DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY
FOR
TURKEY

As approved by the Board of Directors at its meeting on 17 April 2012

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EXECUTIVE SUMMARY

Turkey is committed to and applying the principles of multi-party democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank, although some challenges remain.

Turkey has made significant progress in domestic political reforms by enhancing institutional checks and balances, bringing civil-military relations in line with democratic principles and opening dialogue with the country's minorities, including its Kurdish community. These steps have moved Turkey closer to meeting the political accession criteria in its negotiations with the EU. Areas for further reform include freedom of expression, women's rights and freedom of religion.

Since initiating operations in Turkey in 2009 the Bank signed a total of 55 projects with cumulative investment value of close to Euro 1.6 billion. Total project value of these investments was just under Euro 5 billion. Nearly all of this business was in the private sector with an emphasis on the micro, small and medium sized enterprise sector (particularly in more remote regions), which had difficulty gaining access to finance during the financial crisis and which was consistent with the Bank's strategy and core strengths.

Turkey's economy has shown robust growth in recent years and its banks weathered the global financial turmoil well, as evidenced by their balance sheet strength. Earlier financial sector reforms set the foundations for the stability of the banking system today. Economic growth was 9.2 per cent in 2010 and slowed to 8.5 per cent in 2011, with signs of overheating starting to materialise. Growth in 2012 could slow significantly – to around 2.5 per cent. Private sector credit, financed by foreign borrowing and a post-crisis return of short-term deposits, gradually fell from a high of 43 per cent year-on-year to 33 per cent year-on-year at end 2011.

Throughout the year import growth has outpaced export growth, but fell from a factor of 2.5 in the first half of 2011 to 1.7 per cent at year end, as a result of rapid domestic demand growth and increased energy prices. As a consequence the current account deficit widened to 10 per cent of GDP in 2011. The deficit is financed by increasing FDI as well as relatively short-term public and private sector borrowing.

Turkey's medium-term economic growth and reform prospects are good, notwithstanding certain vulnerabilities to further global financial turmoil. Recent reforms in the energy sector – especially to promote private sector participation, energy savings and renewables – as well as in the areas of competition law, labour market efficiency, improvements in the business environment and promotion of regional trade reinforce the prospects for sustainable growth and development.

Although recent growth and progress in reform have been strong, significant structural reform challenges and associated transition gaps remain. Key transition challenges that can be addressed with EBRD financing and assistance include:

- **Increasing private sector participation, sustainability and efficiency in the energy sectors:** While the Turkish economy as a whole is currently more energy

- **Developing mid-sized corporates in underdeveloped regions:** While larger corporates in the commercial centres have access to a range of finance, mid-sized corporates, especially in the regions, still suffer from lack of access to longer term financial products and from weaker business and corporate standards.
- **Strengthening regional and rural infrastructure sectors:** Municipalities, especially in the underdeveloped regions, have little debt capacity and suffer from inefficient operational management and service delivery for most utilities. The implementation of transparent PPP projects will help to attract more private sector investment into the infrastructure sector.
- **Supporting deepening of financial intermediation and local currency capital markets:** Despite reasonably well-functioning financial markets at short maturities, there is a lack of efficient intermediation of long-term funds to under-funded sectors and uses.

Strategic directions

Considering the financial and economic environment, the country's remaining reform challenges and the early stage of the Bank's operations in Turkey, the operational priorities will remain consistent with the current strategy. The Bank's activities will remain focused on those areas where the transition gaps are significant and where the Bank's finance and expertise are additional to what commercial and non-commercial funding sources can provide. The Bank's activities will concentrate on the following areas:

- **Developing sustainable energy.** The Bank will support through its investments to private sector investors in renewable energy and efficient power production and through policy dialogue, the ongoing reforms of the energy sector including promotion of favourable market conditions for the development of energy efficiency instruments across economic sectors.
- **Promoting the development of MSMEs.** The Bank will continue to increase the availability of risk capital and long term funding to MSMEs, including those engaged in agribusiness, through intermediated financing together with appropriate support to management through its Small Business Support (SBS) programmes, especially in the less developed regions.
- **Enhancing the competitiveness of Turkish industry**. The Bank will seek to support growth and development of the enterprise sector through direct lending and investment operations with domestic and foreign investors in a broad range of industrial and service sectors but with a particular focus on supporting agribusiness, energy efficiency investment, innovation and high value-added industries, sectoral value chains and companies operating outside metropolitan areas.
- **Promoting market approaches toward investment in municipal infrastructure**. The Bank will promote reform and support a secure and efficient delivery of vital utility services to the population and enterprises in the regions of Turkey on a non-sovereign basis.
- **Supporting privatisation**. The Bank will support the Turkish government's privatisation programme in the enterprise, financial and infrastructure sectors including through active participation in financing PPP projects.

Turkey is presently listed in the FATF's Public Statement as a country with strategic anti-money laundering (AML) and countering the financing of terrorism (CFT) deficiencies. Turkey has recently taken steps towards improving the AML/CFT regime. Further work remains to be done to address identified deficiencies. In this context, the Bank will follow the recommendations of the FATF to consider the risks associated with these deficiencies and will implement enhanced due diligence on all projects involving Turkey based sponsors. The Board of Directors will reassess this issue in line with any FATF developments.

In all its operations, and importantly in its policy dialogue with the authorities, the Bank will coordinate closely with other international financial institutions and bilateral donors to achieve maximum impact from its projects. The effectiveness of this Country Strategy in addressing the country's remaining transition challenges will depend crucially on the continued commitment of the Turkish Government to implement market reforms and to further strengthen the business environment.

1. THE BANK'S PORTFOLIO

1.1. Overview over Bank activities to date

As at end-February 2012, the Bank had signed a total of 55 projects with cumulative investment value of close to Euro 1.6 billion since initiating operations in 2009. Total project value of these investments was just under Euro 5 billion. Fifty five per cent of cumulative projects signed since the start of operations was in financial institutions. Corporate sector and infrastructure operations have each accounted for 16 per cent with 13 percent in the energy sector.

The pace of the Bank's operations have reflected a gradual build up in annual business volume from Euro 150m (5 operations) in 2009, to Euro 890 million (26 operations) in 2011 and to an expected Euro 1 billion (30 plus operations) in 2012. The relatively high proportion of business undertaken with financial institutions reflects an approach, particularly during the start-up period, of utilising strong distribution capacity from partner banks to access micro and small businesses (MSEs) in the more difficult regions and for lending to small and mid-sized sustainable energy projects.

Reflecting a strategic approach to concentrate on non-sovereign operations in Turkey, the private-public ratio is at 95 percent with municipal lending without sovereign cover accounting for the balance. Disbursement performance has exceeded expectations throughout and operating assets stood at Euro 1.4 billion at end February 2012.

Table 1: Portfolio Development in Turkey as of 29 February 2012

SECTOR	**NET CUMULATIVE BUSINESS VOLUME**				**CURRENT PORTFOLIO STOCK**				
Amount in EUR million	Number of projects	EBRD signed	Total Project Cost	*EBRD % of Total*	Number of projects	Portfolio	*% of Portfolio*	Operating Assets	*% of Operating Assets*
Energy	**4**	**203**	**804**	**13%**	**4**	**195**	**12%**	**167**	**12%**
Natural Resources	-	-	-	-	-	-	-	-	-
Power and Energy	4	203	804	13%	4	195	12%	167	12%
Financial Institutions	**25**	**865**	**1,960**	**55%**	**25**	**862**	**55%**	**807**	**59%**
Bank Equity	-	-	-	-	-	-	-	-	-
Bank Lending	8	369	629	23%	8	369	24%	369	27%
Small Business	7	247	903	16%	7	247	16%	231	17%
Insurance, Fin Services	10	249	428	16%	10	246	15%	206	15%
ICA	**18**	**256**	**1,195**	**16%**	**18**	**256**	**16%**	**178**	**13%**
Agribusiness	6	88	463	5%	6	88	5%	68	5%
Equity Funds	9	64	219	4%	9	64	4%	5	0%
Manufacturing & Services	3	104	512	7%	3	104	7%	104	8%
Property & Tourism	-	-	-	-	-	-	-	-	-
Telecom, Informatics, Media	-	-	-	-	-	-	-	-	-
Infrastructure	**8**	**250**	**985**	**16%**	**8**	**247**	**16%**	**216**	**16%**
MEI	6	213	902	14%	6	212	14%	195	14%
Transport	2	37	83	2%	2	36	2%	21	2%
TOTAL	**55**	**1,574**	**4,944**	**100%**	**55**	**1,561**	**100%**	**1,367**	**100%**

Table 2: Portfolio Development in Turkey, 2009-2011

Amount in EUR million	2009	2010	2011	Feb. 2012	Development over end 2009 – February 12
Net Cumulative Business Volume	150	647	1,535	1,574	+€1,424m
Current Portfolio Stock	150	644	1,525	1,561	+€1,411m
Number of Operations	5	27	53	55	+ 50 operations
Operating Assets	109	496	1,284	1,367	+€1,258m
% Undrawn	27%	23%	16%	12%	
					(cumulative 2009-February 2012)
Annual Business Volume	150	494	890	54	(estimated €1bn at year end = +€850m)
Number of Operations	5	22	26	4	(est. 30 projects at year end = +57 projects)
Gross Disbursements	109	387	799	100	+€981m
Annual Cancellations	0	0	0	0	no cancellations
Active Pipeline Stock	1,062	1,071	2,129	2,104	
Private Sector Share (% Portfolio)	100%	100%	95%	95%	
Non Sovereign (% Portfolio)	100%	100%	100%	100%	

1.2. Implementation of the previous country strategy

The previous Strategy for Turkey was approved by the Board in July 2009. The Strategy was formulated in the midst of the 2008-2009 global financial crisis and at a time when Turkey was slipping into recession caused by a substantial fall in external demand combined with weakened domestic demand. The global credit squeeze, associated with large external refinancing needs was having a marked effect on both the access to and cost of external sources of finance for Turkish banks and corporates. Within this environment, the Country Strategy highlighted the following priorities:

- Increase availability of risk capital and long term funding to the micro, small and medium sized (MSMEs) enterprise sector together with appropriate support to management, especially in the less developed regions.
- Support investment in the enterprise sector with a clear initial focus on agribusiness. Priority to supporting investment along the food chain (primary agriculture, storage and logistics, processing branded products, and retail) to strengthen linkages and standards and stimulate supply food meeting European quality standards.
- Promote reform and support a secure and efficient delivery of vital utility services to the population and enterprises in the regions of Turkey on a non-sovereign basis.
- Promote through its investments, favourable market conditions for the development of energy efficiency instruments across economic sectors and renewable energy.
- Support the Turkish government's privatisation programme in the enterprise and financial institution sectors.

The crisis significantly increased demand for EBRD finance in key sectors during 2009 and 2010 and the available funds during that period were substantially oriented toward addressing a sharp reduction in Turkish banks' appetite for MSME lending (particularly in more remote regions) as well as for bringing international banks into syndicated transactions for key projects undertaken by Turkish corporates. A significant theme underpinning operations during the three year period has also been support for sustainable energy investment.

Of the five priority areas listed above, all were addressed but with some difficulties related to the municipal and agribusiness sectors. It has proved difficult to provide finance to a broad range of municipalities in the regions of Turkey in support of delivery of utility services. The current approach to municipal financing in Turkey is highly centralised, many mid-sized and smaller municipalities do not meet EBRD's credit criteria and the use of private sector concessions for this type of investment remains undeveloped. Within the enterprise sector, there has also been limited success in developing an agribusiness-related portfolio, partly due to a dominance of large firms in the sector with whom additionality has been a concern, and also due to the early stage of development of the sector in some regions and the related need to develop alternative approaches for delivering finance. This is now being addressed through a bank-intermediated agribusiness SME lending framework and a stronger and ongoing focus on identifying and working with mid-sized agribusiness clients in the less developed regions.

The Bank signed 55 projects during the period to end February 2012, achieving annual business volume of Euro 150 million during 2009, Euro 497 million during 2010, Euro 890 million during 2011 and an expected level of close to Euro 1 billion during 2012. This funding was delivered across the following sectors.

Corporate sectors: To date, the Bank has worked with a somewhat diverse group of nine corporate clients covering agribusiness (6) and manufacturing (3). Two of these clients are relatively large and based on joint ventures with foreign partners, two were relatively small companies and the others were mid-sized corporates. The Bank is now invested in nine equity funds in Turkey, six of which have a regional as opposed to Turkey-specific coverage. This engagement alongside the deployment of the Local Enterprise Facility, has provided a broadly-based capability for developing and executing equity investments with Turkish enterprises.

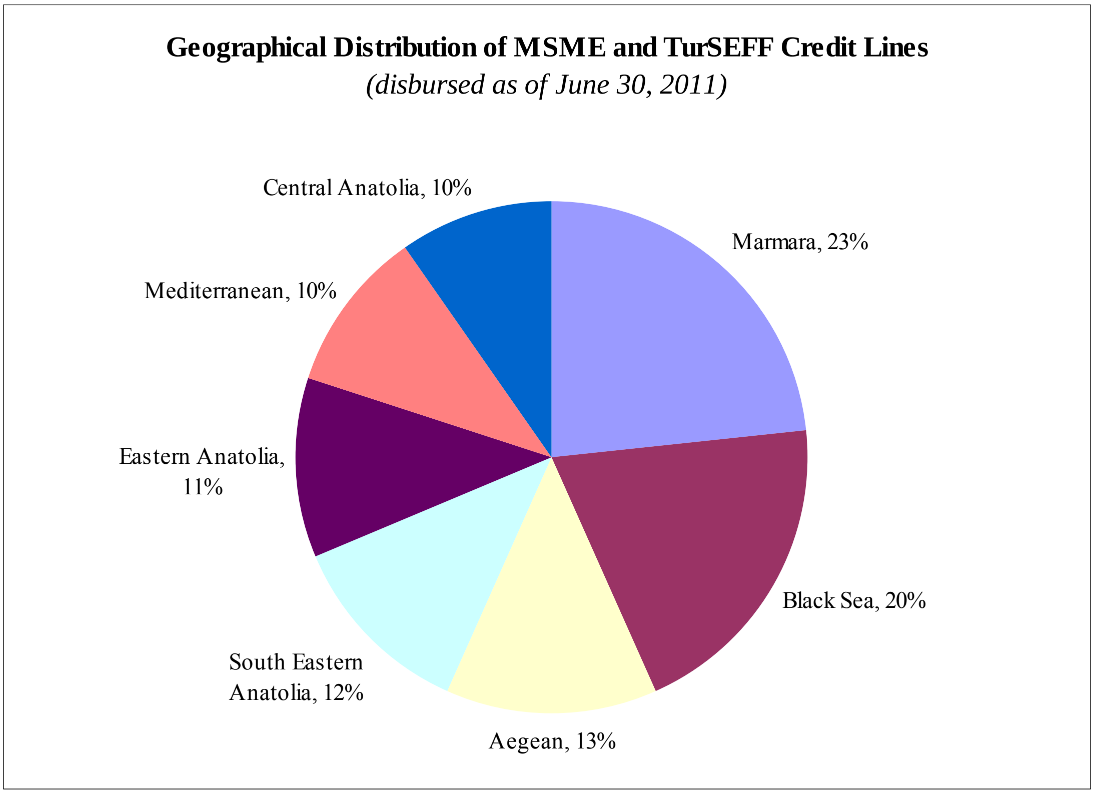
Infrastructure: Lending to municipal projects has been difficult. To date, investments in two private sector water concessions have been supported as has investment in one municipal light rail facility. Each of these transactions has been outside of the main metropolitan centres. Dialogue within the business community and with the government on enhanced use of private sector concessions has also been an important task. Generally, the mid-sized and smaller municipalities have not undertaken commercialisation and corporatisation-based reforms of their key utilities. The Bank has however played a key role in supporting and facilitating the privatisations of both gas and power distribution companies in mid-sized cities as well as the marine ferry service in Istanbul.

Energy: Around 50 per cent of business to date is classified as promoting the objectives of the Bank's Sustainable Energy Initiative. This has largely been achieved through one loan to a large wind farm project and through loans to partner banks under two frameworks, one in support of small scale energy efficiency projects and the other in support of mid-sized renewable energy projects. A Sustainable Energy Action Plan (SEAP) has been signed between the Government and the Bank and an increasing range of related technical assistance projects are now under discussion or implementation.

Financial Sector: Turkey's banking sector is characterised by relatively strong capitalisation, effective regulation and significant foreign ownership. As a result, the effects of the global financial crisis were handled without substantial disruption. The Bank's additionality toward Turkish banks stems largely from the limited access that these banks have to longer dated funding resources and from the expertise the EBRD has been able to bring in support of lending to MSMEs in more difficult regions, lending to SMEs in agriculture, lending for energy efficiency purposes and lending for mid-sized renewable energy projects. Technical assistance in support of these activities, funded by the US Government and the EU, has been provided to all partner banks.

During the strategy period, bank lending operations have focused almost exclusively on the top six private sector banks on the basis that these banks provide the most effective distribution channels, particularly in difficult regions, through their extensive branch networks and their well developed decision-making processes for decentralised lending. The relationships that have developed from this relatively focused approach are effective and have laid the foundations for more strategic co-operation through co-financing across a range of sectors. Figure 1 below shows the geographic distribution of finance provided through partner banks to MSMEs, including through energy efficiency credit lines. Regions outside of the more industrialised Marmara region received 77 per cent of such finance.

Figure 1. Financing MSMEs in the regions



In support of domestic capital market development, the EBRD has taken an equity investment, alongside a Japanese strategic investor, in a Turkish insurance company and has participated as a buyer in a TL-denominated bond issuance from a smaller bank. Technical assistance has been provided to the Central Bank in support of actions to enhance the operation of domestic money markets. An equity stake has also been taken in a NPL company.

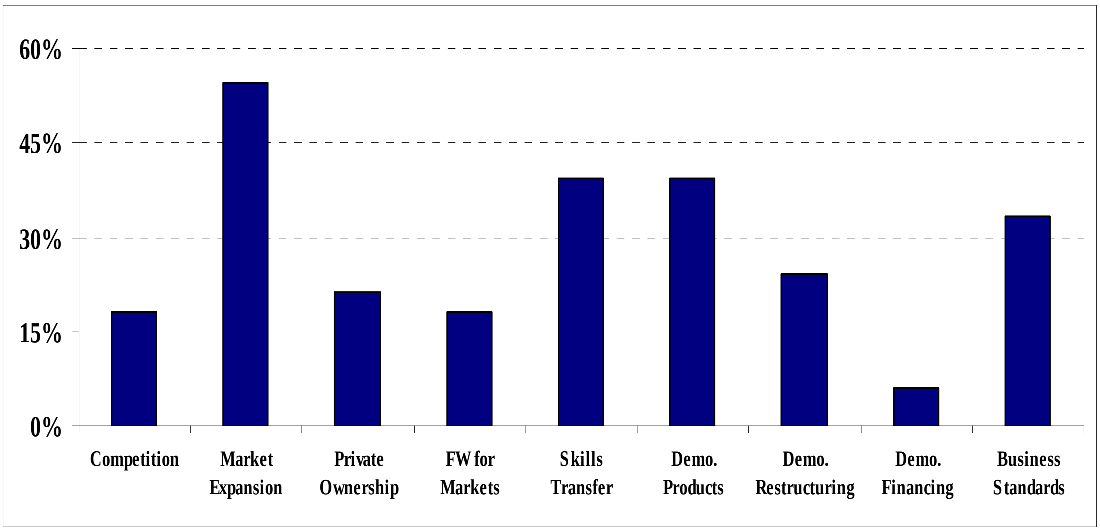
1.3. Transition impact of the Bank's portfolio

Since 2009, 97 per cent of the Bank's 33 rated projects in Turkey were ex-ante rated "Good" or "Excellent" which is above the institution-wide target of 80 per cent of projects to be assessed "Good" or better.[1] Only one operation signed in the corporate sector was assessed with "Satisfactory" transition potential.

Four new operations (12 per cent) were rated "Excellent". Two of them in the infrastructure sector support expansion of private sector participation in water and wastewater sectors. One Excellent rated project in the energy sector is supporting privatisation and restructuring of an energy distribution company. Finally, one Excellent rated operation in the corporate sector addresses increased competition and introduction of new products in the Turkish food market.

The transition objectives of projects signed since 2009 reflect the Bank's response to the main challenges brought by the financial crisis. Key transition objectives across projects have been improving corporate governance standards and supporting market expansion, in particular through an increase in lending by financial institutions to MSMEs that were significantly affected by the crisis (Figure 2). More than half of all projects signed in Turkey addressed market expansion, while one-third of operations have improved business standards as their transition objectives. Around 40 per cent of operations in Turkey targeted demonstration of successful restructuring and supporting companies in their post crisis restructuring efforts to ensure long-term sustainability.

Figure 2. Targeted transition objectives (share of projects), 2009 - present



As of end-October 2011, all active operations in Turkey which are under implementation (i.e. at least 6 months since signing and which have been monitored

[1] 11 of the Bank's 44 signed projects since operations in Turkey began in 2009 were not given separate ex ante ratings as they were parts of existing rated frameworks.

for their transition impact at least once) have a rank of 4 or 5 according to the Bank's Transition Impact and Monitoring System[2]. The average rank of the Turkey's active TIMS portfolio stood at 4.75, which is below the Bank's target. This is due to the fact that the Bank only recently started its activities in this country; therefore, the operations are still in the early stages of implementation and have not yet achieved the desired transition objectives. With the gradual maturing of Turkey's portfolio and the consequent realisation of projects' transition impact potential, it is expected that the average rank will decrease (i.e. improve) and comply with the TIMS institutional scorecard.

2. OPERATIONAL ENVIRONMENT

2.1. Political context

The ruling Justice and Development Party (AKP) won nearly 50 per cent of the votes in the parliamentary elections in June 2011, securing a parliamentary majority for the third time. With voter turnout exceeding 80 per cent, this result indicates confidence in the AKP government and strong support for Prime Minister Recep Tayyip Erdoğan who has obtained a clear mandate for another term in office.

While AKP increased its vote share by over 3 per cent, the number of AKP seats in the new parliament declined by 14 to a total of 327. Hence AKP is now 3 seats short of a two-thirds constitutional majority in the 550 member unicameral parliament. The main opposition party – Republican People's Party (CHP) – came second obtaining 135 seats in the new legislature. The third political party that has cleared the required 10 per cent threshold was the National Movement Party (MHP) with 53 seats. In addition 35 independent candidates were elected, the bulk of which were associated with the recently created Peace and Development Party (BDP), representing voters in some Kurdish communities in Turkey. This outcome means that AKP will need to cooperate with opposition parties on a number of key issues of political transition, including constitutional reforms, and this process should therefore strengthen checks and balances in Turkey's political system.

A key priority of AKP's third term in government is to pursue a comprehensive constitutional reform which is aimed at strengthening the country's democratic governance. The constitutional referendum held on 12 September 2010 approved the government-proposed changes to the constitution with a comfortable margin. After the June 2011 elections, AKP has initiated the process of drafting a new Constitution and has created a parliamentary commission with representatives of all parliamentary parties, including BDP. The government's decision to seek agreement with diverse political forces on the new Constitution confirms its commitment to an inclusive and transparent process of constitutional reform, which, if successful, could help to significantly advance its democratic transition agenda. The constitutional reform process is central for enhancing civil-military relations, rights of minorities, judicial

[2] Rank is a combination of the relevant rating for transition impact potential and risks to transition impact. Expected transition of operations is usually monitored once a year and is ranked numerically from 1 to 8, with 1 to 3 indicating the mostly realised impact, 3 to 6 – generally on track to achieve transition objectives, and 7 to 8 – minimum transition impact or excessive risks.

reforms and human rights policies. However, the recent surge in violence perpetrated by radical Kurdish groups, allegedly associated with the Kurdistan Workers' Party (PKK), which is on the EU and US lists of terrorist organisations, threatens to derail the peaceful dialogue process.

Membership in the European Union continues to be a strategic goal for Turkey. The Government is committed to achieving progress towards full alignment of national legislation with the EU *acquis communautaire*. EU accession negotiations with Turkey started in October 2005. In total, 13 out of 35 negotiating chapters have been opened and one chapter has been provisionally closed. However in the recent years the formal accession process has slowed and no new chapters have been opened since June 2010. In its 2011 Progress Report on Turkey the European Commission concluded that the country has made progress towards meeting EU membership criteria and noted favourably the creation of a dedicated Ministry for EU affairs. At the same time, it also encouraged further efforts to guarantee fundamental rights in practice, in particular freedom of expression, women's rights and freedom of religion.

See Annex 1 for a more detailed assessment of the political environment.

2.2. Macroeconomic context

Economic activity has rebounded strongly with growth at 9.2 per cent in 2010 and 8.5 per cent in 2011, but with overheating risks starting to materialise. Growth is primarily driven by domestic demand, fuelled by capital inflows and loose fiscal and monetary policy stances. Private sector credit, financed by foreign borrowing and a post-crisis return of short-term deposits, fell from a high of 43 per cent year-on-year to 33 per cent year-on-year at end-2011.

Throughout 2011 import growth has outpaced export growth, but fell from a factor of 2.5 in the first half of 2011 to 1.7 at year end, as a result of rapid domestic demand growth and increased energy prices. As a consequence the current account deficit widened to 10 per cent of GDP in 2011. The deficit is financed by increasing FDI as well as relatively short-term public and private sector borrowing. Formal and informal repatriations of assets held abroad by the Turkish private sector also appear to have been an important form of one-off financing in the first half of 2011. Two factors may explain this phenomenon: the political situation in the Middle East, as well as the desire to benefit from the government's scheme to allow restructuring of public claims such as tax and social security payments.

Concerned about the potential impact of rapidly deteriorating global economic conditions and of the widening euro area sovereign debt crisis, the Central Bank of Turkey (CBT) has implemented a policy mix of low interest rates coupled with high reserve requirements. The Lira continued to depreciate further as emerging markets have faced rapid capital outflows due to the deteriorated global risk appetite and by the end of 2011 had lost about 22 per cent of its value throughout the year. The recent devaluation already spilled over into core inflation and poses a threat to the overall inflation outlook. On the back of declining global food prices, the latest inflation figure of 10.4 per cent in February 2012 was substantially above the range of the official target of 5.5 per cent for 2011, with a tolerance band of ±2 percentage points, but the secondary effects of the depreciation are most likely to feed through already towards the end of the year. During the course of the year the Central Bank has become more focused on inflation risk and the country's challenging external financing picture, which has been one of the key drivers of the recent lira depreciation. In October the Central Bank has announced an "action plan" that is broadly focussed on tighter lira liquidity measures for a temporary period, reinforcing its overriding focus on strengthening the lira.

Overall fiscal policy, if implemented as announced, will be broadly neutral in 2011 but will be tightened significantly in 2012. The new Medium Term Programme prioritises improvements in debt and fiscal management and debt sustainability, decreasing current account vulnerabilities as well as mapping out the privatisation programme for the next five years. One of the key indicators is the ratio of central government budget deficit to GDP, which targets a decrease to 1.7 per cent at the end of 2011 and it would drop to 1.5 per cent, 1.4 per cent and 1 per cent in 2012, 2013 and 2014, respectively. Moreover, the current account deficit to GDP will decelerate from 10 per cent in 2011 to 7 per cent in 2014. These projections are based on 4 per cent GDP growth in 2012 and 5 per cent growth in 2013. The government also plans to privatise assets of 12.5 billion Turkish lira in 2012, compared to 4.3 billion lira this year.

Overheating risks and risks of an abrupt reversal of capital flows have started to materialise and are the key short term risk. The government has shown its readiness to act promptly to smooth the possible adverse impact of the new global financial turmoil and economic slowdown by means of monetary and fiscal policy.

See Annex 7 for a table with Selected Economic Indicators.

2.3. Structural reform context

Over the last two years Turkey has focused its structural reform efforts on the energy sector. Recent reforms include the introduction of a new renewable energy law and privatisation of a number of power distribution companies. Turkey has a generous endowment in reliable wind and hydropower resources and has imposed high wholesale electricity prices, which makes significant renewable energy investments profitable, notwithstanding the fact that the feed-in-tariff price floor for renewables is relatively low by international standards. A new law passed in December 2010 introduced feed-in tariffs differentiated by technology, with subsidies for firms using components "made in Turkey". The non-renewable electricity generation system remains mostly in state-owned hands, although the government is in the process of privatising parts of it, with mixed success so far.

A second set of reform efforts has focused on competition laws and labour market efficiency. The National Competition Authority continues to strengthen its anti-trust regulation and competition advocacy activities and the track record of competition law enforcement has improved, with significant fines being issued in a number of cases. Recently, an effort has been made to further coordinate competition policies with public procurement practices and sector regulators in the network industries.

Privatisations have progressed in the power, infrastructure and transport sectors. These include airport facilities, several port facilities, toll-roads (including the

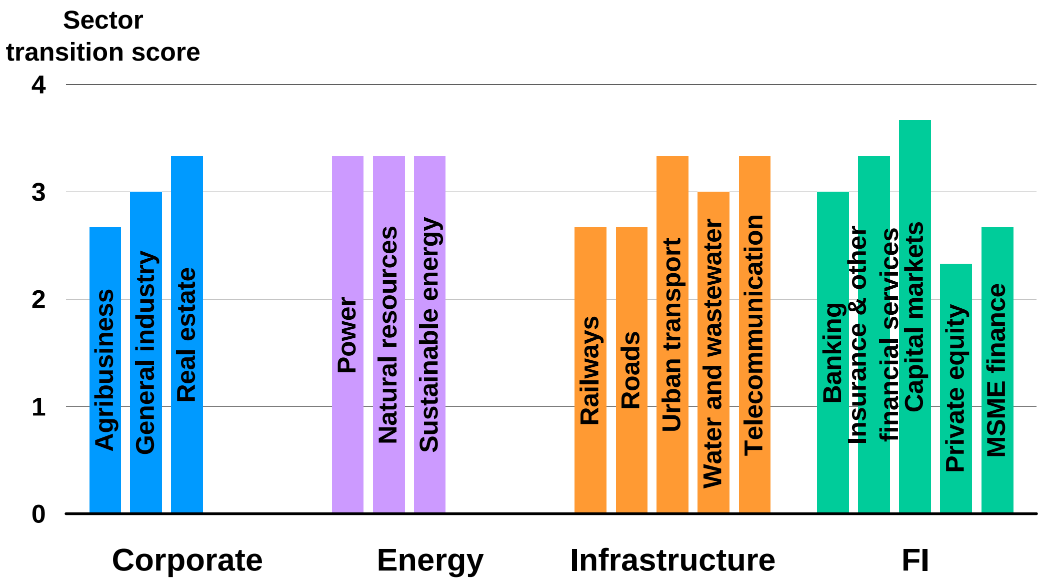
Bosphorus Bridge), and several waste water plants. The authorities have recently also commenced privatisation of the operation and maintenance of the most attractive state-owned motorways. Amendments to the Build-Operate-Transfer (BOT) Law, which has a broad scope of application both in terms of sectors and procuring authorities, have been approved by Parliament; further amendments are being considered. Secondary legislation also has been revised. A new PPP framework legislation would provide a more comprehensive approach towards future infrastructure investments.

Turkey has made concerted efforts to open new export markets and has signed a series of regional trade agreements, with Jordan, Chile, Mauritius, Lebanon, Russia, Syria and the Association of Southeast Asian Nations (ASEAN). However, inefficiencies and protectionism – while in line with Turkey's commitment to WTO regulations – remain significant in the agricultural sector, in particular through comparatively high tariff rates.

The size of Turkey's remaining transition gaps is shown in Figure 3, with the lowest scores and hence the biggest transition gaps in MSME and private equity, agribusiness and infrastructure, specifically railways and roads.

For a more detailed assessment of the remaining transition challenges see Annex 2.

Figure 3: EBRD Sector Transition Scores 2010



Source: EBRD Transition Report 2011.

2.4. Business environment

The business environment in Turkey has steadily improved over recent years. Turkey now ranks 71st in the World Bank's Doing Business ranking, with improvements in particular in starting a business and paying taxes. Key obstacles remain in dealing with construction permits and resolving insolvency issues, whereas Turkey ranks above the Southern and Eastern European (SEE) country group in terms of registering property and enforcing contracts.

The last round of the EBRD/World Bank Business Environment and Enterprise Performance Survey (BEEPS) conducted in 2008-09 concluded that the largest obstacles to doing business in the country as perceived by enterprises were access to finance, political instability, and competition from the informal sector. Around 25 per cent of all enterprises considered access to finance to be the most significant impediment. According to the 2011 Corruption Perception Index published by Transparency International, Turkey is ranked 61st out of 182 countries with a score of 4.2 (0-10 scale where 0 equals most corrupt), which places it as a less corrupt environment than all other South-eastern European countries and a number of EU member states.

Turkey has yet to bring its AML/CFT legislation into line with international standards to improve its status in the Financial Action Task Force (FATF) International Cooperation Review Group process. Since June 2011, Turkey has been listed by the FATF among the jurisdictions with strategic and anti-money laundering/combating the financing of terrorism (AML/CFT) deficiencies that have not made sufficient progress in addressing them. If not improved, heightened due diligence may affect financial markets. Risks that may arise from these deficiencies are taken into account in processing EBRD operations and the Bank follows FATF recommendations in implementing its operations in Turkey.

2.5. Social context

Strong economic growth over the past decade has resulted in notably improved living standards and a decline in overall poverty levels. According to World Bank estimates the poverty headcount has declined from over 28 per cent of the population in 2003 to 18 per cent in their latest survey in 2009. Turkey has also made substantial improvements in a number of health indicators. For instance, Turkey’s maternal mortality rate in 2000 was 70 per 100,000 live births and, partly as a consequence of a new Health Transformation Program that focused on institutional reform, prevention and greater access for underserved areas, this number dropped to 16.4 in 2010. However, the World Bank’s Global Development Report 2012 points at remaining significant gender differences in terms of poverty, education and labour force participation.

The EBRD-World Bank Life in Transition Survey (LiTS), carried out in late 2010, illustrated how Turkish households view the impact of the global financial crisis. Nearly 50 per cent of households reported that the crisis affected them a great deal or a fair amount which is in line with the transition country average. In contrast to the rest of the transition region, Turkish households, in particular the younger age groups, have slightly higher life satisfaction than in 2006.

2.6. Legal context

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, including corporate governance, which will be further strengthened when the new

Commercial Code enters into force in July 2012. In other areas, the system would benefit from upgrading and modernising in order to fully support market activities. This is particularly true of the secured transactions regime, which lacks flexibility. Too many restrictions exist as to the type of collateral that may be used or the contractual arrangements parties may enter into to govern security. However market participants seem to be unaware of this situation and efforts will be required to build a local consensus about reform needs. The insolvency law, which was overhauled after the 2001 economic crisis, is seen to favour debtors to the disadvantage of creditors.

In specific areas of legislation, the EU harmonisation process has led to significant progress, such as in banking laws and in the public procurement sector. Public-private partnerships are expected to play a crucial role in addressing infrastructure needs at the municipal level. The revision of BOT legislation is a step towards establishing the necessary legislative framework. The judiciary is reported to be generally reliable, but there are many reports of lengthy proceedings. The impact of the 2011 amendments passed by parliament to address this issue, including a restructuring of the Court of Appeals, remains to be seen.

See Annex 3 for a more detailed assessment of the legal environment.

2.7. Energy efficiency and climate change context

The Turkish Government adopted an Energy Efficiency Law in 2007 and its Energy Efficiency Strategy 2011-2023 has been sent to High Planning Council for approval, with a target to reduce Turkey's energy intensity by 20 per cent by 2023. The Energy Efficiency Law and its secondary regulation provide the legal basis and measures to promote and support energy efficiency enhancements. Those enhancements are crucial for Turkey's competitiveness and long-run sustainable economic growth. There is a significant need for more Government engagement and mainstreaming of energy efficiency and demand side management across the economy. Specific sectors requiring attention are energy efficiency in the industrial, power, natural resources and the municipal sector.

No timelines have been set for a domestic emissions trading scheme, but Turkey is in discussion with the EU on the harmonisation of environmental/energy regulations, including the EU Emissions Trading Scheme. In the absence of any government regulations, a so-called voluntary carbon market has already emerged.

Climatic shifts are expected to put great strain on water resources, with potentially significant implications for agriculture, drinking water supplies, hydropower, cooling water for thermal power plants, and a range of water-intensive industries such as textiles, paper and pulp and agribusiness.

3. STRATEGIC ORIENTATIONS

3.1. Transition challenges

Although recent progress in reform has been impressive, significant structural reform challenges and associated transition gaps remain. Some of the key challenges which can be addressed with EBRD financing and assistance include:

- **Increasing private sector participation, sustainability and efficiency in the energy sectors:** While the Turkish economy as a whole is currently more energy efficient than the OECD average, the current system has difficulty accommodating demand pressures of a rapidly growing economy. Both the gas and electricity sectors have further restructuring needs. On the demand side, participation in the electricity market is underutilised and there are no dedicated energy efficiency polices.
- **Developing mid-sized corporates in underdeveloped regions:** While larger corporates in the commercial centres have access to a range of finance, mid-sized corporates, especially in the regions, still suffer from lack of access to longer term financial products and from weaker business and corporate standards. The improvement of sectoral value chains (in particular in agribusiness) is crucial to move towards higher value-added production, increased competitiveness and more innovative processes. Further efforts are needed to facilitate trading across borders, including support for further trade integration with the SEMED region, and particularly to lower barriers to trade for agricultural produce.
- **Strengthening regional and rural infrastructure sectors:** Municipalities, especially in the underdeveloped regions, have little debt capacity and suffer from inefficient operational management and service delivery for most utilities. Further expansion of regional infrastructure services is required by rapid economic growth and accelerated regional integration. The implementation of transparent PPP projects will help to attract more private sector investment into the infrastructure sector.
- **Supporting deepening of financial intermediation and local currency capital markets:** Despite reasonably well-functioning financial markets at short maturities, there is a lack of efficient intermediation of long-term funds to under-funded sectors and uses. The domestic institutional investor base that would be able to provide long term local currency funding is small, hampering the development of a sustainable corporate bond market.

A key structural weakness of Turkey's economy – its persistent current account deficit – stems from both the structure and level of competitiveness of its tradable sectors. A high share of re-exported imports and strong reliance on energy imports make increasing competitiveness and energy efficiency a challenge across virtually all sectors of the economy.

3.2. Bank's priorities for the strategy period

While Turkey was hit hard by the global financial crisis, mainly through its trade links with the major industrialised economies, the economy rebounded strongly in 2010 and throughout much of 2011. While the financial sector has proven resilient to the crisis, mid-sized companies in the tradable sector have been highly vulnerable. Considering these lessons in combination with the transition challenges identified above and the early stage of the Bank's operations in Turkey, the operational focus will remain substantially unchanged from the current strategy. Lessons learned during the current strategy, which include those related to crisis response, will be reflected in a re-ordering of priorities with a stronger emphasis on sustainable energy and enterprise financing. Enterprises in more remote regions will remain the main target group, within the context of an expanded sectoral spread to more closely reflect the need to enhance competitiveness more generally for Turkish manufacturing and services companies. The financial crisis has underpinned the need for the EBRD, other IFIs and bilateral funding agencies to work closely together to ensure effective leverage in attracting relatively scarce commercial funding for strategically important projects, particularly in infrastructure. Reflecting the government's preference for centralised financing of municipal services, the Bank's ability to deliver in this area will remain constrained, although opportunities to demonstrate the effectiveness of more commercial approaches will be actively pursued.

The Bank's activities will remain focused on those areas where the transition gaps are significant and where the Bank's finance and expertise are additional to what commercial and non-commercial funding sources can provide. The Bank's activities in Turkey will be focused on the following operational priorities.

- **Developing sustainable energy.** Support through its investments to private sector investors in renewable energy and efficient power production, the ongoing reform of the energy sector including promotion of favourable market conditions for the development of energy efficiency instruments across economic sectors and supporting Turkey in adapting to climate change and in particular to water stress.
- **Promoting the development of MSMEs.** The Bank will continue to increase the availability of risk capital and long term funding to MSMEs, including those in the agribusiness sector, through intermediated financing together with appropriate support to management through its SBS programmes, especially in the less developed regions.
- **Enhancing the competitiveness of Turkish industry**. Support growth and development of the enterprise sector through direct lending and investment operations with domestic and foreign investors in a broad range of industrial and service sectors but with a particular focus on agribusiness, supporting energy efficiency investment, innovation and high value-added industries, sectoral value chains and companies operating in non-metropolitan areas.
- **Promoting market approaches toward investment in municipal infrastructure**. Promote reform and support a secure and efficient delivery of vital utility services to the population and enterprises in the regions of Turkey on a non-sovereign basis.
- **Supporting privatisation**. Support the Turkish government's privatisation programme in the enterprise, financial and infrastructure sectors including through active participation in the financing of PPP projects.

3.3. Sectoral challenges and Bank operational response

3.3.1. Energy and natural resources sector

Sectoral challenges

- Privatisation and private sector participation in electricity generation has increased since the implementation of the Electricity Market Law in February 2001. However, the privatisation of generation assets has not gained momentum due to market circumstances, currently 50 per cent of total installed capacity is still state owned. The state-owned transmission company has been legally unbundled but is yet to be functionally unbundled and its operational efficiency improved.

- Energy demand management has improved in recent years, but the unexploited potential remains vast. In particular, demand-side participation in the electricity market is under-utilised. Improvements in grid infrastructure have progressed; however, significant opportunities exist for the implementation and development of smart grid solutions. Household electricity prices are low relative to end-user industrial power prices by international standards. The government has set energy efficiency targets under the Energy Efficiency Law, however currently there are no dedicated energy audits or white certificates.
- The market dominance of the fully state-owned BOTAŞ remains an obstacle to competition in the gas sector, to the privatisation of electricity generation plants, to carbon efficient electricity generation and to gas storage investments. BOTAŞ owns the gas transmission network, the oil pipeline system and maintains a monopoly over domestic distribution and supply. The domestic distribution market for natural gas has been opened to competition with some private companies entering recently. Under the 2001 gas law, BOTAŞ's share of gas imports were to decrease from 100 per cent to 20 per cent by 2009 and to zero by 2010. Both of these targets have been missed. The Government is working on a draft law to define the roles for BOTAŞ, to facilitate new entry into the wholesale market and to provide security of supply.
- Key challenges within the natural resource sector relate to the need for reform and improved corporate governance within state-owned enterprises, to improve environmental and health and safety standards in the mining industry, to eventually privatise mining assets, and to establish transparent regulatory mechanisms including for the setting of oil and gas transport tariffs and for third party access to storage facilities.

Bank's operational response

To promote the development of an efficient energy market supporting sustainable energy, the Bank will provide financing to private sector investors for renewable energy investments, new efficient power producers, for rehabilitation of privatised power plants and for investment into privatised energy distribution companies. Reflecting the success of approaches already implemented, the Bank will continue to provide financing to SMEs for energy efficiency and for sustainable energy investments via partner banks.

To promote energy efficiency within Turkish industry, the Bank will continue to make use of energy efficiency audits, followed by direct investment in energy efficiency in industry, linked to the new law on energy efficiency and the evolving policy framework.

To promote modernisation in the mining sector, the Bank will seek to work with companies in the east of Turkey to enhance their environmental and safety standards.

Policy dialogue

The Bank will continue to seek opportunities to provide technical assistance to the government under the framework of the Sustainable Energy Action Plan (SEAP) with an underlying objective of strengthening institutional capacity and approaches toward ensuring timely compliance with the European Climate Change package. Related tasks will include continuing to engage with government on market-based support systems for energy savings (e.g. white certificates) and development of a market for energy service companies. The current engagement with the regulators and energy system operators will be deepened to facilitate demand-side participation in the electricity market, smart grid solutions, and for enhanced regulation of the gas and oil sectors, including transport. The already completed study on Marginal Abatement Cost Curves will provide a basis for advice on least-cost policies toward energy issues. The ongoing study on adaptation in Turkey's private sector will help shape the Bank's investment strategy for this important area.

3.3.2. Industry, Commerce and Agribusiness

Sectoral challenges

- Turkish industry needs to continue to modernise and to become more competitive to support expansion into regional markets. Manufacturing and agribusiness enterprises, particularly those in underdeveloped regions, often lack international corporate governance and energy efficiency standards that would enable them to improve productivity and competitiveness. The legislative and regulatory framework for starting and operating a private business needs strengthening; particular areas of concern are enforcement of contracts, licensing, construction permits and labour contracting.
- Key challenges in the agribusiness sector include addressing the high level of state involvement and intervention in agribusiness (although remaining consistent with WTO commitments, there are still high tariff barriers and subsidised lending by a state-controlled bank); helping mid-sized corporates in raising hygiene, quality (in particular traceability of products) and efficiency standards; developing specialised trade and storage infrastructure in the regions; and supporting market-based institutions for financing (warehouse receipts).
- Logistics including IT-networks, techno-parks and high-quality warehouses are limited outside the big cities and pose a bottleneck to private sector development, in particular in the innovation intensive industries.

Bank's operational response

To support enhanced competitiveness, a shift to higher value added and broader regional dispersion of Turkish industry, the Bank will provide financing through debt and equity in support of domestic and foreign investment in a broad range of industrial and service sectors but with a particular focus on supporting agribusiness, innovation, sectoral value chains and companies operating in non-metropolitan areas. Provision of intermediated finance to MSMEs, especially in the agribusiness sector and in the more remote and underserved areas, will continue to be an important priority. Building effective co-investment relationships with investee private equity funds, largely through funding from the Local Enterprise Facility, is expected to be a key means for deepening the Bank's engagement with enterprises, mainly SMEs, throughout the country.

In support of innovation and high-value added sectors, the Bank is reviewing its approach and the financial products available to help build secure ICT infrastructure and promote development of knowledge-intensive industries and innovation in its countries of operations. In Turkey, the Bank will look to selective financing of telecoms projects in the regions and IT projects.

To strengthen the growth and competitiveness of the Turkish MSME sector, the Bank will combine advice and mentoring at the enterprise level with the development of a sustainable infrastructure of business advisory services at the market level. Key industry sectors to be supported will include agribusiness (in particular food processing), manufacturing (in particular textiles and furniture), in services (wholesale and trade) and machinery. SBS programmes – Enterprise Growth Programme (EGP) and Business Advisory Services (BAS) – will strengthen micro, small and medium enterprise performance and sophistication in areas such as managerial skills, branding and marketing skills as well as human resources and environmental management. Both EGP and BAS will focus increasingly on the rural areas outside Ankara and Istanbul and in particular in the less developed eastern parts of Turkey. SBS programmes will seek to supplement the delivery of management and advisory services with increased access to finance through linkages with EBRD banking teams, credit lines and partner financial institutions.

Policy dialogue

The Bank’s policy dialogue toward the corporate sector will largely be undertaken through participation in industry lobby groups including the Turkish Industry and Business Association (TUSIAD) and the Union of Chambers and Commodity Exchanges (TOBB). This will be supplemented through provision of technical assistance where appropriate for addressing regulatory and administrative constraints to doing business. One such area that has already been identified for further work is the development of collateralisation instruments for soft commodities (warehouse receipt system) enhancing regulation of grain storage. This task will require engagement with the government, grain unions and private sector players. A further area for possible engagement will be with the telecoms regulator to see how the Bank could facilitate progress in the interconnection regulatory environment.

3.3.3. Infrastructure

Sectoral challenges

- Institutional restructuring and commercialisation of municipal utility services are the key challenges, especially for mid and small-sized municipalities. Where appropriate PPPs could also be used.
- Lack of fiscal decentralisation and utility corporatisation constrains a more sustainable revenue base to support investment in municipal services – especially for second-tier municipalities – which have limited debt capacity as a result of minimal own revenue sources and high indebtedness (on non-commercial terms) to Iller Bank, the state-owned municipal financing vehicle. Since local governments are the shareholder’s of Iller Bank, it provides more advantageous terms to local administrations compared to commercial banks. For the second-tier municipalities’ infrastructure investments, a 50 per cent state grant and 50 per cent loan rule is applied for Iller Bank financing.
- In the transport sector the key challenges are the restructuring of the railway sector (focused on structural reforms, unbundling of the incumbent operator

Bank’s operational response

To promote market approaches toward investment in municipal infrastructure the Bank will use sub-sovereign lending approaches with creditworthy (mostly top 20) municipalities, supporting investment projects with the potential for high demonstration effect with regard to commercialisation and eventual corporatisation of water, wastewater, solid waste management and urban transport. One area of focus will continue to be seeking out lending and equity investment opportunities in support of private sector concessions and privatisations in municipal services. The Bank will also engage with local financing institutions involved in the municipal market through technical assistance and the financing of intermediated portfolios of investment projects with smaller municipalities that support commercialisation and enhanced management of municipal services.

To enable private sector financing approaches to be applied to Turkey’s substantial transport investment requirements, the Bank will continue to work alongside other IFIs and commercial lenders for participating in the financing of large PPP projects in the transport sector that have a regional dimension.

To address the need for effective transport solutions in more remote regions, the Bank will continue to support private sector operators in the development of intermodal transport operations through the provision of long term funding.

Policy dialogue

A key element of the Bank’s policy dialogue in support of municipal financing will be through an engagement with government and other IFIs to support sustainable fiscal decentralisation and to pursue corporatisation of municipal utility operations in the context of prudent local government borrowing standards and local government sources of revenues and engagement. The Bank will also maintain an active dialogue with the government and the business community related to the effective implementation of the Build-Operate-Transfer (BOT) law.

3.3.4. Financial institutions

Sectoral challenges

- Bank balance sheets show significant maturity mismatches. Funding remains predominantly based on short-term deposits, while loans – about half of banks’ assets – have become increasingly medium to long term. Although the financial authorities in Turkey have put in place regulations aimed at increasing long-term deposit funding, and have encouraged banks to issue longer-term bonds, a key challenge remains to ensure that a more effective maturity match is attained in the banking sector.

- The institutional investor base capable of providing long term local currency funding is small. Foreign currency loans account for over a third of the total stock of loans, restrained by regulation to discourage foreign currency borrowing by unhedged borrowers. The money market benefits from a more reliable benchmark interest rate than in the rest of the transition region but lacks liquidity.
- The corporate bond market is at an early stage of development.

Bank's operational response

To enhance banks' ability to deliver investment finance to the enterprise sector, the Bank will continue to use a range of debt financing instruments designed to lengthen the average maturities on the liability side of key partner banks and other non bank financial institutions. Generally, partner banks will continue to be the larger private sector banks with the strongest branch networks capable of intermediating EBRD funds toward more difficult regions, more difficult sectors including small agribusiness, MSMEs and the development of private sector financing toward small municipalities as well as in support of investment in sustainable energy initiatives.

In support of the development of a more effective local currency capital market, the Bank will work with insurance and pension management companies to actively support the establishment and growth of a domestic institutional investor base capable of seeking sustainable funding based on long term savings instruments. On the sell side, the Bank will continue to participate, where its role is additional, in the issuance of innovative, longer term Turkish Lira-based debt instruments.

Policy dialogue

Bank staff meet on a regular basis with the BRSA, the Central Bank and with the Capital Market Development Board to follow and discuss progress on work underway to improve the framework for corporate bond issuance and to enhance reliability and lengthen maturity of money market benchmarks. Technical assistance is currently being provided for the latter purpose. Within the substantial amount of work being done by the authorities to enable more effective delivery of longer term funds through the capital market, the Bank will continue to seek opportunities for providing technical assistance.

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 align with EU Directives. The EC 2011 Progress Report notes that Turkey has made progress on waste management, whereas limited progress can be reported on horizontal legislation, air quality and industrial pollution control and risk management. According to the Report, very limited progress has also been recorded regarding water quality, chemicals and administrative capacity.

The Framework Directive on health and safety at work has not been transposed into Turkish law and the Bank will work with clients and sponsors to promote the development of an appropriate safety culture. The labour legislation generally is not adequately aligned with the EU and this will also need to be taken into account during appraisal, particularly in areas of core ILO labour requirements.

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 compliance with 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. The development of transport 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.

Climate change adaptation

Turkey is vulnerable to the projected impacts of climate change over the coming decades. The East Mediterranean sub-region is expected to experience decreases in summer and especially winter precipitation, with mean summer temperature increases of up to 4 degrees Celsius. 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. Turkey's large shipping and ports sector may also be impacted by rising sea levels which may increase risks of coastal flooding and storm damage.

EBRD is undertaking with IFC a study of climate change issues relating to the private sector with the aim of developing a methodology to assess potential CC impacts and to raise awareness of the need for companies to consider climate adaptation needs.

Gender

The issue of women's economic empowerment is particularly acute in the case of Turkey. The labour force participation rate for working age women in Turkey is well below the OECD and transition country average. In line with the EBRD's Gender Action Plan, the Bank will enhance its efforts to support women's entrepreneurship and empowerment in Turkey through its projects, policy dialogue and technical assistance. In Financial Institutions projects, the Bank will seek opportunities to increase access to finance for women-owned and women-managed MSMEs, and to address barriers that impede access to credit, in particular in rural areas. Also, it will consider providing technical assistance to a number of commercial banks that have expressed interest in undertaking specific gender-related actions and developing new products for women entrepreneurs. The Bank will continue to promote gender equality and the shared benefits of projects in municipal sectors where appropriate. Across a number of sectors the Bank will look for opportunities to work with clients to adopt gender balanced approaches in their human resources policies and practices (e.g. equal opportunities in recruitment and career development).

For a more detailed assessment of gender issues see Annex 8.

4. ACCESS TO CAPITAL: PRIVATE AND PUBLIC SOURCES OF FINANCE

4.1. Access to capital

Turkish banks have shown resilience during the 2008-2009 global financial crisis, as evidenced by their balance-sheet strength, which has been supported by appropriate loan-loss provisioning, a solid capital base, and recurrent earnings generation. Financial sector reforms that were enacted following the 2000-2001 financial crisis set the foundations for the stability of the banking system today.

The sector is growing rapidly, with a 30 per cent average annual growth of total loans from 2005-2010 and 33 per cent average annual growth in loans to the private sector (45 per cent average growth during Jan-Nov 2011). The sector is well capitalized and the total capital ratio stands above the BRSA requirement of 12 per cent. Long-term funding still remains a problem and nearly all banks are planning to place new Eurobonds as soon as market conditions become more comfortable. Asset quality is strong with low reported NPL ratios. The NPL ratio for the system is currently reported to be as low as 3 per cent (BRSA).

The availability of credit has improved recently, as low interest rates suppressed the banks' margins and created high competition among banks. Progress has been made in encouraging public and private banks to improve credit lines for MSMEs (including a government-sponsored micro-credit facility), however, access to finance remains a major impediment to business start-ups (especially for women) and expansion of existing MSMEs with short business history. In this respect, increasing or facilitating access to private equity for MSMEs could help bridge credit needs.

An expected slowdown in GDP growth is likely to have a negative impact on credit growth. The Turkish lira is depreciating quickly despite the Central Bank actions to intervene at the cost of foreign reserves and develop a currency support plan which is based on higher effective interest rates. This leads to a serious deterioration of the local bond market, pushing benchmark yields to the highest level since 2010. At the same time the negative effect was smoothed by reduction of lira reserve requirements to an average of 10.5 per cent from 12.6 per cent, freeing up US$ 7.6 bn of liquidity. The overall effect still remains to be seen.

On the positive side, the financial market's exposure is limited mainly to government bonds. The banking sector's exposure to risky securities such as high yield corporate bonds and stocks is negligible and liquidity is mainly invested in government bonds with a preference for instruments in local currency.

The main international credit rating agencies Standard & Poor, Fitch and Moody's still rank Turkey lower than "investment grade" at BB, BB+ and Ba2, respectively.

4.2. MDB finance and collaboration with other IFIs and multilateral donors

Donor co-ordination is effective in Turkey and is led by the Treasury as well as through regular meetings held under EU management with all key donors involved. Key themes that form a basis for donor co-ordination include climate change and energy efficiency. The EBRD, IFC and EIB co-ordinate closely and often on an informal basis in Turkey. The need to ensure that IFI and bilateral funding is provided in a manner toward larger and strategically important projects that provides maximum leverage for attracting complementary financing from commercial sources has been an important factor in this co-ordination. The recent establishment of an EBRD Resident Office in Ankara will enhance the Bank's ability to co-ordinate more closely with a broader range of donors including from shareholder embassies.

The World Bank Group

The World Bank Group is now working under its 2012-2015 Country Partnership Strategy (CPS), which was adopted in March 2012. The main pillars of the new CPS are enhanced competitiveness and employment, improved equity and public services, and deepened sustainable development.

Turkey is one of the largest middle-income partners of the World Bank and is the third largest borrower in terms of active portfolio.

International Bank for Reconstruction and Development

During fiscal years 2008 to 2010, total IBRD lending to Turkey at USD 7.6 billion exceeded expectations at the beginning of the CPS period by USD 1.4 billion, mainly as a result of a mid-term adjustment which responded to the 2008/9 global financial crisis. Development Policy lending by IBRD accounted for USD 4.4 billion during this period with USD 3.2 billion provided as investment financing. Of the investment finance, the substantial part of the funding was provided to the municipal, SME and energy sectors.

The EBRD coordinates its activities and policy dialogue with the IBRD's policy engagement in related sectors and occasionally (eg, with the energy sector regulator), directly supports later stage implementation of related sectoral policy adjustments through provision of technical assistance as well as through its loan and investment operations. However, the EBRD's private sector focus results in a clear differentiation of roles between the two institutions. One key area which is receiving close consultation between the two institutions is domestic capital market development.

International Finance Corporation

During fiscal years 2008-11, the IFC provided total financing of USD 2 billion across 45 transactions in Turkey. During fiscal year 2011, IFC provided USD 467 million on its own account and USD 787 million on account of participants.

The main areas of focus for IFC during the recent CPS have been SMEs, energy efficiency and support for Turkish investors abroad. The same focus remains under the new CPS, although support for an expected proliferation of Infrastructure PPPs may also become an important business area.

Particularly during the 2008/9 crisis period, IFC and EBRD co-ordinated closely with the objectives of closing financing gaps on key projects. Two relatively large parallel financings were completed in the energy sector and discussions with other corporate clients have been closely co-ordinated. Three transactions with Turkish banks under securitisation structures were co-financed (albeit with different use of proceeds) and currently, joint mandate approaches are being sought for a major transport PPP project and a major energy sector project.

European Union

Since 2007, Turkey has receiving EU financial aid under the Instrument for Pre-accession Assistance (IPA). IPA assistance to Turkey is implemented under decentralised management according to the five IPA components available to candidate countries.

The EU's substantial program covers all sectors that are a focus for the EBRD in Turkey and close attention is paid to identifying opportunities for working together. To date, EU grant funding has been used in support of MSME lending to remote regions and for energy efficiency operations. Means for leveraging EU funding for municipal operations, particularly water, waste water and solid waste management have been explored. Good opportunities have been identified for working in concert on regional transport projects.

European Investment Bank

The EIB has been involved in lending operations in Turkey since the mid 1960s. The EIB's mission is to support the country's economic development and assist Turkey during its pre-accession phase to the EU. Over the 5 years to end 2010, the EIB achieved total lending volume exceeding EUR 11bn in Turkey. The level of EIB lending increased dramatically from 2005, with the opening of accession negotiations at the end of 2004.

EIB annual lending activity in Turkey is now of the order of EUR 2bn, and is based on three pillars: (i) lending in support of critical infrastructure projects, both at national level (transport sector, energy, the environment, R&D) and local level (water and wastewater management, urban transport); (ii) lending to SMEs, through an extensive network of both private and public partner banks; and (iii) corporate lending, mainly in favour of the energy sector and in support of foreign direct investments.

Turkey is the largest recipient country of EIB funds outside the EU.

EBRD and EIB have co-financed one corporate project in the energy sector and are in advanced discussions for co-financing a large transport infrastructure project. The EIB has participated as a lender to four banks under the EBRD-initiated MidSeff project, which provides long term funds and technical assistance to partner banks for financing mid-sized renewable energy projects. The EBRD has also co-invested alongside the European Investment Fund into two Turkey-specific investment funds. Discussions are held on a regular basis to inform each institution on the respective project pipelines and opportunities to work together on specific transactions are actively sought.

Council of Europe Development Bank

The Council of Europe Development Bank (CEB) has an exclusively social mandate and has three main fields of action: Strengthening social integration (including aid to refugees), managing the environment, and developing human capital (including education, training and health).

CEB lending in Turkey over the past decade has focused on projects related to natural disaster mitigation, environmental and urban infrastructure, health, education and job creation in SMEs. Total lending in Turkey from 2002 to date is Euro 1.95 billion, of which Euro 100 million was provided during 2011.

Islamic Development Bank

The Islamic Development Bank (IDB) has accelerated its operations in Turkey from 2009 and since then has put in place total finance of Euro 550 million. This has been provided to five projects, two in transport infrastructure, two for SME financing and one for renewable energy.

Currently, the EBRD is participating in a financing consortium for a major road and bridge PPP project. IDB has recently expressed interest in joining the consortium and work is now underway to develop structures that will effectively and efficiently enable interest-based and sharia banking to jointly participate in this form of project financing.

ANNEX 1 - POLITICAL ASSESSMENT

Overview

Turkey is committed to and applying the principles of multi-party democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank, although some challenges remain.

Free and fair Parliamentary elections took place on June 12, 2011 and delivered a clear mandate to the Justice and Development Party (AKP) and Prime-Minister Recep Tayyip Erdoğan for a third consecutive term in government.

Turkey has taken positive steps to adopt the EU's *acquis communautaire* in all fields, while the pace of formal accession negotiations has slowed. In this respect, the country has made significant progress in domestic political reforms by enhancing institutional checks and balances, bringing civil-military relations in line with democratic principles and initiating a democratic opening process aimed at raising the democratic standards for all citizens, including those of Kurdish origin. These steps have moved Turkey closer to meeting the political accession criteria in its negotiations with the EU. However, as the 2011 EU Progress Report notes, further efforts are required to guarantee fundamental rights in practice, in particular freedom of expression, women's rights and freedom of religion.

Political accountability

Elections

The unicameral Parliament – Grand National Assembly – of Turkey is composed of 550 deputies elected for a four-year term on the basis of a party list proportional representation system with a threshold of 10 per cent of eligible national votes required to enter Parliament. The 10 per cent threshold for political party representation in Parliament – the highest in the OSCE region – remains one of the central issues affecting the representative nature of the legislature.

The ruling Justice and Development Party (AKP) won the recent parliamentary elections, held on 12 June 2011, by securing almost 50 per cent of the votes which translated into 327 seats in the Grant National Assembly. This result allowed AKP to form another single party government. The opposition Republican People's Party (CHP) came second obtaining 135 seats in the new parliament. The third political party that managed to clear the required 10 per cent threshold was the National Movement Party (MHP) with 53 seats in the Parliament. In addition 35 independent candidates were elected, the bulk of which were associated with the recently created Peace and Development Party (BDP), representing voters in some Kurdish communities in Turkey. After a boycott that lasted until October, BDP has taken up its participation in the parliament and has sent its representatives to the newly established parliamentary commission charged with drafting the new Constitution.

Although the AKP increased its share of the popular vote from the last 2007 general election, the number of AKP share of seats has decreased by 14 (from 341 to 327) leaving it a few seats short of the 330 needed for a constitutional majority. This outcome means that AKP will need to cooperate with opposition parties on a number of key issues of political transition, including constitutional reforms. The government's decision to launch an inclusive and open constitutional process, with participation of all parties, promotes a spirit of compromise between political parties.

The June 2011 parliamentary elections were assessed by international observers from the Parliamentary Assembly of the Council of Europe and from the OSCE as democratic, well-managed and pluralist, but still requiring improvement in fundamental rights, including freedom of speech, rights of minorities and women. The Parliamentary Assembly of the Council of Europe (PACE) has recommended lowering the existing 10 per cent threshold to enhance the representative nature of the legislature.

Constitutional Reform

A comprehensive constitutional reform has long been one of AKP's key domestic political priorities. During its previous term in office AKP initiated a referendum on the constitutional package which was held in September 2010. The referendum delivered a public mandate to the government to introduce changes to the existing Constitution, which was adopted in 1982 following the military coup. The EU called the referendum "an important step towards Europe". However, the referendum has also exposed divisions within the Turkish society with 58 per cent backing the government proposed constitutional changes and 42 per cent voting against.

Following the June 2011 Parliamentary elections, a special constitution drafting commission was set up in the Parliament consisting of an equal number of representatives from all parties represented, including AKP, CHP, MHP and BDP. The commission, which started its work in October 2011, is chaired by Parliamentary Speaker Cemil Çiçek. The Chairman of the commission and the Turkish Prime Minister expressed their expectation that the new Constitution could be adopted before the end of 2012.

The Turkish Constitution provides for political accountability through the separation of executive, legislative and judicial powers. Under the Constitution, the President appoints the Prime Minister, the Ministers of the Government (on the Prime Minister's recommendation), the members of the Constitutional Court and the Chief of the General Staff of the armed forces. However, real political power is vested with the Prime Minister and Government. In the past the military have played a powerful political role in Turkey. During its last term in office the AKP government has implemented reforms which have reinforced civilian oversight in the security sector. The key priorities for the new Constitution include reinforcing democratic institutions, enhancing civil-military relations and promoting human rights and freedoms for all Turkish citizens. The new Constitution may also reshape the balance of power between the Presidency and the Prime-Minister. All opposition parties have also articulated their priorities for the constitutional process. The EU and the Council of Europe have welcomed Turkey's constitutional reform process.

The rule of law and integrity

The Turkish Constitution provides for the formal independence of the judiciary from legislative or executive interference. However this principle has not always been enforced in the past since the judiciary alongside the military acted as the guardians of Turkey's secular state. AKP has implemented reforms, including through the 2010 constitutional reform package, which have enhanced the independence and impartiality of the judiciary and increased its effectiveness.

A report issued in 2012 by the Council of Europe Commissioner for Human Rights concludes that despite serious reforms undertaken in recent years, Turkish law and practice is still not in line with the case-law of the European Court of Human Rights. One of the major factors hampering progress lies in the established attitudes and practices followed by judges and prosecutors at different levels giving precedence to the protection of the state over the protection of human rights.

The European Commission's 2011 Progress Report for Turkey identified the length of pre-trial detentions as a source for concern. In recent high profile cases involving alleged plots against the state, the time lag between the arrests and presentation of indictments, the restricted access by the defence to evidence put forward by the prosecution and the secrecy of investigation orders fuelled concerns about effective judicial guarantees for all suspects.

In comparison to many countries of operations of the Bank, corruption is a moderate problem in Turkey. According to Transparency International's Corruption Perceptions Index (CPI) in 2011 Turkey was ranked 61st out of 182 countries. In its anti-corruption effort Turkey is actively engaged in implementation of the recommendations by the Group of States against Corruption (GRECO).

Civil and human rights

Civil and human rights are enshrined in 1980 Turkish Constitution and are expected to be further advanced in the next Constitution which is being drafted by the Parliament. Turkey has ratified all major international human rights conventions. Among new ratifications of the human rights instruments is the Optional Protocol to the UN Convention against Torture in September 2011.

The protection of Turkish citizens' rights has improved in recent years. However, international human rights monitors continue to express concerns related primarily to the rights of religious minorities and different cultures; the right to freedom of expression, and in relation to that the number of court cases against writers and journalists and restrictions on access to the Internet; the application of anti-terror legislation; and gender equality. There is a need to promote more participation and representation of women in the political life of the country.

Turkey has a pluralistic media that expresses diverse views and promotes open debates on some of the more sensitive issues including minority and cultural rights and the role of the military. However, freedom of expression is strained by the large number of legal cases and investigations against journalists. At present Turkey has the largest number of journalists in detention among all OSCE states. In May 2011 the

Turkish Constitutional Court amended the Press Law to extend the statute of limitations for filing criminal cases against journalists from two months to eight years. This ruling has been cited by the OSCE Representative on Freedom of the Media as putting journalists under threat of criminal lawsuits. The Turkish authorities have committed to addressing the concerns raised by the OSCE.

The AKP government has pursued an ambitious agenda regarding the democratic opening towards Kurdish communities, which was announced in 2009. Numerous steps have been taken towards this end, such as the use of multiple languages by municipalities. A Kurdish Language and Literature Department was opened in one Turkish University. However, the 2011 EU Progress Report concludes that "Turkey's approach to minorities remains restrictive" and that "full respect for and protection of language, culture and fundamental rights in accordance with European standards has yet to be achieved."

The constitutional reform process opens a window of opportunity for addressing the issue full protection of citizen's rights and to create a basis for promoting peace and stability in the South and South-eastern regions. BDP's participation in the constitutional commission enhances the opportunity for dialogue and reconciliation. The constitutional reform process, which involves all parties represented in the Parliament, has the potential to further enhance democratic standards and freedoms in Turkey.

ANNEX 2 - ASSESSMENT OF TRANSITION CHALLENGES

The table and the supporting text below provide an overall assessment of Transition Challenges by sector, based on the Transition Report 2011. There are two separate scores for each sector, rating market structures and market-supporting institutions. Scores range from negligible, small, medium and large. "Negligible" means that the remaining challenges are minor and that the sector is well advanced in moving towards the standards of a well-functioning market economy. "Large" means that the remaining challenges are major and that this dimension of the sector is at an early stage of reform.

Corporate Sectors	**Market structure**	**Market supporting institutions**
Agribusiness	Medium	Small
General industry	Small	Medium
Real estate	Small	Medium
Telecoms	Medium	Small
Energy		
Natural resources	Medium	Small
Sustainable energy	Medium	Medium
Power	Medium	Medium
Infrastructure		
Water and wastewater	Medium	Medium
Urban transport	Medium	Small
Roads	Medium	Medium
Railways	Medium	Medium
Financial Sectors		
Banking	Medium	Medium
Insurance, other fin. services	Medium	Small
MSME finance	Medium	Medium
Private equity	Large	Small
Capital markets	Small	Small

CORPORATE SECTOR

Agribusiness

Market structure: *Medium*
Market institutions: *Small*

Agriculture remains a relatively protected sector. Turkey maintains high import duties on many live animals and animal products. Although over 50 per cent of Turkey's land is arable, the lack of proper irrigation, the relatively small and uneconomic size of individual family-owned farms and the undersupply of capital for employment of modern production inputs, techniques and machinery prevent the country from realising its full agricultural potential. In recent years, major industrial conglomerates have started investing in, and consolidating, the food processing sector, which has led to significant improvements in ISO certification and quality standards, while mid-sized corporates still lag behind. Progress of large-scale retail is impeded by difficulties in acquiring business permits. While inline with Turkey's commitments to WTO, key challenges in the agribusiness sector include addressing the high level of state involvement and intervention in agribusiness; helping mid-sized corporates in meeting western hygiene, quality (in particular traceability of products) or efficiency standards; developing specialised trade and storage infrastructure in the regions; and supporting market-based institutions for financing (WHR).

Manufacturing and Services
Market structure: *Small*
Market institutions: *Medium*

The Turkish M&S sector is generally open to international trade. However Turkey recently imposed tariffs on textile imports from selected countries outside the EFTA for four years with the explicit aim to protect domestic producers. There has been an increase in R&D expenditures and patent registrations, and they are now at par with the best in the CEB region. The legislative and regulatory framework for starting and operating a private business needs strengthening, particularly the implementation of existing laws and enforcement of contracts. Competitiveness could be enhanced by structural reforms that help to shift activity from the informal to the formal sector. Restructuring and improvements in corporate governance and energy efficiency standards remain significant challenges among mid-sized corporations and those in underdeveloped regions. The relative competitiveness of the Turkish manufacturing sector is also still adversely affected by incomplete reforms in the energy and transport sectors.

Real estate
Market structure: *Small*
Market institutions: *Medium*

The real estate sector has developed significantly over the past decade, including new types of property as well as financing instruments. The retail sector is nearing saturation, especially in the largest markets of Istanbul and Ankara, a trend that has been exacerbated by lower demand as a result of the global financial crisis. On the other hand, the medium term growth potential for the Class A office and industrial market continues to be positive. Regional imbalances exist and all sub sectors remain underdeveloped in the east and south of the country. The tourism sector is relatively well developed although there are inequalities in the development between the major cities and the coast and the rest of the country. Institutional investors are active in the country although the size of the market would accommodate a larger number of them. The legislative and regulatory environment regarding property markets needs to be improved. Mortgage financing is relatively underdeveloped; however, a new mortgage law was introduced 2007 that should begin to improve conditions for property finance. Development of real estate is hindered by a difficult and times consuming process of land acquisition.

Telecommunication

Market structure: *Medium*
Market institutions: *Small*

The Information and Communications Technologies Authority (ICTA) is an administratively and financially independent national regulatory authority. Turkcell, the largest player in the three-operator mobile market, continues to control a market share of about 55 per cent, despite the availability of mobile number portability. The fixed-line incumbent, Turk Telekom (in which the state still holds a golden share), dominates the fixed-line market due to the reach of its copper-based network. TTnet, Turk Telekom's internet arm, still maintains a dominant position in the broadband internet market with DSL services, although its market share has been consistently decreasing since 2006. However, mobile broadband is growing fast and takes an increasing share of the broadband market. There are a large number of licensed and operational ISPs in Turkey. The number of internet users has recently increased significantly, although the internet penetration still remains relatively low due to the low level of PC penetration in the residential sector. Regional disparities in terms of internet connectivity remain important and dial-up remains the most used connection in rural areas. The digitalisation process is expected to be completed by 2015/17, given the large territory to be covered and the massive investments to be incurred.

ENERGY AND INFRASTRUCTURE

Natural Resources

Market structure: *Medium*
Market institutions: *Small*

TPAO, the state-owned oil and gas exploration and production company, produces some 90 per cent of the domestic production. TUPRAS (the petroleum refinery corporation) and POAS (a major petroleum product retailer) have been privatised but remain dominant producers. The retail fuel sector is being de-regulated and the market has seen the entry of new players. In 2005, the Petroleum Market Law stimulated competition in the sector by abolishing price ceilings and removing import quotas on petroleum products. However, insufficient storage capacity and transportation bottlenecks prevent greater competition in the market. Turkey's oil and gas pipeline network is operated by state-owned gas company BOTAŞ. Despite legal requirements to do so, little progress has been made in unbundling, privatisation of activities outside transmission (only 10 per cent of the total capacity has been successfully tendered) and introduction of competition. To improve gas market' operations and enhance competition, the capacity of the regulatory authority needs to be strengthened. The key transition challenges for the natural resource sector are to reform, corporatise and improve corporate governance within state-owned enterprises, including BOTAS; to improve the environmental and health and safety standards in the industry; to eventually privatise mining assets; and to establish transparent regulatory mechanisms, including for the setting of oil and gas transport tariffs and for third party access to storage facilities.

Sustainable Energy
Market structure: *Medium*
Market institutions: *Medium*

Turkey has approved an energy efficiency (EE) law and has already established basic institutions for EE (energy efficiency agency), but further work is still required, such as setting indicative targets for energy savings and instruments to achieve these. Energy tariffs reflect operating costs and provide some incentive for low cost efficiency measures, but still do not reflect environmental costs. The Turkish economy is relatively energy efficient (low energy intensity). The Turkish Energy Efficiency Strategy was adopted in 2004 with the aim to harmonize Turkish legislation and regulation with the relevant EU *acquis*. The RE framework is in place and provides support, including feed-in tariffs and mandatory off-take for a variety of RE technologies. In January 2011 the new RE law was approved which guarantees power purchase prices for a period of ten years. The use of renewable resources (hydro and wind) is already established, though well below the country's potential renewables capacity. Turkey has ratified the Kyoto protocol in August 2009 but the protocol does not impose any measures on Turkey. Remaining challenges are to achieve more effective energy efficiency project implementation and support institutional development and project deployment for climate change.

Power
Market structure: *Medium*
Market institutions: *Medium*

The power sector has been fully unbundled into separate generation, transmission, trading, and distribution companies. While the liberalisation process is proceeding, private sector participation is still limited. State-owned companies dominate every link of the electricity supply chain. The generation segment is dominated by state-owned EUAS (approximately 50 per cent of capacity) and some questions have been raised about IPP access to networks. The privatisation process of generation is just starting and the government intends to sell 45 hydroelectric, coal and gas fired power plants. Transmission is and most likely will remain fully state-owned. The privatisation of distribution assets is proceeding rapidly. Progress has been made to improve the quality of Turkish institutions. An independent regulator (EMRA), which is licensing participants and approving market rules, has been established. The Government has been gradually moving towards cost reflective tariffs. A feed-in tariff and a mandatory off-take mechanism are in place to support the development of renewables; these were recently revised to differentiate by type of renewable energy at the end of 2010 and should aid further the development of some types of renewable projects (geothermal and biomass in particular).

Water and wastewater
Market structure: *Medium*
Market institutions: *Medium*

Local authorities are responsible for municipal water services. Few water utility services are corporatised, most remain integrated into municipalities. Municipalities are under strict financial control by the central authorities are typically not creditworthy due to excessive borrowing from the state Iller Bank and a narrow and rigid revenue base. While focus on service delivery is common and operational and financial performance is generally good, access to services needs to improve further, particularly in smaller municipalities. Tariffs are generally at cost recovery levels in tier-1 cities and close to cost recovery in smaller municipalities. Challenges in the sector include the corporatisation of municipal utility services to ease the financing burden for municipalities, further developing a culture of cost reflective tariffs and good operational and financial performance of water services. Other priorities include the restructuring of weaker operators, particularly outside the largest cities, more private sector participation to accelerate service expansion and improve service quality (particularly for wastewater treatment).

Urban Transport
Market structure: *Medium*
Market institutions: *Small*

Local authorities are responsible for municipal public transport provision and planning and regulatory capacity is relatively developed (at least in larger municipalities); approval for new light rail-metro investments is required from the national authorities. Financial and operational performance is generally good, comparable with the advanced urban transport markets in the world. Infrastructure assets are typically financed by the municipalities using loans from Iller Bank or direct transfers from the central government, as municipalities have limited tax raising abilities and are over-burdened with high and unsustainable levels of debt. Private bus and minibus operators in the urban transport sector are widespread. The approach to tariff setting is based on cost recovery principles, but contracting structures, particularly more sophisticated service contracts (e.g. including service standards), are not yet widespread. The main challenge is to build on an established culture of cost-related tariffs and good operating performance through corporatisation of municipal transport operators to allow them to finance investments on their own balance sheet. Other challenges include the improvement of service coverage in most smaller cities and localities in the less developed parts of the country, refinement of service contracts, expansion of PPP structures and refining the urban road and street management and planning capabilities in larger cities.

Roads
Market structure: *Medium*
Market institutions: *Medium*

The responsibility for highways and regional key corridors falls in the General Directorate of Highways, which has operated on a separate budget, but it is not autonomous from the central government. There are several toll roads and tolled bridges in Turkey. Some private sector companies have been awarded maintenance contracts for state roads and motorways. In addition the government has identified a number of road sections to be developed on a PPP basis. A BOT contract for the Eurasia Tunnel and the Gebze-Izmir Road have been tendered and the financing is under negotiation with several banks. A tender for existing motorways and bridges has also been launched. The fuel levy is one of the highest in the region. The transition challenges remain in development of fair and clear tendering processes and introduction of performance-based contracts for road maintenance; the development of PPP projects in line with international best practice; and improvements in governance and accountability in road agencies.

Railways
Market structure: *Medium*
Market institutions: *Medium*

The railway sector is underdeveloped by international standards despite some recent progress. The block train operation has decreased freight cost, branch lines were organized in industrial zones, one logistics center (Gelemen) has begun operations and three others are under construction (Kaklık, Hasanbey and Köseköy), and the Ro-La model – widespread in Europe to move freight transport from roads to rail – has begun to be implemented. However, the Turkish State Railways (TCDD), despite being a corporate entity, is not yet fully commercialised and persistently loss-making. The policy-making function rests with the government. TCDD is a fully integrated railway (i.e. no separation of operations from infrastructure) 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, let alone road transportation. The government has identified a number of potential PPP projects for the construction of new rail lines and a high speed railway station in Ankara, but these have yet to be tendered. Transition challenges remain in 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; and development of an adequate regulatory framework.

FINANCIAL INSTITUTIONS

Banking

Market structure: *Medium*
Market institutions: *Medium*

Despite a strong and well-regulated banking sector, the Turkish financial sector remains relatively small and shallow in terms of financial intermediation. Domestic bank lending to the private sector has increased significantly in recent years, though it still remains relatively low at about 47 per cent of GDP as of end 2010. Deposits continued to grow, however by September 2011 84 per cent of these deposits had a maturity of 3 months or less while loans – about half of banks' assets – have become increasingly medium- to long term. This mismatch represents an important vulnerability as private sector credit has been growing at about 30 percent (year-on-year) each month since mid 2010. Access to domestic sources of long term finance remains a constraint for MSMEs and households. State ownership accounts for about 32 per cent of total assets, and no major privatisations have taken place since 2008. Though roughly 40 per cent of the banks were majority foreign owned in 2010, they only accounted for 17 per cent of total assets. Banking supervision and regulation were improved significantly since the 2001 financial crisis with the unified BRSA applying stringent laws and regulations with further recent improvements in prudential regulation. There are 30 foreign counterparts of the BRSA with which an MoU has been signed to cooperate in the field of supervision of banks and training of staff.

Micro, Small and Medium-sized enterprises

Market structure: *Medium*
Market institutions: *Medium*

MSMEs account for about 99.9 per cent of the number of companies (majority micro and small), and 82 per cent of employment as of end-2008. However, they accounted for about 51 per cent of value added of non-financial companies in the economy. Financial intermediation is low and there is limited MSME financing outside the major cities. Although policymakers have encouraged public and private banks to improve credit lines for MSMEs (including a government-sponsored micro-credit facility) and MSME market (Emerging companies Market-EMC) set up at Istanbul Stock Exchange access to finance is still an impediment to business investment and expansion. In response to the crisis, the government increased significantly the capital of the Credit Guarantee Fund in 2009. Improved coverage of credit information services, better enforcement of bankruptcy laws as well as an operating, geographically unified collateral registry would help minimise the banks reluctance to provide long-term financing.

Insurance and other financial services
Market structure: *Medium*
Market institutions*: Small*

The role of the non-banking financial sector has been growing but remains relatively limited. The insurance sector is fragmented and at early stages of development. There are few barriers to entry. The top three companies account for 34.1 per cent of the market. Compulsory third party motor liability (CPTML) has been the predominant driver of premiums in the non-life insurance industry. Compulsory earthquake insurance and consumer loan insurance schemes as well as a subsidy scheme for agricultural insurance are likely to contribute to further growth. Turkey is aiming to align insurance legislation, regulation and supervision with the EU framework, however, the June 2007 Insurance Law is only partially in line with the *acquis communautaire*. Following the social security reform of 1999, private pension funds started operations in 2003. The pension system is supervised by the Treasury and the Capital Markets Board. Private pension fund assets have reached 0.67 per cent of GDP. The leasing segment is fairly well developed, with 36 companies providing a lease portfolio of 8 percent of GDP.

Private equity
Market structure: *Large*
Market institutions: *Small*

Despite a few large headline deals by international funds, private equity in Turkey is still at a relatively early stage and the foundation of the sector is less developed than in most new EU member states. There are less than five country dedicated fund managers in the market and over 10 regional fund managers that include Turkey in their fund scope. Approximately EUR 700 mln in private equity investments were made in 2009, leading the EBRD region. However transactions still remain at very low levels relative to the size of the economy, with active capital estimated at only 0.3 per cent of GDP and estimated capital available for investment only 0.15 per cent of GDP. The bulk of committed capital is focused on buyouts, followed by growth and distressed strategies. There is a lack of committed capital in small company and venture capital as well as mezzanine and infrastructure funds. On the institutional side, Turkey shows reasonable conformity with OECD Corporate Governance Principles and there is some, if limited, participation by a broad range of local investors.

Capital markets
Market structure: *Small*
Market institutions: *Small*

Securities market legislation is substantially in line with IOSCO principles, with the only weakness identified in the operation of self-regulating bodies overseeing financial markets. A new Turkish commercial code, passed in March 2011, aims to incorporate internationally accepted accounting standards into domestic legislation, increase the transparency of enterprises and bring Turkish legislation in line with corresponding EU legislation. The domestic equity market is among the deepest and most liquid of any

EBRD country of operation, providing viable funding sources in conducive market conditions. While Turkish banks and companies have issued bonds internationally, the domestic corporate bond market is extremely small, as credit to the private sector is dominated by the banking sector. Since deposit banks were allowed to issue domestic bills and bonds in Turkish lira in October 2010 there has been some issuance by deposit banks, dominated by the bank bills with maturities of 12 months or less. New capital market instruments such as corporate warrants, asset covered bonds and ijara certificates have been introduced and first issuance of these instruments has been realized in the last two years. Money market infrastructure in Turkey is well developed. Turkey's government bond market is, together with Poland's, the most developed within the EBRD region. Primary and secondary market infrastructure is fully in place and liquidity in secondary trading is high.

ANNEX 3 - LEGAL TRANSITION

Overall Assessment

Turkey has had a long-standing, un-interrupted commercial law tradition, going back to the 1920s when the young Republic adopted Swiss-based models for its legislation. According to the EBRD assessments, Turkish laws are advanced in a number of areas, including corporate governance and public procurement. In other areas, the system still requires upgrading and modernising in order to fully support market activities. This is particularly true of the secured transactions regime, which lacks flexibility. The judiciary is reported to be generally reliable, but there are many reports of lengthy proceedings.

Through its Legal Transition Programme, the EBRD helps create an investor-friendly, transparent and predictable legal environment in transition countries. Programme activities may include policy dialogue, legal assessment, and technical cooperation with the country's authorities. Below is a review of legal developments in the sectors crucial to the Bank's investment strategy for Turkey, together, where applicable, with a summary of planned EBRD technical cooperation activities.

Investment climate / private sector

Improvements required to private sector-supporting legislation

The Civil Code is the main source of law governing **secured transactions** – both pledges (security rights over movable property) and mortgages (security rights over immovable property). 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. Practitioners have proposed ways to circumvent legislative limitations, but these alternatives are complex and apply under restricted circumstances. There is a need to build a consensus among the Turkish authorities and the private sector over the best way to simplify and modernise the secured transactions regime. The mortgage market too would benefit from a reform in the mode of enforcement, which is lengthy and costly.

The 2007 EBRD assessment on **corporate governance** placed Turkey in the "High Compliance" with the OECD Principles of Corporate Governance category and indicated only minor shortcomings. The relevant legislation is to be found in the Commercial Code, a new version of which will enter into force in July 2012. The new Commercial Code will introduce important changes such as strengthened shareholder rights, use of information technology in commercial transactions and applying international standards for auditing. In particular, it will allow both limited liability companies and joint stock companies to be established with one person, to hold their own shares by creating treasury stocks, and will allow minority shareholders to request a court decision to dissolve the company for a justified reason. The new Commercial Code further introduces an independent audit requirement, which is expected to bring more transparency to Turkish corporate practices.

The **insolvency** regime is governed by the Execution and Bankruptcy Code (EBC) of 1932, subsequently amended in 2003 and 2004. The Turkish Commercial Code, the Code of Obligations, the Code of Civil Procedure and the Banking Act also govern some aspects of the insolvency system. In the wake of the Turkish economic crisis of 2000-2001, the Turkish authorities reviewed insolvency procedures. The crisis was far reaching and led to various corporate bankruptcy proceedings, prompting a strong effort to reform and modernise Turkish insolvency regulation and enforcement. The 2003-2004 amendments resulted in a number of measures (e.g. postponement of bankruptcy, reorganisation procedures), whose objectives were to rejuvenate the national economy by providing regulatory and legal tools to rescue and rehabilitate financially distressed companies. However, the general view on these is that they disproportionately favour debtors at the disadvantage of creditors. In addition, practitioners in Turkey report that there are shortcomings in the system that can hamper its efficiency. The bankruptcy process is seen as relatively slow and it appears both common and easy for debtors to delay the process even further. The courts are also overburdened, resulting in breaks of several months between hearings.

The debt **capital market** of Turkey is not as developed as those in Western Europe due to its small size and relatively young age, but the legal and regulatory framework has been refined, due to the EU adaptation process, and became more effective. Banking laws and regulations are mostly in line with EU directives. Basel II will be applied between July 01, 2011 and June 30, 2012 for reporting purposes. After that period it will be put into force. As opposed to many other countries, Turkey was not significantly affected by the global financial crisis of 2008-2009. No laws impacting the debt capital markets were adopted specifically to address the financial crisis. Much of Turkey's current success stems from the way its financial system was rebuilt after its collapse of 2001. Turkey strengthened the local banking system and created strong, independent regulators. Turkey is a priority country in the Bank’s Local Currency and Local Capital Market Initiative, under which the Bank commits to a number of activities aimed at promoting the use of local currency and development of local capital markets.

Judicial capacity in commercial matters

One of the key concerns about the effectiveness of the Turkish judicial system has been the large backlog of cases and the slow speed of proceedings, particularly in relation to appeals. The latest EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS) revealed that only 25 per cent of business respondents believe the Turkish legal system is sufficiently fast. In order to address this problem, the parliament passed amendments in 2011 restructuring the Court of Appeal and providing it with greater resources. In particular, the number of chambers at the Court of Appeal was increased from 32 to 38. A further reform which could assist the authorities to tackle the backlog problem would be the introduction of a system of mediation of civil disputes.

Infrastructure

There is no general framework for **public-private partnerships (PPP)/concessions** in Turkey but BOTs and concessions have been commonly used for some time. The relevant provisions are to be found in sector-specific laws, for example on infrastructure and public services, electricity, highways or in municipal laws. Law no 3996, regulating the BOT model, has a wide range of applications covering most of the sectors and almost all public institutions.

Amongst legal gaps worth noting are the following: current decentralisation of PPP rules presents certain difficulties for market participants and financiers; current legislation does not cover all the common sectors with concession potential (those covered do not include justice and culture). . There is no unified definition of a "concession". Although there is no specific provision regulating the creation of security interests in PPP projects, securities are nevertheless created in accordance with the civil code and code of obligations. Some positive features of the legislation include the possibility for the parties to choose arbitration for the settlement of disputes.

Given the EBRD investment portfolio and pipeline, PPP policy dialogue and PPP legal/regulatory development will represent a priority area for the future. The draft PPP law initiated by the Ministry of Development (formerly State Planning Organisation) has been in existence for a few years. It aims at defining the PPP concept, principles, sectors, procedures and models, while allowing a sufficient degree of flexibility. In order to facilitate PPPs in Turkey the development of a modern law, oriented towards bankability of projects and lenders' protection, is clearly needed.

Public procurement in Turkey is governed by the Public Procurement Law Act and the Law on Public Contracts. Since 2002 these laws have been amended several times. The most significant and extensive amendment was adopted in October 2008, in order to align the national law with the EU Public Procurement Directives. The institutional framework in public procurement is comprehensive and well-managed and local contracting entities in Turkey are clearly increasing their procurement capacity and learning new procurement techniques (i.e., eProcurement).Public procurement legislation is in high compliance with international standards. However, some key regulatory matters still need attention, and implementation problems were identified by the EBRD survey of local practice. The main weaknesses in public procurement legislation are preferential treatment of domestic tenderers, a far-reaching black listing system, and insufficient independence of the public procurement remedy procedures (the review proceedings are conducted by the regulatory authority).

The **telecoms sector** is regulated by Law on Electronic Communications of 2008, together with supplementary subordinate legislation. The legislative framework is largely based on the 2003 EU Electronic Communications Regulatory Framework. Competition has been slow to take hold in the sector in Turkey, owing mainly to the fact that full voice liberalisation and introduction of 3G mobile did not occur until 2009. Now that those policies are in place the competitive market is advancing. In the future, however, the authorities should focus on finalising and adopting primary and secondary legislative amendments, strengthening the institutional independence of the regulatory authority and effective implementation of relevant competitive safeguards. The focus of the authorities should be on implementing the policy and regulatory measures which support a more rapid development of broadband infrastructure and services.

ANNEX 4 - SMALL BUSINESS SUPPORT (SBS) ACTIVITY

SBS supports economic transition by achieving enterprise change in potentially viable micro, small and medium sized enterprises (MSMEs) and contributing to the development of a sustainable infrastructure of local business advisory services.

Previous Enterprise Growth Programme (EGP) experience

EGP Turkey started in 2009 with approximately €970,000 of donor funding mobilised through the EU Instrument for pre-Accession (IPA) Private Sector Support Facility. All projects have been undertaken in the regions specified under the IPA Regional Development Operational Programme, namely Kayseri, Trabzon, Sanliurfa, Hatay, Corum and Gaziantep.

The main objective of EGP activities is to promote the transfer of management skills to SMEs leading to restructuring and improvements in all aspects of business. Projects have been initiated so far in various sectors, such as agribusiness, footwear manufacturing and plastic products. One project has also been initiated under the Korean TAC Fund in the electronics sector. EGP has provided assistance in improving production efficiency and increasing profitability by introducing better costing systems and recommending more effective market segmentation.

Previous Business Advisory Services (BAS) experience

2011 was the first year of BAS operations in Turkey. The programme is funded with €1,481,250 from the EU IPA Private Sector Support Facility for Turkey. In the initial stage of launching operations, the main objectives were to raise awareness among target groups and potential beneficiaries about the programme, create several showcases aimed at increasing demand for the programme as well as position the programme in order to create synergies with other related donor and government programmes.

MSME and Consulting sector in Turkey

The MSME sector and business environment

According to the EU, around 95 per cent of Turkish enterprises have fewer than 10 employees and MSMEs account for 64 per cent of total employment in Turkey. This is well in excess of their contribution to gross value-added, which is only 36 per cent of the national total. Smaller Turkish enterprises tend to have lower productivity and rely less on ICT, R&D and innovation compared to larger enterprises, and a higher share of their activities falls into the informal sector of the economy. At the same time, micro-firms are the most dynamic in terms of growth. The Turkish MSME sector still has difficulties with access to finance, insufficient credit guarantee systems, limited usage of modern marketing techniques, low level of education, shortage of capital for high technology investments and lack of harmonization to global standards. All this make it more vulnerable to international competition and the global economic crisis.

The consultancy market

The Turkish consultancy market has developed significantly in the past decade, largely owing to significant aid from the European Union. Nevertheless, the sector remains fragmented and significant discrepancies persist both in terms of quantity and quality between the main cities and the Western part of Turkey, and the areas further to the East. Demand remains somewhat limited and many entrepreneurs, in particular in Eastern Turkey, are reluctant to engage with external advisors. However, as awareness of the benefits of consultancy services is increasing, it is expected that demand will accelerate in the medium-term for services such as reorganisation and enterprise restructuring – especially for family-owned companies – HR management, brand development and management, financial management as well as implementing MIS systems. The Turkish Association of Consultants (YDD) represents the domestic consultancy industry and has currently approximately 200 members, most of which reside in Istanbul, Ankara and other major cities in Western Turkey. Despite YDD's efforts to implement training programmes on consultancy standards and procedures to the sector, overall the Turkish consultancy market lacks professionalism.

Infrastructure of MSME support

The main agency for implementing government policy on MSMEs in Turkey is the Small and Medium Industry Development Organisation, KOSGEB, a publicly-funded institution that is part of the Ministry of Industry and Trade, which is represented across most regions. The EU also offers advice and assistance to MSMEs through a network of Euro Info Centres. The Union of Chambers and Commodity Exchanges of Turkey (TOBB) represents the private sector and has been the beneficiary of an the EU-funded European-Turkish Business Centres Network project (ABIGEM), which established 15 business centres in various parts of Turkey for MSME support. The Confederation of Tradesmen and Artisans of Turkey (TESK), the Turkish Technology Development Foundation (TTGV) and the Turkish Foundation for Small and Medium Business (TOSYOV) are other private sector initiatives providing support to MSMEs.

SBS continuation in Turkey

Continuation of EGP

Subject to donor funding, the EGP plans to further support the transfer of management skills to SMEs in Turkey in line with the EBRD's operational priorities. Identification of planned projects will be carried out in order to ensure adequate geographical coverage, focusing solely on the South-Eastern Anatolia region. EGP will mainly work with enterprises located in less developed regions which have a potential to become major suppliers for the domestic market and export potential. EGP assistance will focus on product development, business planning, sales and marketing. The EGP will also help enterprises to improve their organisational and management skills and enhance their exposure to international best practices. Sectoral focus will be on agribusiness, manufacturing (such as textiles, machinery and furniture), energy and ICT.

Continuation of BAS

The BAS programme will be highly additional in the rural areas in Eastern Turkey, where both the consultancy and MSME market remain underdeveloped. BAS Turkey plans to undertake a minimum of 25 projects per year engaging local consultants and focusing in the regions specified under the IPA Regional Development Operational Plan, mainly in the South-Eastern Anatolia region. In addition, BAS will undertake market development activities (MDAs) to increase awareness of the programme and to develop the domestic consultancy market, which directly increases the supply and quality of advisory services offered. A Grant Guideline Matrix is proposed for Turkey to prioritise intervention and avoid duplication of efforts with international donors and governmental organisations. Subject to funding availability, higher grants will be allocated for projects outside the main cities and for more complex consultancy services, including those aiming to improve environmental management and promote energy efficiency.

BAS assistance at the enterprise level will be complemented with the following market development activities in order to maximise the programme's transition impact in Turkey:

- *Visibility and dissemination:* Steps will be undertaken to promote the use of business advisory services, especially in the Central and Eastern Anatolia regions, and to stimulate demand for more sophisticated consultancy services.
- *MSME and consultancy training*: Capacity building for local consultants will be organised to help broaden the supply and improve the quality of local advisory services.
- *Support to and development of existing local institutions*: BAS will continue supporting local institutions that contribute to the development of MSMEs and the business advisory services market. For example, BAS will continue supporting the consolidation and the sustainability of local management consultancy associations such as YDD.

ANNEX 5: TC COMMITMENTS

TC COMMITMENTS BY DONOR THROUGH EBRD, 2009-2011

Donor	TC Commitments (€)
Austria	450,000
Clean Technology Fund	1,620,000
Czech Republic	150,000
EBRD Shareholder Special Fund	3,164,736
EU	3,812,425
European Commission	1,640,108
Italy*	160,760
Korea	75,000
Slovak	280,000
Spain	925,016
Taipei China	40,000
United States of America	2,184,122
Total	**14,502,167**

* Italy's contribution was received in December 2008

TC COMMITMENTS BY SECTOR THROUGH EBRD, 2009-2011

Sector/Team		TC Commitments (€)
SME Development*	SBS (formerly TAM/BAS)	2,393,828
E2C2	E2C2	3,675,043
Environment	Environment	312,699
Financial Institutions	FI	5,692,597
LTT	LTT	3,000
Infrastructure	MEI	1,890,000
	Power and Energy	400,000
Other	Other	135,000
Total		**14,502,167**

Note: Commitment values based on year end data for each year.

* 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)

ANNEX 6 - SELECTED ECONOMIC INDICATORS

Turkey

	2006	2007	2008	2009	2010	2011 *Estimate**	2012 *Estimate*
Output and expenditure			*(Percentage change in real terms)*				
GDP	6.9	4.7	0.7	-4.8	9.2	8.5	2.5
Private consumption	4.6	4.7	-0.4	-2.0	5.9	7.2	…
Public consumption	8.4	6.5	1.7	7.8	2.0	4.5	…
Gross fixed capital formation	13.3	5.8	-4.8	-28.6	48.4	17.0	…
Exports of goods and services	6.6	7.3	2.7	-5.0	3.4	6.5	…
Imports of goods and services	6.9	10.7	-4.1	-14.3	20.7	10.6	…
Industrial gross output	6.2	7.4	-16.8	9.1	14.9	15.2	…
Labour Market			*(Percentage change)*				
Labour force (end-year)	2.7	-0.8	5.4	4.3	3.1	2.6	…
Employment (end-year)	3.5	-0.8	1.7	4.8	5.7	4.5	…
Gross wages and salaries in industry, LCU	13.2	14.8	10.6	-1.9	15.8	14.9	…
			(In per cent of labour force)				
Unemployment (end-year)	10.9	10.9	14.0	13.5	11.4	9.8	…
Prices			*(Percentage change)*				
Consumer prices (annual average)	9.6	8.8	10.4	6.3	8.6	6.5	11.1
Consumer prices (end-year)	9.7	8.4	10.1	6.5	6.4	10.4	7.7
Fiscal Indicators /1			*(In per cent of GDP)*				
General government balance	-0.8	-1.7	-1.9	-5.6	-3.7	-1.4	…
General government revenues	33.2	32.2	32.2	34.2	35.2	35.5	…
General government expenditure	33.4	33.8	34.7	40.1	38.8	37.1	…
General government debt /2	46.5	39.9	40.0	46.1	42.2	40.1	…
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	24.7	15.7	26.7	13.0	19.1	14.8	…
Credit to private sector (end-year)	36.7	27.8	22.4	13.4	40.4	32.8	…
			(In per cent of total loans)				
Non-performing loans ratio	3.7	3.4	3.6	5.2	3.5	2.7	…
Interest and exchange rates			*(In per cent per annum, annual average)*				
Policy rate /3	27.0	25.0	25.0	15.0	6.5	5.8	…
Interbank money market rate	15.6	17.2	16.0	9.2	5.8	3.0	…
Deposit rate	21.6	22.6	22.9	17.2	15.0	14.2	…
Lending rate /4	28.0	27.0	26.5	21.0	19.0	17.0	…
			(Liras per US dollar)				
Exchange rate (end-year)	1.4	1.2	1.5	1.5	1.5	1.8	…
Exchange rate (annual average)	1.4	1.3	1.3	1.5	1.5	1.7	…
External sector							
			(In per cent of GDP)				
Current account	-6.1	-5.9	-5.7	-2.2	-6.4	-10.0	…
Trade balance	-5.2	-5.2	-4.8	-1.2	-5.6	-9.2	…
Merchandise exports	17.6	17.8	19.2	17.8	16.5	18.5	…
Merchandise imports	-25.4	-25.0	-26.5	-21.8	-24.2	-30.1	…
Foreign direct investment	3.6	3.1	2.3	1.1	1.0	1.7	…
Gross reserves, excluding gold (end-year)	11.4	11.3	9.7	11.2	10.8	9.9	…
External debt stock	39.3	38.4	38.0	43.7	39.1	38.4	…
Public external debt	13.5	11.3	10.7	13.6	13.1	13.8	…
Private external debt	25.7	27.1	27.3	30.1	26.0	24.7	…
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	5.0	4.9	4.0	5.5	4.8	5.1	
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	68.1	68.9	69.7	70.5	71.3	72.4	…
GDP (in billions of liras)	758.4	843.2	950.5	952.6	1,098.8	1,294.9	…
GDP per capita (in US dollars)	7,775.0	9,421.6	10,474.8	8,710.5	10,309.5	10,709.7	…
Share of industry in GDP (in per cent)	23.1	22.9	22.3	20.6	21.3	22.3	…
Share of agriculture in GDP (in per cent)	8.0	7.4	7.4	8.1	8.3	7.9	…
FDI (in millions of US dollars), net	19261	19941	16955	6858	7574	13440	…
External debt - reserves (in US$ million)	147.1	176.4	207.1	199.6	211.0	229.9	…
External debt/exports of goods and services (	174.4	172.9	157.6	187.1	186.3	168.0	…
Broad money (M2, end-year in per cent of GD	39.3	40.8	45.9	51.8	53.4	52.1	…

1/ Turkish Treasury
2/ EU Defined Debt Stock (% of GDP), Undersecretariat of Treasury, 31 October 2011.
3/ Discount rate is shown for 2006-2009. In May 2010 policy rate has been changed to one-week repo.
Number shown for 2011 is end of 2011 one-week repo rate.
4/ EIU data.

ANNEX 7 - GENDER EQUALITY

According to the UNDP 2010 Human Development Index (HDI), Turkey is amongst the high human development countries at 83rd place out of 169 countries. The HDI is comprised of three dimensions: health, education and decent standard of living. The country ranks slightly better in terms of the Gender Inequality Index at 77th globally.

Women are significantly falling behind men in employment. For example, according to Eurostat data, in 2009 the share of women aged 15 to 64 in employment was only 24 per cent compared to 65 per cent for men in the same age category. This rate is well below the OECD employment rates for women, which currently stands at average 58 per cent. The gender pay gap is high, ranging from 20 per cent to 30 per cent depending on the data source and method of calculation during the period of 2003-2010.

Indicator	Female	Male	Year
Employment rates	24.2%	64.5%	2009
Entrepreneurial activity rates	3.7%	13.4%	2010

Source: Eurostat 2009; Global Entrepreneurship Monitor (GEM) 2010

The extent and form of women's participation in the labour force is connected, among other factors, to institutional support mechanisms, such as childcare services, parental leave policies and flexible work arrangements. According to the 2010 Women's Economic Opportunity Index, for example, Turkey ranks 16th out of 33 countries in Asia when a number of indicators in the area of labour policy and practice are compared, such as maternity and paternity leave provisions, regulations on equal pay for equal work, and the availability, affordability and quality of childcare services. It continues to be typical for women in Turkey to quit their job when pregnant and only return to the labour market once their children have grown-up, and often then only if motivated by economic necessity. Women often face discrimination in employment, particularly in recruitment, promotion and remuneration. Social disapproval of their employment further adds to the challenges women experience in the labour market.

Educational attainment is another key element affecting both female participation in the labour market and their earnings in Turkey. While significant progress has been made in closing gender gaps in education, men still outnumber women at all levels of education with significant disparities reported by eastern and western, and rural and urban regions. A variety of social and economic factors, such as distance of travel to rural schools, gender bias favouring early marriage over education and the need for children to support family income continue to inhibit girls' education. Gender segregation in tertiary education is also obvious. For example, in 2004-2005 only about 18 per cent of women were enrolled in engineering, manufacturing and construction courses compared to 82 per cent for men, while women dominated 'female' courses, such as humanities and arts, and health and welfare. In 2007, as the UN Economic Commission for Europe reports, only 20 per cent of women used a computer in the last three months preceding the survey compared to 39 per cent for men.

According to the IFC 2008 Enterprise Survey, 40 per cent of 1152 firms surveyed in Turkey had women among the owners; women constituted 25 per cent of full-time workers; 7 per cent of women were among full-time non-production workers, and 12 per cent of firms had women in top management.

Turkish women entrepreneurs face numerous obstacles, some of which are universal. These include institutional and regulatory issues, lack of access to finance, relatively low rates of business education or work experience, confinement of women's businesses to slower growth sectors, and the burden of household management responsibilities. According to the Global Entrepreneurship Monitor, in 2010 in Turkey the male entrepreneurial activity rates were more than 3 times higher (13 per cent) than that for females (4 per cent). More than 68 per cent of men and only 40 per cent of women surveyed believed that they have skills, experience and knowledge needed for entrepreneurship, and 68 per cent of men and 40 per cent of women know a person who started a business in the past two years.