiative, and that parliament should follow up on its recommendations.

The EU Progress report notes that Turkish legislation and its implementation concerning the right to assembly and regarding intervention by law enforcement officers are still to be brought in line with European standards.[27]The UN Special Rapporteur on the rights to freedom of peaceful assembly and of association urged the authorities to take positive measures to ensure that all individuals without discrimination of any kind can freely exercise their right to freedom of association and of peaceful assembly in all parts of the country.[28]

Freedom of worship continued to be generally respected in Turkey. Further reforms are needed to bring the legislation on freedom of thought, conscience and religion and application of this legislation in line with ECtHR rulings, Council of Europe recommendations and EU standards.[29]

Political inclusiveness for women, ethnic and other minorities[30]

Political inclusiveness of women and minorities remains an area for further attention, though progress has been made in enhancing the rights of Kurdish and other

[27] EU progress report 2014 p.15
[28] UN Human Rights Council (2013): Report by the Special Rapporteur on the rights to freedom of peaceful assembly and of association, p. 56
[29]EU progress report 2014 p.24
[30]"Minority rights" in Turkey are regulated in accordance with the Lausanne Peace Treaty of 1923. According to this Treaty, Turkish citizens belonging to non-Muslim minorities fall within the scope of the term "minority. Turkish legislation which is based on the Lausanne Peace Treaty contains the term "non-Muslim minority" only. The term "minority" cannot be used for Muslim Turkish citizens. In line with the state philosophy based on assuring the equality of its citizens without discrimination, Turkish citizens belonging to non-Muslim minorities enjoy and exercise the same rights and freedoms as the rest of the population. They also benefit from the exclusive assurances accorded to them deriving from their minority status under Articles 37-45 of the Lausanne Peace Treaty."

communities. Political representation of women remains low; however, the June 7 2015 Parliamentary elections produced the most diverse parliament in recent Turkish history with the share of female MPs increasing to 17 per cent after 96 women won seats (an increase from 79 in the previous parliament). Yazidi, Roma, Christian and Kurdish communities have all increased their representation.

In January 2013, new talks were initiated to put an end to terrorism, which claimed over 40,000 lives since the 1980s and to provide a suitable environment for democratic and legitimate politics to everyone. Later the Turkish parliament adopted a law to ‘bring a stronger legal foundation to the settlement process’ which included measures to eliminate terrorism, strengthen social inclusion, and reintegrate those who leave the PKK and lay down their arms. The dialogue process continues in parallel with steps taken in the September 2013 Democratisation Package of reforms aimed at enhancing rights for all citizens. There has been progress, but further violent attacks could undermine this process.

Freedom from harassment, intimidation and torture

The government continued its work to ensure compliance with legal safeguards for the prevention of torture and ill-treatment. The UN Special Rapporteur urged the authorities to ensure no one is subject to, or threaten to be subject to, discrimination, threats or use of violence, harassment, persecution, intimidation or reprisals when exercising their fundamental rights and freedoms[31]. Turkey signed and ratified the Optional Protocol to the UN Convention Against Torture (OPCAT). The National Human Rights Institution (NHRI) was assigned the role of the national preventive mechanism (NPM) under the Optional Protocol to the United Nations Convention on Prevention of Torture.

The downward trend in the incidence and severity of ill-treatment in official detention places continued. However, the use of excessive force during demonstrations and arrests remains a matter of concern. The Turkish Ombudsman’s office issued a report on the 2013 Gezi protests – in which seven protesters and one police officer lost their lives – concluding that police used disproportionate force in suppressing the protests. The recommendations in the report were addressed not only to administrative agencies, but also to media, political parties and international institutions. Several policemen were dismissed and the total of 329 investigations into disproportionate use of force during Gezi protests were launched, most of them are still pending. Investigations into authorities’ handling of Gezi protests were reportedly hampered by the loss of evidence, obstruction and incomplete investigation of claims of sexual harassment.[32]

[31] Ibid p. 56
[32] European Commission (2014): Turkey Progress Report 2014, p.50

ANNEX 2 – SELECTED ECONOMIC INDICATORS

Turkey	2008	2009	2010	2011	2012	2013	2014
Output and Expenditure				*(Percentage change in real terms, s.a.)*			
GDP	0.7	-4.8	9.2	8.8	2.1	4.2	2.9
Private consumption	-0.3	-2.3	6.7	7.7	-0.5	5.1	1.4
Public consumption	1.7	7.8	2.0	4.7	6.1	6.5	4.7
Gross fixed capital formation	-6.2	-19.0	30.5	18.0	-2.7	4.4	-1.3
Exports of goods and services	2.7	-5.0	3.4	7.9	16.3	-0.2	6.8
Imports of goods and services	-4.1	-14.3	20.7	10.7	-0.4	9.0	-0.2
Industrial gross output	…	…	…	…	…	…	
Labour market				*(Percentage change)*			
Gross average monthly earnings (annual average)	…	…	…	…	…	…	…
Real LCU wage growth	…	…	…	…	…	…	…
				(In per cent of labour force)			
Unemployment rate	10.0	13.1	11.1	9.1	8.4	9.0	9.9
Prices				*(Percentage change)*			
Consumer prices (annual average)	10.4	6.3	8.6	6.5	8.9	7.5	8.9
Consumer prices (end-year)	10.1	6.5	6.4	10.4	6.2	7.4	8.2
Fiscal Indicators				*(In per cent of GDP)*			
General government balance	-1.6	-5.5	-3.0	-0.4	-1.0	-0.7	-0.8
General government revenues	32.9	34.6	35.5	36.4	37.8	40.0	39.1
General government expenditure	34.6	40.1	38.5	36.8	38.8	40.7	39.8
General government debt	40.0	46.0	42.3	39.1	36.2	36.1	33.5
Monetary and Financial Sectors				*(Percentage change)*			
Broad money (M2, end-year)	27.5	12.9	19.0	11.5	12.9	22.8	11.2
Credit to the private sector (end-year)	22.4	9.7	44.7	34.7	18.5	33.3	19.3
				(In per cent of total loans)			
Non-performing loans ratio	3.7	5.3	3.7	2.7	2.9	2.7	2.8
Interest and exchange rates				*(In per cent per annum, end-year)*			
Local currency deposit rate	18.1	8.8	7.9	10.0	7.2	8.1	9.4
Foreign currency deposit rate	3.7	1.6	2.1	3.3	2.0	2.2	1.5
Lending rate	17.5	9.0	9.0	12.5	9.1	11.7	11.8
Interbank rate (end-month)	15.0	6.5	6.5	10.9	5.5	7.7	10.8
Policy rate (Overnight borrowing rate)	15.0	6.5	1.5	5.0	5.0	3.5	7.5

Turkey	2008	2009	2010	2011	2012	2013	2014
				(TL per US dollar)			
Exchange rate (end-year)	1.53	1.49	1.54	1.89	1.78	2.14	2.32
Exchange rate (annual average)	1.30	1.55	1.50	1.68	1.80	1.90	2.19
External sector				*(In per cent of GDP)*			
Current account	-5.4	-1.9	-6.2	-9.7	-6.2	-7.9	-5.8
Trade balance	-7.1	-4.0	-7.7	-11.5	-8.3	-9.7	-7.9
Merchandise exports	19.0	17.8	16.5	18.4	20.6	19.6	21.1
Merchandise imports	-26.1	-21.8	-24.2	-29.9	-28.9	-29.4	29.1
Foreign direct investment	2.3	1.1	1.0	1.8	1.2	1.1	0.7
Gross reserves, excluding gold (end-year)	15.3	17.5	14.3	13.0	15.0	15.5	15.2
External debt stock	37.9	43.6	39.9	39.3	43.1	47.3	50.3
Public external debt	12.5	15.7	13.8	13.4	14.1	14.7	15.0
Private external debt	25.4	27.9	26.1	25.9	29.0	32.6	35.3
				(In months of imports of goods and services)			
Gross reserves, excluding gold (end-year)	6.4	8.6	6.4	4.8	5.7	5.8	5.7
Memorandum items				*(Denominations as indicated)*			
Population (end-year, millions)	71.1	72.1	73.0	74.0	74.9	76.7	77.7
GDP (in billions of TRL, nominal)	950.5	952.6	1,098.8	1,297.7	1,416.8	1,567.3	1,747.4
GDP per capita (in USD, nominal)	10,444.4	8,560.7	10,002.6	10,427.6	10,459.2	10,807.0	10,404
Share of industry in GDP (in per cent)	19.7	19.1	19.4	19.9	19.4	19.1	19.5
Share of agriculture in GDP (in per cent)	7.6	8.3	8.4	8.0	7.9	7.4	7.1
FDI (in billions of USD)	17.3	7.0	7.6	13.8	9.2	8.8	5.5
External debt - reserves (In US$ billion)	81.3	75.4	52.0	104.0	88.7	117.9	154.0
External debt/exports of goods and services (per cent)	158.	185	185.7	165.8	165.2	186.3	183.5
Broad money (M2, end-year in per cent of GDP)	45.7	51.9	53.5	51.3	52.9	56.9	58.2

ANNEX 3 – ASSESSMENT OF TRANSITION CHALLENGES

Market Structure	**Market Institutions**	**Key challenges**
CORPORATES		
Agribusiness		
Medium	Small	▪ Reducing state intervention in agriculture by lowering the level of tariff protection and privatising state-owned enterprises in the sector ▪ Easing access to financing for primary agriculture from private commercial banks ▪ Enhancing standards in hygiene, quality and energy efficiency
Manufacturing and Services (M&S)		
Small	Medium	▪ Improving the legislative and regulatory framework for starting and operating a business, with a particular emphasis on construction permits, resolving insolvency issues and labour regulations ▪ Reducing the share of the informal sector, which is still high and hampers the full development of a market economy in Turkey ▪ Accelerating reforms in the infrastructure sector, which is critical to enhancing the competitiveness of the M&S sector ▪ Supporting better management and corporate governance in mid-sized companies in the regions
Real Estate		
Small	Medium	▪ Further increasing the focus on modern construction techniques and technologies, including sustainability (e.g. by improving the quality of primary and secondary legislation related to energy efficiency and sustainability in the sector) ▪ Further developing modern commercial property (with significant potential for setting high standards) in the less developed regions in the east and south of the country ▪ Further streamlining the property-related bureaucracy and improving access to land
Information & Communication Technologies (ICT)		
Medium	Small	▪ Completing the privatisation of the fixed line incumbent, Türk Telekom ▪ Further developing the telecommunications infrastructure (broadband internet outside of main metropolitan areas) ▪ Further modernising the ICT regulatory framework (aligning it with the EU 2009 regulatory framework) and ensuring enforcement of the access regulation (access to the incumbent's network)

Market Structure	Market Institutions	Key challenges
ENERGY		
Natural Resources		
Medium	Small	▪ Promoting greater participation of private operators in the upstream oil and gas sector ▪ Taking further steps to unbundle and liberalise the natural gas market, and to facilitate entry of new participants ▪ Reducing concentration in the fuels distribution market by promoting the expansion of smaller operators ▪ Reinforcing the legal and regulatory framework of mining activities, with special emphasis on environment, health, safety and sustainability (EHS&S)
Sustainable Energy		
Medium	Medium	▪ Strengthening institutional capacity to promote energy efficiency ▪ Achieving more effective energy efficiency project implementation ▪ Supporting institutional development and project deployment for climate change
Power		
Medium	Medium	▪ Increasing competition from the private sector in both generation and retail energy supply ▪ Strengthening independence of the regulator ▪ Completing the tariff reform and improving cost reflectiveness of tariffs for end-consumers
INFRASTRUCTURE		
Water and wastewater		
Large	Medium	▪ Corporatisation of municipal utility services to ease the financing burden for municipalities and retain financial resources within the water sector ▪ Restructuring of weaker operators, particularly outside the largest cities ▪ Tariff reform to introduce volumetric charging for residential users ▪ Increase in private sector participation to accelerate service expansion and improve service quality (particularly for wastewater treatment)

Market Structure	Market Institutions	Key challenges
Urban Transport		
Medium	Medium	▪ Corporatisation of municipal transport operators to allow them to finance investments on their own balance sheet, which coupled with good financial performance is the direct route of addressing access to financing which can complement fiscal decentralisation that could enhance the financial resources available to municipalities ▪ Introduction of transparent Public Service Contracts to regulate the relations between municipalities and operators ▪ Improvement of service coverage across all municipalities in the country ▪ Expansion of PPP structures ▪ Refining the urban mobility management and planning capabilities to include more widespread use of economic instruments (e.g. congestion charging)
Roads		
Medium	Medium	▪ Development of fair and clear tendering processes and introduction of performance-based contracts for road maintenance ▪ Development of PPP projects in line with international best practice ▪ Improvement in governance and accountability of road agencies
Railways		
Medium	Medium	▪ Implementation of the large scale sector reform aiming at commercialisation, structural unbundling and corporate restructuring ▪ Private sector development in core freight operations and ancillary services ▪ Development of an adequate regulatory framework
FINANCIAL INSTITUTIONS		
Banking		
Medium	Small	▪ Continuing to develop a more dynamic banking sector capable of more complex credit analysis and product innovation ▪ Continuing progress in financial deepening, including outreach to underserved regions and segments
Insurance and other financial services		
Medium	Small	▪ Aligning insurance legislation, regulation and supervision with the EU framework ▪ Further developing the insurance industry's product range and skills ▪ Re-examining the framework for pension fund fees and asset allocation ▪ Broadening the availability of mortgages and developing a secondary market financing for mortgages

Market Structure	Market Institutions	Key challenges
Micro, small and medium-sized enterprises		
Small	Medium	▪ Increasing financial intermediation by private commercial banks and other providers of MSME financing outside major cities ▪ Improving enforcement of bankruptcy laws and implementing a unified collateral registry
Private equity		
Medium	Small	▪ Demonstrating to local entrepreneurs how they benefit from the growth impact of bringing in private equity ▪ Building capacity particularly in mid-cap company private equity and in venture capital ▪ Develop the local institutional investor base
Capital markets		
Negligible	Small	▪ Deepening the interbank money market by addressing fragmentation and lack of reliable reference rates ▪ Developing the interest rate swaps market ▪ Expanding the range of products utilised in the market to include covered bonds and corporate bonds (including secured bank issues) ▪ Developing the local investor base to reduce vulnerability arising from foreign dominance of Borsa Istanbul capitalisation ▪ Privatising Borsa Istanbul to enhance efficiency and product innovation and become a regional trading hub

ECONOMIC INCLUSION GAP RATINGS

Inclusion gap dimension	Inclusion gap	Key challenges
REGIONS		
Quality and Quantity of Education	Large	▪ Improving the relevance and quality of educational deliverables in Turkey's underdeveloped regions (4 – 6) by enhancing private sector engagement in the development of training standards and curricula in relevant sectors ▪ Promoting greater quality and uptake of work based learning provision by employers and trainees ▪ Supporting access to education for girls in rural areas, particularly in the southeast of the country, with a focus on primary school leavers
Access to services	Large	▪ Increasing access to infrastructure and services that substantially enhance the economic opportunities of the local population, specifically in relation to improved health, water, and infrastructure
Access to finance	Large	▪ Promoting the development of financial products and services that particularly target businesses (especially SMEs) in south eastern parts of the country ▪ Enhance the provision and quality of financial literacy, and business support training for local entrepreneurs
Labour markets	Medium	▪ Promoting training opportunities, including higher quality work based learning programmes (such as apprenticeships) for local populations, particularly for young labour market entrants, by creating progression routes into formal employment.

Inclusion gap dimension	Inclusion gap	Key challenges
		YOUTH
Opportunities for Youth	Large	▪ Developing effective active labour market policies (ALMPs) to address in particular the mismatch between the large numbers of vacant positions and the high youth unemployment rates as well as low female workforce participation; targeting specifically the lowest-skilled groups through basic skills training in order to enable them to benefit from any ALMPs ▪ Improving education and career choices for young people, particularly women, through better focused career guidance that is delivered in partnership with the private sector ▪ Developing effective progression routes from training into formal employment through improved links and partnerships between employers (clients) and education providers to reduce skills-mismatch ▪ Enhancing opportunities for youth with no schooling and early school leavers through lifelong learning provision
Quality and quantity of education	Large / medium	▪ Building on (successful) existing programmes such as Skills 10 (see p. 31) which strengthen the policy focus on (vocational) education and training to better align the output of the education system with the demands of employers to minimize the current skills-mismatch and reduce early school dropouts ▪ Improving the quality and uptake of vocational training provision and enhance the work based learning component (e.g. apprenticeships, internships, traineeships) ▪ Increasing access to secondary education, especially for girls and women ▪ Enhancing the monitoring of outcomes and policy impact assessments to benefit the policy decision-making processes.
Labour market structure	Medium	▪ Enhancing labour market flexibility and reducing labour market entry barriers for youth (and women), specifically in relation to wage setting flexibility
Financial inclusion	Medium	▪ Incentivising financial institutions to develop and bring to the market financial products aimed at young entrepreneurs, coupled with non-financial support such as basic literacy training and business / management training programmes targeted at youth ▪ Increasing the availability of entrepreneurship training in schools and universities ▪ Enhancing active partnerships between universities and financial institutions to create a conducive environment for business start-up and growth based on best international practice

Inclusion gap dimension	Inclusion gap	Key challenges
GENDER		
Labour practice	Large	▪ Incentivising clients to improve and monitor equal pay for jobs of equal value ▪ Incentivising clients to promote gender equality/diversity plans to promote equal opportunities in the workplace including, career promotion, access to leadership and management, and the prevention of fight against harassment ▪ Enhancing elements of the labour code specifically to promote the introduction of a guarantee of the same or equivalent job for women returning from maternity leave and reduce restrictions for women to undertake certain types of jobs
Employment and firm ownership	Large	▪ Promoting the increased uptake of equal opportunities measures (including relevant accreditations such as the FEM KAGIDER scheme or the participation in the Equality at Work Platform) by companies across different sectors and geographic regions in the country ▪ Incentivising clients in developing female leadership, mentoring, training and networking programmes ▪ Improving entrepreneurial opportunities and business training and financial literacy programmes specifically aimed at women ▪ Improving the number of women on boards (following the IWD initiative with the support of Borsa Istanbul)
Access to finance	Large	▪ Supporting the banking sector to recognise female entrepreneurs as a viable and profitable customer segment ▪ Improve financial literacy and business management skills of female entrepreneurs, which still fall below those of their male counterparts ▪ Enhancing the availability and quality of SME business consultancy support provision
Education	Medium	▪ Enhancing the enrolment rates of girls in secondary and tertiary education, especially in rural areas ▪ Improving career guidance specifically for girls and young women, including female early school leavers ▪ Improving the quality and reach of lifelong learning provision to encourage more women to upgrade their skills and seek employment

ANNEX 4 – LEGAL TRANSITION

Introduction

This annex offers critical analysis on selected legal topics relevant to the Bank's investment strategy in Turkey during the forthcoming period. It is based on the assessments of commercial laws conducted by EBRD Legal Transition Programme.[33] This analysis focuses on the main themes highlighted as priorities for policy dialogue in the country strategy, namely energy, public-private partnerships, pledge law (SME access to finance), and corporate governance.

1. Energy Efficiency and Renewable Energy

Renewable Energy

Turkey is rich in hydroelectric, geothermal, solar and wind energy resources and has a high potential for their development. The Electric Energy Market and Supply Security Strategy Paper approved by the government in 2009 introduced a 30 per cent target for the share of renewable energy sources (RES) in electricity generation by 2023.

The Law on Utilisation of Renewable Energy Resources for the Purpose of Generating Electricity (Renewable Energy Law) enacted in 2005 and subsequently amended in 2011, aims at enhancing and supporting the use of RES in Turkey. A range of incentives are available for RES development, such as feed-in tariff and the EMRA-issued Renewable Energy Resource (RER) Certificates, which allow holders to benefit from the RER support mechanism, including purchase guarantee or regulated rates applicable to renewable energy regulation. Purchase guarantee applies to default electricity suppliers, which are required to purchase a certain amount of electricity from companies participating in the RER support mechanism at a minimum price per kWh set by regulation. The regulated rate for energy produced using domestically manufactured components applies if certain components are domestically manufactured. This incentive has been widely criticised by the international community as it creates unfair competition in favour of local companies. Other incentives include exemption of small scale generation plants using RES with a maximum installed capacity of 1 MW from the requirement to obtain a generation license. The feed-in tariffs were revised to differentiate by type of renewable projects (geothermal and biomass in particular).

Some of the major barriers to RES development are the complicated bureaucratic and administrative procedures, whereby, licence and permission processes for renewable energy are issued and maintained by different administrative authorities. Also, frequent changes in secondary legislation reduce the perception of market predictability for foreign investors.

[33] See www.ebrd.com/law.

Energy efficiency

Energy use in Turkey is increasing rapidly due to the country's growing population, production and industrialisation. The Energy Efficiency Law was adopted in 2007 and a basic institution (energy efficiency agency) was set up. Together with the relevant secondary legislation the Energy Efficiency Law aims to provide the legal basis and measures to promote and support energy efficiency (EE) in the industrial, transport, building, services and electricity sectors. The incentives for EE improvements include support for EE projects in industrial enterprises, EE support programme for small and medium sized enterprises (SMEs), training, audit and consultancy support, and other measures.

The Energy Efficiency Strategy Paper adopted in 2012 sets a 20 per cent target for reducing energy intensity by 2023. Further work is still required to set indicative energy savings targets per sector and to identify relevant instruments to achieve these. Research and development activities and implementation projects are underway to improve efficiency in the power sector, particularly in the area of electricity generation. Energy tariffs provide some incentives for low cost efficiency measures but still do not reflect environmental costs. The energy EE campaign ENVER has been set up to increase public and private sector awareness on EE through providing information on EE as well as the different types of RES available for use by various industries.

Several pieces of legislation were enacted to harmonise the national legal framework with EU legislation on energy labelling of electrical household appliances. Regulation on Energy Performance of Buildings was passed in 2008 to enable certification of buildings for efficient energy use. The General Directorate of Renewable Energy (YEGM) completed the tender works concerning the EE surveys and the preparation of the building performance certificates of 166 public buildings in 2014.

Turkey ratified the Kyoto Protocol in August 2009 but did not undertake any emission reduction commitments.

2. Public–Private Partnerships (PPP)

PPP schemes are governed by a combination of general and sector specific laws. Some of these acts date back to the 1990s and even the 1980s, e.g. the Privatisation Law No 4046 of 1994 that applies, in particular, to private sector selection procedures, and the Build-Operate-Transfer Law No. 3996 of 1994.

A stream of sector specific laws is applicable directly to private sector participation in infrastructure in the electricity sector since 1984, roads since 1988, airports and ports since 2005, as well as in health and regulates a number of possible PPP models. In addition, secondary legislation is applicable to PPPs in some sectors as well.

There is no single authority in charge of coordinating, monitoring or supervising PPPs/concessions. It is the line ministries that deal with the initiation, preparation and implementation of the projects subject to responsibility. Secretariat of the High Planning Council within the Ministry of Development coordinates the consultation process with the Ministry of Development, the Ministry of Finance and the Undersecretariat of Treasury. These entities are consulted regarding the technical, legal and fiscal aspects, where appropriate, of PPP project-related decisions to be made by this Council.

Generally the PPP legislation can be referred to as fairly comprehensive. There has been support to PPP schemes on the part of the authorities and for a long time a clear determination to promote public sector participation has been evident. This together with general laws and a well-established legal and administrative system contributed to the fact that PPP projects do work in practice. However, investors observe the relative complexity of PPP models and there is no single database of current and planned PPP projects. Security issues and government support instruments may be singled out as an area most in need for reform, possibly together with selection procedure regulations.

Following the requirement for improvement of the PPP system set out in the 10th Development Plan 2014-2018, the Ministry of Development is reported to have started working on further reforms. Sector approach may have been the preferred way for PPP implementation so far, yet the country will benefit even further from developing a more consistent legal framework applicable to PPPs and concessions.

3. Pledge Law (SME Access to Finance)

The Civil Code is the main source of law governing secured transactions – both pledges and mortgages. The Civil Code comprises a chapter with provisions on property rights, including mortgages (articles 850–938) and pledges (articles 939–972). The Code of Obligations, The Execution and Bankruptcy Act, the Commercial Enterprise Pledge Act and the Law Amending the Laws Related to the Housing Finance System also contain relevant provisions.

Taking security under Turkish law remains a fairly inflexible process, which limits the type of collateral that borrowers may be able to offer and the parties' contractual agreements over the security package. A uniform modern legal system of taking non-possessory security over any type of movable property and efficient registration of such rights does not exist. The main type of a non-possessory security over movable properties and rights is a commercial enterprise pledge in accordance with the Commercial Enterprise Pledge Law. The assets included in the pledge are listed by law on a limited basis (trade and enterprise names, machinery, equipment and vehicles used by the enterprise, and if the parties choose to do so, intellectual property rights) and do not include assets that were not allocated to the activity of the enterprise at the time of the agreement (future equipment), stock in trade or accounts receivable. Moreover, the pledgee's consent will be required for any operation on the collateral (including replacement). Registration of the security is done in the register operated by the Chamber of Commerce. Registers are not electronic or centralised, so search is cumbersome.

Taking security over intangible assets such as accounts receivable or bank accounts is a well-established practice but remains highly formalistic and restrictive. Accounts receivable are usually assigned, as opposed to pledged, and this requires a precise description of the assigned claims. Although the third-party obligor's consent is not needed for the validity of the assignment, the common understanding is that notice should be formally given to the obligor – in fact, many market participants require that this be done by a notary public, to guarantee evidence of the notification's date and contents. An assignment of all future and present claims would not be possible according to the general principles of the Civil Code. Future rights and receivables could be pledged as long as they can be defined in monetary terms at the time of the pledge.

Pledging bank accounts is widely used in practice. Notification to the bank where the account is held is recommended (but not required for the validity of pledge) and the pledged accounts should be specifically identified in the pledge agreement. It seems that there is a consensus among users that the pledgor would not be allowed to close and to draw money from the pledged account without the pledgee's consent.

Promoting the development of a modern all-encompassing system for taking non-possessory security over movable assets, and exploring other legal tools for access to finance such as reverse factoring is recommended.

4. Corporate Governance

The Turkish *Principles on Corporate Governance* (hereafter CG Principles) were first issued in 2003 and revised in 2005 in line with the 2004 amended OECD Corporate Governance Principles. The Principles consist of four main chapters, dealing with (i) Shareholders; (ii) Public Disclosure and Transparency; (iii) Stakeholders; and (iv) Board of Directors. The CG Principles were initially implemented on a "*comply or explain*" basis. In 2011, the Capital Market Board (CMB) Communiqué IV-54 provided for mandatory application of some of the Principles for the 30 largest companies listed on the Borsa Istanbul. In 2014 this requirement was extended to the companies listed on the National Market, Second National Market and Collective Products Market. The Principles not specifically included in the Communiqué are still to be applied on a "*comply or explain*" basis. However, the CMB has not yet developed any proper implementation and monitoring mechanisms. As a result, many key provisions from the CG Principles do not seem to be duly implemented.

The most recent EBRD assessment looking at the corporate governance legislation and practices of companies highlighted a relatively sound framework, among the best in the EBRD region. However some shortcomings appear especially with reference to the composition and functioning of boards.

The mandatory CG Principles require listed companies to establish an audit committee as well as several other committees, including a nomination and a remuneration committee. Committees are to be composed of a majority of non-executives, except for the audit committee, which must be made only of independent non-executive directors. All other committees can also be made of non-board members. This practice should be carefully considered, as the common wisdom is that committees should include only board members if the functions delegated to the committee are typical board functions. Secondly, it is essential that those members sitting in the committee and recommending specific actions to the board, do actually vote on the committee's recommendations at the board, therefore reinforcing their position and the board "objective judgement." Finally, committees that include outsiders might create problems with confidentiality and accountability issues.

Further, committees – with the exception of the audit committee – can include executives. This practice – especially for the remuneration committee – is likely to put the executive in a position of conflict of interest, as it allows executives to decide on their own remuneration.

The Bank has recently launched a corporate governance project titled “Implementation of the Turkish Corporate Governance Principles,” with the aim to assist the CMB to develop a set of tools and templates which would allow the CMB to monitor the implementation of the CG principles and that listed companies could use to duly implement the CG Principles. The project should start in mid-2015.

ANNEX 5 – GENDER PROFILE

Gender inequality and human development

According to the UNDP's Human Development Report 2013, Turkey ranks 68th out of 187 countries on the Gender Inequality Index (GII).[34] On the Human Development Index (HDI), Turkey ranks 90th out of 187. The 2014 World Economic Forum Global Gender Gap Index ranked Turkey 125th out of 142 countries.[35]

Education

There is near universal and equal primary school enrolment between boys and girls, but the gender gap in school enrolment widens at the secondary school level, and even more so at tertiary level. The OECD (2012) and UNESCO (2011) estimate that Turkey has the highest secondary school-level gender disparity in the OECD, East Europe and Central Asia regions. According to UNESCO's 2012 Gender and Education statistics, 97 per cent of boys and 96 per cent of girls are enrolled in primary school, 87 per cent boys and 82 per cent girls in secondary school, and 66 per cent of men and 55 per cent of women in tertiary education. The Turkish Statistical Institute (TUIK) reported that as of 2012 approximately 7 per cent of the female population was illiterate, compared to 1.4 per cent of the male population. Girls' enrolment rates in rural areas are roughly half of those in urban schools according to the World Bank (2010).

Labour force participation

As of 2013, Turkey's labour force participation (LFP) rate was 30.8 per cent for women and 71.5 per cent for men (TUIK 2013). This is the lowest female LFP rate among OECD countries, and one of the lowest among EBRD countries of operations, only comparable to female labour force participation in SEMED. Women's employment rate in the informal sector (i.e. not registered for social security) is approximately 48.4 per cent, significantly higher than men's at 29.3 per cent (TUIK 2014). The official unemployment rate is 11.9 per cent for women and 8.7 per cent for men (TUIK 2013). Turkish law prohibits women's access to employment in certain areas and sectors (e.g. coal mines, underground quarries, embanking, soil digging and excavation).

The labour code states that maternity leave in principle should last 16 weeks (eight before and after birth), but does not guarantee that women can return to the same or equivalent position after taking leave. Employers of a certain size are required to provide nursing rooms and day-care centres, potentially creating an economic disincentive to recruit women over a certain numerical threshold.

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[34] The GII is a new index for the measurement of gender disparity and is a composite measure which captures the loss of achievement, within a country, due to gender inequality, and uses three dimensions to do so: reproductive health, empowerment, and labour market participation.

[35] The WEF Global Gender Gap Index measures the gap between men and women in four fundamental categories: Economic Participation and Opportunity, Educational Attainment, Health and Survival and Political Empowerment. It varies between 1 – indicating no gap between men and women, and 0, meaning a very high gap between men and women. Turkey's score is 0.6183.

Entrepreneurship, access to finance and credit

The World Bank Enterprise Survey 2008 estimated that 40.7 per cent of firms in Turkey had female participation in ownership. Women have the same legal rights as men with respect to access to credit or bank loans, but the fact that Turkish women are less likely to own property affects their access to credit, as most commercial banks require collateral as a condition for loans. Women's access to credit is also affected by gender gaps in broader financial literacy. In a recent study of 15 emerging markets, Goldman Sachs (2014) identified Turkey (alongside Brazil and Indonesia) as the emerging market where women face the most restrictive bank financing relative to men. The World Bank (2012) estimates that only around 15 per cent of women-owned businesses in Turkey have access to credit, and 54 per cent are either financially unserved or underserved (IFC, 2014). Only 2.4 per cent of women reported having obtained a loan from a financial institution in 2011 compared with 6.7 per cent of men (WB FINDEX, 2011).

Participation in politics and decision-making

The latest official CEDAW[36] report on Turkey (2010) cites concerns over underrepresentation of women in political and public life, including in academia, the Foreign Service and the judiciary, with women particularly lacking in leadership and decision-making positions. According to the Inter-Parliamentary Union (2014), only 79 out of 548 parliamentarians are women (14.4 per cent). Only 0.9 per cent of mayors, 4.21 per cent of members of Municipal Councils and 3.25 per cent of members of City Councils are women, according to the results of the 2009 local elections.

[36] The Convention on the Elimination of All Forms of Discrimination against Women.

ANNEX 6 – EBRD AND THE DONOR COMMUNITY

Donor-funded technical cooperation (TC) in Turkey has allowed the Bank to undertake early diagnostic work, including feasibility studies and preparation of investment opportunities, build capacities of prospective clients, in particular project implementation support in the infrastructure sector, and share transition experience from policy makers and private sector stakeholders from EBRD Countries of Operations in Central and Eastern Europe. Significant donor funds were provided to support the transfer of skills and the growth of local private MSMEs through a range of advisory and investment and lending programmes, including the Business Advisory Services, the Enterprise Growth Programme and the Local Enterprise Facility.

Over the past four years, there has been an increased donor support in key infrastructure and sustainable energy sectors for Energy Efficiency and Climate Change programmes such as Mid-size Sustainable Energy Financing Facility (MidSEFF), Turkey Private Sector Sustainable Energy Financing Facility (TurSEFF) and Turkey Residential Energy Efficiency Financing Facility (TurREEFF). Some of these programmes will continue under the current strategy period. Additionally, the largest volume of grant funding for a single programme has been directed towards the Women in Business facility, launched in March 2014 and offering a comprehensive package of financial and technical support for entrepreneurship among women across Turkey.

Along with TC assignments, Turkey has benefited from non-TC grants supported by donor resources in the form of investment grants, performance incentive fees and risk-sharing first loss guarantees.

The focus of donor grants is expected to remain in improving the infrastructure, energy efficiency and climate change, as well as gender and inclusion areas in Turkey. Efforts will be made to ensure that donor funding benefits clients and end-beneficiaries in outer regions of the country to support regional inclusion.

To sustain these needs, the EBRD will rely on a number of donor funds administered by the Bank or managed externally, in addition to resources made available by its shareholders.

- **The European Union** has been supporting EBRD's work in Turkey since the Bank launched operations in the country in 2009. The EU has provided significant resources through its Instrument for Pre-Accession Assistance (IPA) to support EBRD's lending and policy dialogue work in such areas as SME finance, energy efficiency and renewable energy. The EU has also been instrumental in enabling implementation of advisory services to MSMEs under EBRD's Small Business Support programmes. It is expected that the EU will continue to play a major role in supporting Bank's operations during the current strategy period. The EU support will be sought through IPA II across several areas including SME finance, sustainable energy, resource efficiency, environment, and others. The Bank also looks forward to working with the EU on a loan and grant blending facility that the EU is considering to set up in Turkey to maximise the impact of EU grants and enhance cooperation with IFIs.

- **Global Funds for Climate Change and Environment activities**: The Climate Investment Funds (CIFs) have been one of the largest providers of donor support in Turkey, alongside the EU, with emphasis in supporting energy efficient and renewable energy investments via intermediated lending (SEFF structures). Additional donor resources are being sought from the CIFs sub-programme the Clean Technology Fund and from the Global Environment Facility, in particular for capacity building and non-TC instruments in the areas of climate change mitigation, geothermal exploration, material efficiency and private sector adaptation.

- **Bilateral donors**: grant funds will be sought from donors having bilateral donor accounts administered by the EBRD, who have expressed interest in supporting activities in Turkey across all sectors.

- **EBRD Shareholder Special Fund (SSF)** is endowed by the Bank's net income. The SSF is a complementary facility to donor resources and will provide TC and non-TC support in areas that are priorities for the Bank to advance transition, but where there is shortage or lack of support.

TC COMMITMENTS BY DONOR THROUGH EBRD, 2011–2014*

Donor	TC Commitments (€)
EU	25,512,042
EBRD Shareholder Special Fund	5,024,685
Spain	1,465,223
Austria	1,336,485
CIF – Clean Technology Fund	886,114
Slovak Republic	879,703
Italy	571,145
Czech Republic	150,000
Korea	114,101
Taipei China	55,859
Total	**35,995,357**

TC COMMITMENTS BY SECTOR THROUGH EBRD, 2011–2014*

Sector/Team	TC Commitments (€)
Sustainable Energy Initiative***	15,241,341
Small Business Initiative**	9,105,838
Financial Institutions	7,161,042
Infrastructure	3,712,409
Other (Gender, OCE)	526,500
Agribusiness	159,338
Legal Transition Programme	88,889
Total	**35,995,357**

Note: Commitment values based on year-end or period-end data for each year.
* Reflects commitments status as of 31 October 2014.
** This sector category encompasses direct assistance to SMEs and indirect assistance through policy dialogue between the EBRD, the authorities and commercial/business associations (e.g. Investment Councils).
*** This sector includes Energy Efficiency and Climate Change (E2C2) TC projects.

ANNEX 7 – TURKISH SUSTAINABLE ENERGY ACTION PLAN (SEAP) – STATUS REPORT

Sector	**Description of activity**	**Ministries/ Institutions**	**Action**
Resource Efficiency			
ESCO Market Development Potential	Preparatory work to assess the public and private sector ESCO market potential. TC completed and ESCO financing integrated into SEFF.	**MoENR,** MoEU	***Completed***
Waste to Energy Scale-up	Market potential and financing approaches for waste to energy installations. Market Assessment TC completed (donors include CTF and GEF). Development of a sustainable energy financing framework.	**MoENR,** MoEU, **MoD**	***Completed***
Glass recycling pilot project	Launch pilot project for glass recycling in 4 municipalities and develop a country-wide strategy for waste recycling	**Municipalities, Private sector**	***Completed***
National Energy Efficiency Action Plan (NEEAP)	Develop a NEEAP along the lines of the EU National EEAPs which has been approved.	**MoENR**	***Launched***
Power and Renewable Energy			
Geothermal market assessment	Development of financial risk mitigation tools to support private sector geothermal investment	**MTA, MoENR**	***Completed***
Smart metering Market potential	Smart metering market potential for Turkey, TC completed		***Completed***
Renewable Energy Action Plan (REAP)	Develop a REAP along the lines of the EU National REAPs. TC completed and ongoing support to Government on actions	**MoENR, MoEU**	***Completed***
Climate Change			
Carbon Emission Factor Modelling	Calculate, model and disseminate the grid emission factor of Turkey	**MoENR,** MoEU	***Launched***
Climate Change Adaptation	Climate Change Adaptation Analysis – TC study completed		***Completed***
National Appropriate Mitigation Actions (NAMA)	Develop sectoral NAMA plans and portfolio of potential projects for Turkey	MoEU**, MoENR**	***Under consideration***

MoENR: Ministry of Energy and Natural Resources, MoEU: Ministry of Environment and Urban Planning, MoD: Ministry of Development, MTA: Mineral Research & Exploration General Directorate