The World Bank in Turkey

Country Snapshot

An overview of the World Bank’s work in Turkey

October 2018

TURKEY

Country Context

Turkey’s economic and social development performance since 2000 has been impressive. Macroeconomic and fiscal stability were at the heart of its performance, leading to increased employment and incomes and making Turkey an upper-middle-income country.

Turkey has maintained a long-term focus on implementing broad and ambitious reforms in many areas, and government programs have targeted vulnerable groups and disadvantaged regions. Poverty incidence more than halved over 2002–15, and extreme poverty fell even faster.

During this time, Turkey urbanized dramatically, opened to foreign trade and finance, harmonized many laws and regulations with European Union (EU) standards, and greatly expanded access to public services. It also recovered well from the global crisis of 2008/09.

Turkey’s response to the influx of approximately 3.6 million Syrian refugees has been exemplary and provides a model to other countries hosting refugees.

However, some of Turkey’s much-lauded development achievements have been slowing down after the long period of success, exacerbated by the economic turbulence of mid-2018.

Today, the country still faces stubborn human development challenges: inequality has been rising since the 2008/09 crisis; the labor market continues to be too rigid; women’s labor force participation is significantly below comparator countries; and educational performance has weakened.

At a Glance

- With a GDP of around US$860 billion, Turkey is the 17th-largest economy in the world. From 2000 to 2016, per capita GDP in Turkey nearly tripled and reached US$10,597 in 2017. Turkey is a member of the OECD and the G20, and an increasingly important donor of Official Development Assistance.

- Despite good macroeconomic management for more than a decade, Turkey still faces significant development challenges. Educational quality is in decline, competitiveness and productivity are weakening, women’s labor force participation is still very low, and the influx of 3.6 million Syrian refugees is putting a strain on already stressed public services.

- Turkey is also facing a particularly acute set of economic challenges that emerged in 2018. Increasing economic stress, due to a persistently high current account deficit and perceived policy weaknesses, has resulted in intense exchange rate volatility in international currency markets and a significant depreciation of the Turkish lira since mid-August. The economic outlook for Turkey in the short to medium term is increasingly uncertain.

- The World Bank and the new Government formed in mid-2018 are discussing ways to support Turkey in addressing these economic challenges and in implementing the New Economic Program of September 2018. The World Bank’s program continues to maintain a long-term focus that maximizes opportunities to support Turkey’s progression to higher-income status.

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<th>2017</th>
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The World Bank and Turkey

The partnership between Turkey and the World Bank Group (WBG) is outlined in the Country Partnership Framework (CPF), which covers FY18–21 and sets out the main areas of WBG engagement, both technically and financially. The CPF has an embedded flexibility in the framework that allows the program to be adapted and to respond to evolving country circumstances and development priorities.

The CPF proposes a mix of instruments, drawing on the strengths of the International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), and Multilateral Investment Guarantee Agency (MIGA). The WBG investment portfolio and pipeline support a range of sectors, with programs both underway and planned in the energy sector, financial and private sector development, urban development, transport, social protection, labor market development, and health care. IBRD financing for FY18–21 is estimated at US$5–7.5 billion, while IFC’s own-account investment program is expected to be US$600–800 million p.a.

Turkey engages the WBG’s analytical and technical knowledge work. An extensive range of knowledge products aim to inform policy discussions in various areas (education, labor, finance, competitiveness, transport, forestry, land, and energy) and are the Bank’s primary instruments for broadening engagement with all stakeholders in Turkey. Recently, the increased Trust Fund portfolio enabled the preparation of detailed and broader coverage in education, labor market development, energy, disaster risk management, and urban development.

Key Engagement

The current CPF is progressing well thus far. In FY18, IBRD approved US$1.49 billion in new lending to Turkey, including the Resilience, Inclusion and Growth Development Policy Finance, US$400 million; a second Sustainable Cities Project, US$91 million; a Gas Storage Expansion Project, US$600 million; and an Inclusive Access to Finance Project, US$400 million.

One key engagement involves supporting the Government’s response to the large number of Syrian refugees living in Turkey. The WBG is partnering with the EU’s Facility for Refugees in Turkey (FRiT) and helping in the areas of social support and adaptation, labor markets and the economy, and education, as well as in the cross-cutting areas of data collection, measurement, and monitoring. In addition to the FRiT funds, the portfolio is also supported by a broad set of Trust Funds, most notably, the Clean Technology Fund (CTF), EU Instrument for Pre-Accession Assistance (IPA) funds, Global Environmental Facility (GEF) funds, and Swedish International Development Cooperation Agency (SIDA) Gender Funds.

In FY18, Turkey signed a Reimbursable Advisory Services (RAS) agreement with the World Bank on business environment reforms. The objective of the RAS is to help the Government of Turkey to improve selected aspects of the business environment.

On September 20, 2018, the Government launched its New Economic Program (NEP) to respond to the evolving economic challenges. The WBG is using the flexibility allowed by the CPF to discuss ways to support the priorities of the NEP. At the same time, the WBG program continues to maintain a long-term focus that maximizes opportunities to support Turkey’s progression to higher-income status.
Recent Economic Developments

The past six months have been marked by market volatility and growing economic stress in Turkey. Tightened global liquidity conditions and macro imbalances (17.9% year-on-year [y-o-y] inflation by August, a 6.5% current account deficit by June, 6.2% y-o-y growth in the first half of 2018) have combined to produce high bond yields and a 50% depreciation of the lira since early 2018. Though markets recovered from a first shock in May, the situation deteriorated further in August.

Demand started decelerating in the third quarter of 2018, prompting supply side adjustments. A weaker lira and slower growth have increased the private external debt burden.

Banks have already restructured over US$20 billion of corporate debt since April. Concerns over external financing risks have increased. The Central Bank’s efforts to offset this through liquidity measures have reduced international reserves (currently around US$90 billion).

Poverty has been continuously decreasing over the past decade, but recent labor market trends pose a downside risk to the sustainability of that progress. Although high economic growth led to a decrease in the unemployment rate during 2017, the trend has reversed in recent months. The seasonally adjusted non-agricultural unemployment rate has climbed from 11.8% in February 2018 to 12.5% in May.

The weaker lira has helped to narrow trade imbalances in the past three months up to July. The Central Bank reverted to a conventional single policy rate in June and has hiked it by more than 1,000 basis points since March to 24% in September. In August, the authorities made regulatory changes aimed at providing liquidity and avoiding market speculation.

Economic Outlook

The economic outlook is subject to higher levels of uncertainty, with increased chances of a downward adjustment to growth. Growth is projected to moderate from 7.4% in 2017 to 3.7% in 2018 and 2.3% in 2019. This assumes some policy adjustment (tight monetary policy, fiscal discipline, partial corporate debt restructuring). Consumption is expected to moderate, while investments are projected to decline due to a credit crunch and the ongoing uncertainty.

A comprehensive stabilization package, with a consistent policy framework, clear milestones, and active communication, could result in a softer adjustment and faster recovery. Policy uncertainty and inaction, on the other hand, could tip the economy into a deeper crisis.

Currency and inflationary pressures are projected to remain high over the coming year. Turkey has a sizable external financing requirement. There will be some reprieve, as the current account deficit is projected to shrink from 5.6% in 2017 to 4.7% in 2018.

Public finances will be squeezed by slowing revenue, triggered by lower growth and falling import demand, and higher budget financing costs due to rising bond yields. The budget deficit is projected to rise to 3.8% of GDP in 2018. At the same time, current economic conditions may require additional social assistance to protect the poor.

Poverty is forecast to decrease at a slow pace, from 9.3% in 2017 to 9% in 2018 and 8.8% in 2019, measured with the upper-middle-income country poverty line (US$5.5 per day in 2011 purchasing power parity). The forecast, however, is subject to uncertainty surrounding projected growth, the labor market, and food and non-food inflation.
Project Spotlight

Turkey Sustainable Cities Series of Projects

The Turkey Sustainable Cities Program, which supports improvements in the environmental, financial, and social sustainability of Turkish cities, was designed as Series of Projects (SOP) to provide financing to a single borrower (İllerBank) for subnational lending to selected municipalities and utilities that are interested in improving public services.

This approach allows İllerBank and the World Bank to expand the sustainable cities approach both sectorally and spatially. Sustainable Cities Project 1 (SCP1), with an IBRD loan amount of US$132 million for water and sanitation investments in Muğla and Denizli municipalities, was approved by the Bank Board in December 2016 and is now under implementation. Sustainable Cities Project 2 (SCP2), with a US$91.5 million IBRD loan amount for water and sanitation investments in Muğla and Antalya, was approved by the Board in April 2018.

The Sustainable Cities SOP provides investment financing for priority municipal investment projects to eligible municipalities for water, wastewater, solid waste, energy efficiency, and street lighting. It also provides technical assistance (funded by a €25 million EU IPA grant) to participating municipalities to help them i) prepare comprehensive integrated plans and capital investment plans and ii) prioritize investment financing plans with climate change aspects in mind. This assistance is currently provided to the cities of Antalya, Denizli, Muğla, and Kayseri.

Turkey’s Sustainable Cities Program stands on a public-private investment coordination platform, which, in cooperation with IFC, targets the maximization of finance for development (MFD) through interventions at the national and local levels. The local-level leg, jointly supported by the World Bank and IFC, assists cities in becoming more creditworthy to mobilize and leverage private finance. The technical assistance and investments enable the WBG to play a catalytic role in helping municipalities to secure financing directly from capital markets for their infrastructure needs, thus leveraging the private sector while focusing public funding where it is most needed and thereby optimizing the use of scarce public resources. At the national level, the program continues to sustain a constructive dialogue with the central government to modernize the existing municipal financing and investment frameworks and to improve the environment for leveraging private sector participation.