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ECONOMIC REFORM PROGRAMME

OF

TURKEY
(2022-2024)

COMMISSION ASSESSMENT

The economic reform programme (ERP) was submitted on 31 January 2022.

The economic consequences of Russia’s war against Ukraine may render the macro-fiscal scenarios presented in the ERP partially obsolete. The Commission will publish its updated macroeconomic and fiscal projections for candidate countries, reflecting the expected impact of the war against Ukraine and related sanctions, in its spring economic forecast in mid-May 2022.

The short-term macro-fiscal outlook may change considerably. However, the major medium-term fiscal and structural reform challenges and priorities identified in this assessment remain valid irrespective of the short-term outlook. Appropriate policy responses are essential to ensure a sustained economic recovery, greater resilience and fiscal sustainability.

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY	2
2. ECONOMIC OUTLOOK AND RISKS	4
3. PUBLIC FINANCE	8
4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES	14
5. OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2021	23
ANNEX A: ASSESSMENT OF THE AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE 2022-2024 ERP	27
ANNEX B: OVERVIEW OF THE MAIN INDICATORS PER AREA/SECTOR OF THE ECONOMY	38
ANNEX C: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM THE 2021-2023 ERP	42
ANNEX D: COMPLIANCE WITH PROGRAMME REQUIREMENTS	46
REFERENCES	47

1. EXECUTIVE SUMMARY

Turkey's economy faces growing challenges and is highly exposed to the fallout of the Russian invasion of Ukraine. In 2021, economic growth surprised on the upside and the economy grew by double-digits. Private consumption, exports and manufacturing performed particularly well. However, economic activity slowed down in the last quarter of the year, as the significant depreciation of the lira, increased market volatility and the steep rise in inflation took a heavy toll on economic sentiment. The economic reform programme's (ERP) macroeconomic scenario is optimistic and does not take into account the adverse effects of recent policy decisions. The overly loose monetary policy and weak central bank independence drove inflation up to a two-decade high, denting disposable incomes and eroding economic confidence. The unorthodox policy stance led to a series of unconventional measures to contain the slide of the lira and reverse dollarisation, but at the cost of increased uncertainty and potentially large contingent liabilities. Reducing external imbalances sustainably remains an elusive policy target, despite notable increases in international trade integration. Although the banking sector went through the crisis relatively unscathed, legacy issues remain, in particular in state-owned banks. Turkey's economy is highly exposed to the fallout of Russia's war against Ukraine, in particular via its energy and wheat imports. Though tourism may also be impacted, Turkey might receive more tourists from Russia as the alternative destinations in Europe have effectively been closed to Russian visitors. Thus, the effect of the crisis on tourism revenues of Turkey might be more limited than initially thought.

The programme targets fiscal consolidation but spending priorities do not adequately address challenges related to higher energy prices and growing poverty. Since the beginning of the pandemic, budget execution has consistently exceeded expectations. Like in previous years, maintaining fiscal prudence is the cornerstone of the authorities' macroeconomic policy. Fiscal consolidation, largely based on an overly strong reduction of current expenditure and transfers, is planned to continue. However, the medium-term budgetary plan is based on overly benign macroeconomic assumptions. It also fails to sufficiently address major structural policy issues, like high energy prices, growing poverty and inequality and does not include the effects of a number of recently-adopted measures. The ERP projects government debt to remain below 40% of GDP, but underestimates the debt-increasing effects of the weaker lira. Despite an overall conservative fiscal policy and debt management efforts, fiscal risks and debt vulnerabilities have increased. The programme outlines further efforts to improve the quality of public finance but, in the absence of strong fiscal anchors, the medium-term budgetary framework is subject to frequent changes and is not sufficiently credible and binding.

The main challenges for future economic policy are the following:

- **The unbalanced policy mix and high policy-induced uncertainty hamper growth and increase vulnerabilities.** The overly loose monetary policy has led to very high inflation and increased risks, not least in the context of tightening global financing conditions and with the impact being particularly harmful to the most vulnerable. Addressing these challenges will require restoring central bank independence and maintaining a tight monetary policy stance in keeping with achieving price stability, under a transparent framework and consistent communication.
- **The spending priorities under the fiscal scenario would need to be revised to sufficiently address the main challenges and risks.** The 2022 budget needs to be revised as it does not take into account the changed macroeconomic environment and a number of recent measures to support the lira. In view of the high uncertainty about potential further

pandemic effects and the impact of Russia's war against Ukraine, standing ready to provide crisis mitigation if needed seems appropriate. Contingent on the economic outlook, maintaining a prudent and broadly neutral fiscal stance as communicated by the authorities is an asset. However, increased poverty and inequality call for more and better targeted fiscal support, while a credible medium-term consolidation plan and further improvements in public finance management could help contain growing fiscal risks.

- **The regulatory and institutional environment lacks transparency, independence and predictability necessary to promote competitiveness, which hampers much-needed foreign and domestic investments.** Turkey needs to improve the rule of law and the independence of the judiciary, and to strengthen the independence of regulatory authorities in order to promote the investment climate and competitiveness. A step in the right direction has been in dispute resolution, where Turkey made progress in 2021 by further improving mediation practices in a range of fields. State interventions in price-setting mechanisms in key product areas continue to hamper the free functioning of product markets.
- **Adapting to climate change as a competitive advantage.** Adapting to climate change and moving from a linear to a circular and sustainable use of resources is key for ensuring the competitive advantage for businesses. As proposed in the Turkish “Green Deal Action Plan” establishing an emissions trading scheme aligned with the European system, and fostering a circular economy, can contribute to the decarbonisation of the economy and can prepare for the implementation of the EU Carbon Border Adjustment Mechanism. Resolute action is needed to ensure that businesses can adapt.
- **The labour market shows signs of recovery and efforts were made to tackle skills mismatches and shortages, although the relevance of education and women's and young people's situation on the labour market remain key challenges.** The potential of women in the labour market remains largely untapped. Low participation rates in early childhood education and care have a negative impact both on women's labour market participation and on the educational foundation of children later in life. The share of young people not in education, employment or training (NEET) and the youth unemployment rate remain high. Active labour market policies as well as upskilling and reskilling opportunities do exist, and further efforts were made in 2021, but remain limited in scope.

The policy guidance set out in the conclusions from the Economic and Financial dialogue of July 2021 has been partially implemented, with a lower rate of implementation compared to the previous year. The budget deficit outperformed in 2021, while transfers to the most vulnerable households and allocations for capital expenditure and active labour market policies increased somewhat, although remaining overall rather limited. The lira's share in new borrowing increased and fiscal plans envisage a continuation of fiscal consolidation over the medium term. No progress has been achieved, however, in streamlining tax exemptions, improving control of expenditure arrears, and in the management and monitoring of PPPs. Monetary policy was overly loose, triggering further rise of the already high inflation. Several members of the monetary policy committee have been dismissed unexpectedly and there are persistent concerns over the central bank's ability to determine independently the policy stance. There is a high uncertainty about the future monetary policy direction. The banking sector has remained largely resilient to market distress. Non-performing loans (NPLs) declined, banks' capital adequacy ratios were on average soundly above the regulatory minimum, and profitability rebounded. Some reform measures have been announced on the rule of law and the business regulatory environment, but these fall short of addressing core problems in these areas. The number of companies

under trusteeship decreased but still remains significant. Some measures have been adopted for young people and NEET, for example to improve access to vocational education and training (VET). Efforts were stepped up on upskilling and reskilling through tailor-made measures at vocational training centres and measures were taken to encourage higher enrolment rates. The rate of participation in early childhood education and care remain low.

Overall, the programme correctly identifies the main structural challenges facing the economy, but policy credibility and reform implementation remain weak. The Turkish authorities are aware of the numerous structural challenges and vulnerabilities facing the economy. Reform plans have been prepared to address many of them across a wide range of sectors. However, their timely implementation would test the authorities' resolve. Some of the proposed measures in the ERP are also rather small-scale projects that will not result in systemic changes. Despite a strong rebound from the crisis, the recovery remains fragile and major imbalances persist. Turkey has started to address the challenge related to raising skills levels to improve job prospects, in particular of women and young people, and has adopted a number of relevant reforms on this dimension, while further efforts remain necessary.

The shared European growth model based on the green and digital transition will also have to be strengthened in the ERP process, even more so in the current geopolitical context reflecting a much more uncertain economic outlook.

2. ECONOMIC OUTLOOK AND RISKS

Turkey's economic growth surprised on the upside in 2021. Real GDP grew by 11% and, supported by base effects, both domestic and external demand expanded strongly. The initial growth expectation of 5.8% was, thus, surpassed by a large margin. Private consumption was particularly buoyant, catching up after 3 years of subdued performance. Exports increased by close to 25%, with exports of goods reaching a record high level. Inventories adjusted downwards, following an excessive build-up the year before, while investment growth sputtered in the second half of the year. Manufacturing activity was very strong, boosting the post-COVID-19 recovery. However, the economy slowed down by the end of the last quarter of 2021 as the significant depreciation of the lira, increased market volatility and the steep rise in inflation took a heavy toll on economic sentiment.

The ERP forecasts steady and robust economic growth over the medium term. At around 5-5.5% per year, growth expectations are also largely unchanged from last year's programme. Domestic demand is projected to remain the main driver of growth, with a significant contribution from private consumption. The growth of public consumption is expected to be subdued, in particular in 2022. Investment is forecast to continue to recover, albeit at a more modest pace. The ERP expects the very good export performance to continue in the next years, benefiting from rebounding external demand, especially of international tourism and travel. Outpacing imports growth, it would thus sustain a positive contribution of net exports to growth in each year of the programme. The ERP projects a persistently strong industry performance, growing 5.7% on average, trailed by services (5.4%) and agriculture (3.8%). The output gap is projected to close in 2022 and be slightly positive in the following years. By factors of production, economic growth in 2022-2024 is expected to be driven mainly by the increasing capital stock (growing 6% per year on average), while as pandemic effects dissipate further, employment contribution will also rise (3.9%). The ERP estimates that total factor productivity will have a marginal effect on growth, continuing its downward trend and averaging just 0.5% during this period.

The macroeconomic scenario is optimistic and does not take into account the effects of recent policy changes on inflation, exchange rate, economic sentiment and risks. Turkey's economy is highly exposed to the fallout of Russia's war against Ukraine, in particular via its energy and wheat imports, and tourism. The macroeconomic and fiscal outlook continue to be affected by the still relatively high uncertainty surrounding the evolution of the COVID-19 pandemic. In addition, the baseline scenario is based on a set of outdated assumptions, in particular about inflation and the lira exchange rate. It also does not take into account adverse effects of the overly loose monetary policy and other more recent major economic policy decisions, like the introduction of FX guaranteed-deposits (which came late in the process of ERP preparation), which make the ERP baseline highly improbable. The ERP sketches a number of risks linked to the length of the pandemic, global supply bottlenecks and the tightening of financial conditions by major central banks, among others. However, new risks have emerged due to the Turkish economy's very high exposure to the fallout of Russia's war against Ukraine. Rising global prices of energy and other key commodities represent a particular challenge for external sustainability and the already very high inflation. On the upside, the ERP also notes Turkey's strong competitive position to benefit from a projected shortening of global supply chains and nearshoring. However, despite some pick-up in foreign direct investment last year, the investment potential remains dampened by policy uncertainty and market volatility. With the balance of risks clearly tilted on the downside, the failure to present an alternative scenario is a major drawback of the programme and a step back from previous years.

Table 1:

Turkey - Comparison of macroeconomic developments and forecasts

	2020		2021		2022		2023		2024	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
Real GDP (% change)	1.8	1.8	9.0	9.0	4.0	5.0	4.0	5.5	n.a.	5.5
<i>Contributions:</i>										
- Final domestic demand	4.0	4.0	6.5	7.4	2.9	4.3	2.9	4.7	n.a.	5.0
- Change in inventories	4.9	3.1	-1.9	-1.8	-1.0	-0.4	0.0	0.1	n.a.	0.0
- External balance of goods and services	-7.1	-5.3	4.4	3.4	2.0	1.1	1.1	0.6	n.a.	0.5
Employment (% change)	-4.8	-4.5	6.7	6.8	4.6	4.5	3.1	3.7	n.a.	3.6
Unemployment rate (%)	13.1	13.2	12.7	12.6	12.6	12.0	12.2	11.4	n.a.	10.9
GDP deflator (% change)	14.8	14.8	20.2	20.9	18.3	12.9	17.0	8.8	n.a.	7.9
CPI inflation (%)	12.3	12.3	17.8	19.6	17.7	12.2	15.4	8.4	n.a.	7.6
Current account balance (% of GDP)	-4.9	-5.0	-2.7	-2.6	-2.2	-2.2	-1.6	-1.5	n.a.	-1.0
General government balance (% of GDP)	-4.7	-3.9	-3.6	-3.6	-3.5	-3.5	-3.1	-3.4	n.a.	-2.6
Government gross debt (% of GDP)	39.7	39.7	39.1	36.6	38.9	35.8	38.7	35.4	n.a.	34.7

Sources: Economic Reform Programme (ERP) 2022, Commission Autumn 2021 forecast (COM).

Overly loose monetary policy and weak central bank independence drove inflation up to a two-decade high. Inflation increased to more than 50% year-on-year in February 2022. The inflation targeting regime and the free floating exchange rate nominally pursued by the central bank have effectively stopped being the guiding framework for monetary policy. Under the new governor appointed last year, since last September the bank moved aggressively to cut interest rates by 500 bps. to 14% despite high and growing inflation. Real interest rates turned deeply negative, leading to depreciation pressures on the lira. However, monetary policy became increasingly inefficient as most of the market interest rates have not reacted to the cut in the central bank policy rate and actually increased, as inflation expectations went up significantly.

Unorthodoxy breeds unorthodoxy. The increased pressure on the lira led in December 2021 to direct official central bank interventions for the first time since 2014 and the adoption of a number of new initiatives, including sizeable tax reductions and a scheme protecting the FX value of lira time deposits. The new instrument was initially offered to natural persons and was later extended to legal entities; it was further extended to include Turkish citizens residing abroad and then to foreign residents and entities. By mid-February, it attracted more than TRY 300 billion or about a fifth of all time deposits in lira. Another of the announced measures, with potentially significant impact, is a requirement that exporters sell to the central bank 25% of their FX receipts. The central bank interventions and the new measures have stemmed the tide of lira depreciation and, at the margin, even temporarily reversed the deposit dollarisation trend. However, the FX-protected deposits (gold-protected deposits were also offered in February 2022) created unknown but potentially large contingent liabilities. They are also not a long-term solution and cannot replace a stability-oriented monetary policy, as indicated by the high market interest rates and risk premium.

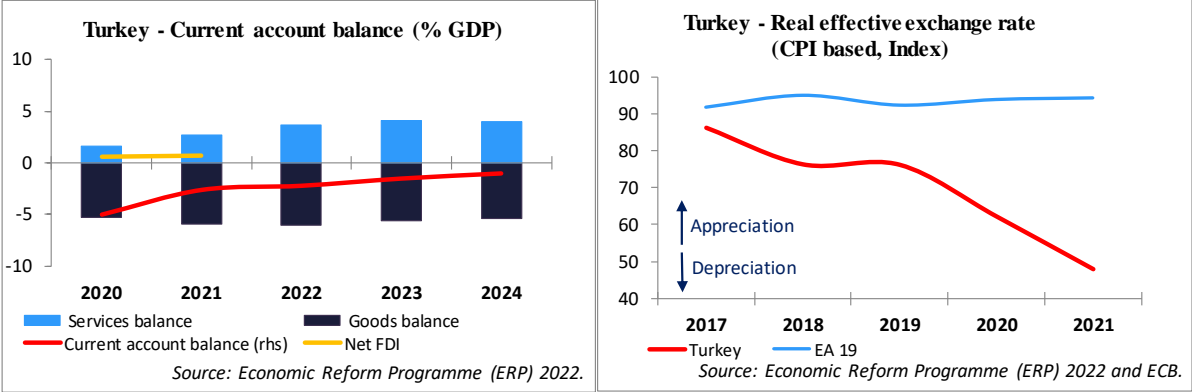
Inflation is likely to remain persistently high. The ERP has not taken the latest major policy and market developments into account and projects an inflation path that is notably lower than market expectations and the central bank's latest forecast from January that by the end of 2022 inflation would approach 30% year-on-year. The steep depreciation of the lira, second round effects, the impact of the war in Ukraine, and higher expectations are likely to sustain very high inflation in 2022. The significant acceleration in producer price inflation, which reached 105% in February, and continued global price increases of energy goods and other commodities, are set to continue exerting inflationary pressure as well. Fundamentally though, it is the central bank policy of deeply negative real interest rates, the lack of an effective policy anchor and undermined institutional independence that are the key factors keeping inflation high over the medium term and providing fertile ground for continued volatility.

Turkey's integration in international trade increased markedly but external vulnerabilities remain significant. Trade openness grew by around 50% in the last 5 years, with both exports and imports reaching record highs in 2021 when Turkey's share in global trade exceeded 1% for the first time. However, exports continue to be dominated by low and medium-low technology industries. The gap between the respective shares of medium-high and high-technology imports and similar exports is high, at above 20 pps. The economy is strongly exposed to international commodity price developments, in particular energy. The current account deficit remained non-negligible, despite coming down from its peak in the crisis to below 2% of GDP. External debt hovers just below 60% of GDP, but the share of short-term debt in total external debt rose to 28% last year, driven by increased borrowing by the non-financial sector. The central bank foreign exchange reserves have recovered somewhat from their lows in 2020, before deteriorating again by the end of 2021 because of interventions to stabilise the lira. Foreign exchange swaps in non-core currencies with other central banks increased further, while net reserves remained deeply negative. The country's risk premium rose from already high levels, reflecting the market's negative assessment of the overly loose monetary policy and elevated policy uncertainty.

Sustainably reducing external imbalances remains a key policy target but it is likely to prove challenging. The ERP reaffirms the 11th Development Plan's strategic goal of moving to a less import-dependent, sustainable, export-oriented and non-inflationary growth structure. The authorities have also highlighted as a top priority the need to move away from short- to long-term external financing. With its vibrant private sector, strategic location and strong industrial base Turkey is well placed to pursue these goals. However, the current macroeconomic policy mix has increased volatility and is not conducive to attracting long-

term foreign investors. In addition, the steep fall in the lira, while providing short-term cost competitiveness gains, also breeds higher inflation. The recovery of international travel and tourism is threatened by the fallout of Russia’s war against Ukraine in the short term, while a strategic reassessment of the economy’s long-term dependence on them is missing. The ERP also fails to provide details on the specific instruments and policies to increase productivity and the technological sophistication of its exports.

Graphs: external competitiveness and current account



Although the banking sector went through the crisis relatively unscathed, legacy issues remain. Bank lending has been the authorities’ preferred demand management tool for many years. As the economy recovered in 2021, some of the prudential measures supporting new credit and shielding the banks from the full impact of the crisis fallout have been lifted and total lending growth decelerated as a result. The banking sector’s headline capital adequacy ratio remained soundly above the regulatory minimum and profitability rebounded somewhat, although remaining rather low. In recent years, the use of subordinated debt increased and core capital levels fell below 13% in 2021. In addition, relaxed prudential measures still protect capital adequacy ratios, in particular by using a 252 business day rolling average FX rate and suspending mark-to-market accounting rules, thereby postponing the recognition of related losses. Banking system duality continued, as state-owned banks’ expansion during the crisis came at the price of weaker capital and profitability positions. However, their non-performing loans ratio fell to just 2.1% at the end of 2021, 1 pp. below the level of the total banking system, while provisioning increased to 86%. State banks have been recapitalised several times in the last years, mostly through government securities. In the beginning of 2022 they have been recapitalised again (TRY 52 billion) with the view to prepare them to lead again a new cycle of credit expansion. The banking sector’s external debt roll-over ratios have remained stable at close to 100%, but at around USD 80 billion or 10% of GDP their obligations remain significant. The non-financial sector’s negative net FX position shrank to USD 115 billion, its lowest level in nearly a decade, while its short-term position remained positive and stable at close to USD 60 billion. In view of its importance for attracting investments and supporting economic growth, Turkey is working on the implementation of an action plan to ensure effective anti-money laundering and countering the financing of terrorism regimes, compliant with recommendations by the Financial Action Task Force.

Table 2:

Turkey - Financial sector indicators

	2017	2018	2019	2020	2021
Total assets of the banking system (EUR million)	719	641	676	678	628
Foreign ownership of banking system (%)	28.2	26.8	26.0	25.0	26.0
Credit growth (aop)	21.9	21.3	6.5	29.6	23.3
Deposit growth (aop)	20.3	22.9	18.8	37.0	29.7
Loan-to-deposit ratio (eop)	1.23	1.18	1.03	1.04	0.85
Financial soundness indicators (eop)					
- non-performing loans*	3.0	3.9	5.4	4.1	3.2
- net capital to risk-weighted assets	16.9	17.3	18.4	18.8	18.3
- liquid assets to total assets	8.0	10.7	10.0	9.4	13.3
- return on equity	15.9	14.7	11.5	11.6	15.3
- forex loans to total loans (%)	32.6	39.9	38.0	34.0	42.0

* including the impact of write-offs.

Sources: National Central Bank, Macrobond.

3. PUBLIC FINANCE

Since the beginning of the pandemic, budget execution has consistently over-performed.

At around 2.8% of GDP in 2021, the central government deficit was significantly below the revised 2021 target and the 2020 deficit (both at 3.5%). Although data are not yet available, the general government deficit is estimated to have declined as well, to around 3% of GDP. According to the ERP, the fiscal stance remained procyclical; while the output gap is estimated to have remained negative, the -cyclically-adjusted primary balance improved as a result of both strong revenue performance and expenditure restraint. Buoyant domestic demand lifted central budget total revenue to 20.7% of GDP, with tax revenue exceeding by a large margin the revised estimate and previous year's results. On the other hand, the reduced pandemic-related budget support and rampant inflation suppressed real personnel expenditures and current transfers, which came in far below their 2020 levels and pushed total expenditure down to 23.5% of GDP. Nonetheless, in order to cover some of the surging energy costs, budget lending, mainly to the Turkish state energy company BOTAS, shot up at the end of the year, more than doubling this expenditure line. Interest payments remained elevated at 2.7% of GDP, reflecting some of the costs of the weaker lira.

<i>The effect of the measures taken to tackle the COVID-19 pandemic on public finance*</i>					
A) Support provided from the central government budget	Number of Beneficiary Person/Household/Businesses	2020-2021 Amount Provided (Billion TRY) ⁽¹⁾	2021 Additional Planned	2021 Year-end Forecast	2020-2021 Year-end Realisation Forecast
Medicine, medical equipment, health personnel payments	-	27.3	11.5	24.6	38.8
Additional payments for treasury interest supported loans given to agricultural producers and tradesmen ⁽²⁾	-	1.7	0.6	1.0	2.3
Social security premium effect of short-	-	29.2	0.0	13.0	29.2

time work, unpaid leave application					
Increasing the minimum retirement salary to 1 500 TL	645 823	0.9	0.0	0.0	0.9
Grant payments to tradesmen ⁽³⁾	2 548 968(4)	9.0	0.1	9.2	9.2
SMEDO World Bank and JICA loans	-	0.0	0.8	0.8	0.8
Social support programme ⁽⁵⁾	-	4.4	0.0	0.0	4.4
Others	-	0.3	0.0	0.3	0.3
Subtotal		72.8	13.0	49.0	85.8
Tax deductions (waived income tax) ⁽⁶⁾	-	43.8	0.0	28.8	43.8
Financing cost of tax and SSP deferrals	-	4.0			4.0
Total (A)		120.6	13.0	77.8	133.6
B) Unemployment Insurance Fund and Social Assistance and Solidarity Encouragement Fund Payments	Number of Beneficiary Person/Household/ Businesses	2020-2021 Amount Provided (Billion TRY) ⁽¹⁾	2021 Additional Planned	2021 Year-end Forecast	2020-2021 Year-end Realization Forecast
Cash aid support ⁽⁷⁾	3 095 356	14.0	0.0	6.8	14.0
Short-time work allowance ⁽⁸⁾	3 773 121	36.7	0.1	11.3	36.8
Unemployment benefits ⁽⁹⁾	1 421 144	7.8	1.8	4.8	9.6
Normalization support ⁽¹⁰⁾	1 997 258	4.8	0.5	1.2	5.3
Social support programme ⁽⁵⁾	-	5.5			5.5
Total (B)		68.8	2.4	24.0	71.1
Total (A+B)		189.3	15.4	101.8	204.6
C) Deferred and granted loans	Number of Beneficiary Person/Household/ Businesses	2020-2021 Amount Provided (Billion TRY) ⁽¹⁾	2021 Additional Planned	2021 Year-end Forecast	2020-2021 Year-end Realization Forecast
Tax, social security premium deferrals	2 300 000	70.2			70.2
Loan deferrals	-	143.2		7.9	143.2
Loans granted	9 503 881	315.1			315.1
Total		528.5		7.9	528.5
GRAND TOTAL (A+B+C)		717.8	15.4	109.7	733.1

Source: Economic Reform Programme (ERP) 2022

*The GDP data of 2020 is used

(1) As of October 2021.

(2) It shows the additional payments arising from the Presidential Decree, which ensured that the interest burden arising from the

increase in the demand for treasury interest-supported loans given to agricultural producers and tradesmen due to the changing market conditions during the epidemic period, the loan delays made in this period and the interest increase in the loans extended before 2021, shall be covered by the Treasury.

(3) Includes rental support, cash support and loss of turnover payments granted to tradesman. Rental and cash support grant as of December 14 2021; Turnover support February 6 2021; Cash support to tradesmen was announced to the public on May 17 2021.

(4) Includes information on 'loss of income, rent and turnover support' as of June 2021. The number of approved applications for income loss support is 1 077 506; the number of approved applications for rental support is 171 203; number of application for loss of turnover support is 8 232 ; the number of approved applications for the new tradesmen support is 1 292 027. Loss of income support and loss of turnover support are not paid at the same time, and if any beneficiaries of loss of income support, they are paid by deducting from the loss of turnover support.

(5) Support programme and additional periodic shares transferred within the scope of COVID-19 expenditure has been made. Of this amount, TRY 4.4 billion is treasury support, TRY 2.1 billion is the donations collected within the scope of Donation Campaign, and the remaining TRY 5.5 billion is used from the SASI Fund. As of October 22 2021, the number of single households benefiting from the assistance within the scope of the Pandemic Social Support Programme, Donation Campaign and Full Lockdown Social Support Programme is 7.2 million.

(6) All segments of the society benefited from tax rate reductions.

(7) The termination restriction expired on 30 June 2021. The year-end estimation was made within the framework of this assumption.(8) The short-time working allowance, which was applied due to the pandemic in the current legal framework, expired on 30 June 2021. The year-end estimation was made within the framework of this assumption.

(9) It is assumed that the monthly unemployment allowance amount will return to the usual trend before pandemic, after the termination restriction and short-time working application ends on 30 June 2021.

(10) The total number of people who receive uncombined support on the basis of insured is 6 191 391. The number of people benefiting from combination is 1 997 258. The number of beneficiaries represents the total number that has not been combined on the basis of the insured. An insured person who returns to his normal working order can benefit from this support for 6 months.

The crisis-related economic support declined substantially and many of the measures expired in 2021. Of the estimated TRY 733 billion (around 14% of the 2020 GDP) package of policy support provided since the beginning of the pandemic, most funds (85%) were allocated in 2020 while the remainder was spent in 2021. The relative weight of the assistance, however, shifted towards the government budget, as the exceptional credit support measures have been largely terminated. With the gradual recovery of the labour market, the short-time working allowance scheme and the ban on dismissals were also lifted in mid-2021. Overall, the total economic relief package has reached more than 10 million people. Despite its coverage and the strong economic rebound, however, poverty and inequality increased strongly in the last 2 years because of rising inflation and limited direct transfers to the most vulnerable parts of the population.

The ERP targets continued mild fiscal consolidation. Like in previous years, maintaining fiscal prudence is the cornerstone of the programme and of the authorities' macroeconomic policy. The primary balance is expected to steadily improve, by 1.4 pps. to a surplus of 0.7% of GDP in 2024, and the overall budget deficit to fall to 2.6% of GDP. The ERP envisages a strong reduction of current expenditure and transfers, which would contribute around four fifths of the planned total expenditure adjustment of 2.5 pps. over the programme period. Investment expenditure and transfers are also set to decline, from already low levels. In contrast, interest payments are projected to rise further. Measures on the revenue side are expected to have limited effect, mostly through declining non-tax revenue, while tax revenue is forecast to remain broadly stable in terms of GDP.

Table 3:

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

	2020	2021	2022	2023	2024	Change: 2021-24
Revenues	32.4	30.7	29.8	29.7	29.2	-1.5
- Taxes and social security contributions	25.4	24.5	24.6	24.7	24.7	0.2
- Other (residual)	7.1	6.2	5.2	5.0	4.5	-1.7
Expenditure	36.4	34.3	33.3	33.1	31.7	-2.5
- Primary expenditure	33.6	31.4	30.1	29.7	28.5	-2.9
<i>of which:</i>						
Gross fixed capital formation	2.6	2.7	2.5	2.5	2.2	-0.5
Consumption	16.2	15.0	14.3	14.3	13.7	-1.3
Transfers & subsidies	8.4	7.1	6.9	6.8	6.7	-0.4
Other (residual)	6.4	6.6	6.3	6.1	5.9	-0.8
- Interest payments	2.8	2.9	3.2	3.4	3.3	0.4
Budget balance	-3.9	-3.6	-3.5	-3.4	-2.6	1.0
- Cyclically adjusted	-5.7	-4.0	-3.7	-3.4	-2.4	1.6
Primary balance	-1.1	-0.7	-0.3	0.0	0.7	1.4
- Cyclically adjusted	-2.9	-1.1	-0.5	0.0	0.9	2.0
Gross debt level	39.7	36.6	35.8	35.4	34.7	-1.9

Sources: Economic Reform Programme (ERP) 2022, Commission calculations.

The fiscal scenario does not adequately address challenges from the changed macroeconomic environment. The medium-term budgetary plan is based on benign macroeconomic assumptions, and does not take into consideration the much higher inflation and the strong depreciation of the lira. Maintaining a tight fiscal stance and an overly loose monetary policy is suboptimal and creates fertile ground for increased volatility. The current situation, where the economy is close to its potential and inflation significantly above the central bank target, calls for a bold shift of the macroeconomic policy mix towards a more neutral fiscal stance and a significantly tighter monetary policy. The budgetary scenario also fails to sufficiently address major policy issues, like higher energy prices, and growing poverty and inequality. The envisaged retrenchment in current and capital spending is only partially justifiable by the lifting of pandemic-related measures. Its magnitude goes beyond the needs of maintaining spending discipline and risks harming the quality of public services.

The 2022 budget was outdated already by the time of its adoption. The Parliament approved the central government budget on 17 December, envisaging a deficit of TRY 278.4 billion (3.5% of GDP). The budget is based on an assumption of a real GDP growth of 5.0%, annual average inflation of 12.2%, and a TRY/EUR exchange rate of 11.0. However, the current much higher inflation and exchange rate projections would inflate tax bases and necessitate a budget revision of most expenditure and revenue lines. The larger nominal GDP in 2022 would also mean that the current nominal deficit target actually corresponds to 2.8% of GDP, remaining broadly unchanged from the better than expected 2021 outcome.

The budget does not include all recently-adopted measures, some of which have a potentially significant impact. Many of the measures, incorporated in the 2022 budget, are a continuation from the previous year. The corporate income tax rate, for example, was temporarily increased from 20% to 25% in 2021, and is set at 23% in 2022. Additional customs duties on thousands of products, levied in previous years, were extended into 2022. The application of the sliding scale system for smoothening the price dynamics of some fuels is also not new and is expected to bring some revenue losses. In an effort to address rising poverty and to foster labour force participation, income taxes and social security contributions

on the part equalling the minimum wage will be temporarily covered by the State in 2022. On the other hand, the termination of the temporary reduction, introduced in 2021, of VAT rates on certain products should increase revenue. The budget, however, did not include the effects of a number of recently-adopted measures. The 50% increase in the net minimum wage, as well as higher payments for civil servants and pensions have not been envisaged on the expenditure side, while surging energy prices might lead to higher subsidies and lending to soften their social and business impact. Importantly, the programme and the budget also did not include the effects of the numerous measures adopted to protect and incentivise the holding of lira assets or to lower inflationary pressures. In the first quarter of 2022, the VAT on a number of basic consumer goods was reduced from 18% to 8%. Legal entities choosing to convert part of their deposits into the new financial instruments could benefit from withholding and corporate income tax exemptions, reduced corporate income tax rate, and lower tax on certain dividend payments. In addition, the State contribution to the private pension system was raised from 25% to 30%. There is also an unknown, but potentially significant budgetary impact from guaranteeing the FX value of lira time deposits.

The ERP projects government debt to remain below 40% of GDP but underestimates debt-increasing effects from the weaker lira. The programme estimates government debt to have come down from its peak in 2020 to 36.6% of GDP in 2021, and expects it to continue falling in the next years. It forecasts the snow-ball effect, mainly driven by the high inflation rate, to remain the dominant debt-reducing factor. Real GDP growth would also exert downward pressure on the debt ratio, although covering only half of the debt-increasing effects from higher interest payments. The largely balanced primary deficit would have a broadly neutral debt effect under the envisaged budget scenario. The programme, however, grossly underestimates the negative stock-flow adjustment related to the strong lira depreciation in 2021 that drove debt above 40% of GDP at the end of the year. Net government debt increased as well, rising above 20% of GDP and nearly tripling in the last 4 years.

Government debt vulnerabilities increased, despite debt management efforts to reduce them. There were concerted steps to increase the share of lira-denominated new domestic borrowing, which rose from 63% to 72% in 2021. The weighted average maturity of domestic borrowing increased as well, from 34 to 53.5 months, lifting the average time to maturity of domestic debt and the total debt stock to 3.0 and 5.4 years, respectively. However, some key debt metrics aggravated further due to the sharp lira depreciation, while the flight of some non-resident investors has shrunk the investor base for government debt and affected market liquidity. Non-residents' holding of domestic debt declined to 2.9%, the lowest level on record, while corporate investors' share shrank to 11.9%. Public banks, however, increased their share, and hold nearly 40% of domestic debt. For the first time in decades, in 2021 the share of domestic debt fell below 50% of total debt. Despite increased borrowing in lira, its strong depreciation pushed the share of foreign exchange-denominated debt up by 10 pps. to a record high of around two thirds of total debt. The average time to maturity of external central government debt fell to 7.8 years. Borrowing costs increased across the board, with lira yields going above 20% by the end of the year and the yields on USD-denominated Eurobonds also moving up, in some segments even above the levels reached during the 2018 currency crisis. The outlook on the country's long-term credit rating worsened and it remained several steps below investment grade, while in February Fitch downgraded Turkey's rating from BB- to B+. The 5-year credit default swap spread increased above 600 bps in December 2021. After subsiding somewhat in the beginning of 2022, it went up again because of the war in Ukraine to 650 bps. in early March.

<i>Debt dynamics</i>					
Composition of changes in the debt ratio (% of GDP)					
	2020	2021	2022	2023	2024
Gross debt ratio [1]	39.7	36.6	35.8	35.4	34.7
Change in the ratio	7.1	-3.2	-0.8	-0.4	-0.7
<i>Contributions [2]:</i>					
1. Primary balance	1.1	0.7	0.3	0.0	-0.7
2. “Snowball” effect	-1.8	-6.1	-2.3	-1.1	-0.9
<i>Of which:</i>					
Interest expenditure	2.8	2.9	3.2	3.4	3.3
Growth effect	-0.5	-2.7	-1.5	-1.7	-1.7
Inflation effect	-4.1	-6.3	-4.0	-2.7	-2.4
3. Stock-flow adjustment	7.8	2.2	1.3	0.7	0.9

[1] End of period.

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

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

Source: Economic Reform Programme (ERP) 2022, ECFIN calculations.

Despite an overall conservative fiscal policy, fiscal risks have been building up. The volatile macroeconomic performance in recent years has imperceptibly increased fiscal risks. As part of the authorities’ reaction to this volatility, there has been a series of tax restructurings and amnesties, and multiple tax exemptions and reductions have been introduced, which has undermined the tax base and complicated fiscal planning. In addition, rising poverty and inequality are likely to put additional pressure on government resources, especially in view of the very high energy prices. Previous large scale projects to improve infrastructure through PPPs continue to weight on the budget. Large contingent liabilities, not sufficiently recognised in the government’s policy documents, also arise from the constant need to recapitalise state-owned banks, which are used as strategic levers to boost lending for the economy (often at below-market interest rates), or to bail out structurally important state-owned enterprises, in particular in the energy and transport sectors. The most recent round of measures to support the lira and stimulate the holding of lira time deposits have also brought not only direct costs to the budget (which are still not estimated and formally accounted for), but also unknown and potentially significant contingent liabilities linked to the exchange rate dynamic. The elevated risks and volatility have kept government liquidity preference high, with public sector deposits and other financial assets persistently above 5% of GDP since mid-2020.

The ERP outlines further efforts to improve the quality of public finance. The programme budgeting approach continued to be applied for the 2022 budget cycle. Some expenditure reviews have been initiated to improve efficiency in resource allocation and fairness in income distribution. From the beginning of 2022, the minimum subsistence allowance was abolished and the labour income equalling the minimum wage has been exempted from income and stamp taxes. However, systematic public information on expenditure arrears remained scarce. The envisaged new framework to improve the PPPs management and monitoring, and to consolidate them into a single framework, fully integrated in the budget process, is not yet adopted. The structure of public expenditure is not sufficiently supportive of growth, as the level and share of investment in human and physical capital remains low.

The fiscal framework lacks strong anchors. There are no national fiscal rules and independent fiscal institutions to monitor fiscal performance, review forecasts and advise the government on fiscal policy matters. The medium-term budget framework is subject to frequent changes and is not sufficiently credible and binding. The macroeconomic forecast, underpinning budgetary planning, remains biased, underestimating domestic and external imbalances. Nonetheless, conservative revenue estimates have provided significant budgetary leeway to ensure the achievement and even overachievement of deficit targets. The pandemic-related measures have been overall transparent and properly estimated and accounted for. However, transparency related to quasi-fiscal activities and risks could be further improved.

4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES

Turkey benefits from a strategic geographic position, a strong and entrepreneurial business sector, a large domestic market and a young population. It also has privileged access to the EU market through the Customs Union with the EU. To provide jobs for the many new entrants to the labour market, since the early 2000s, the Turkish economy has relied on credit growth and foreign financing. As a consequence, structural imbalances worsened, amplifying the economy's vulnerability. As Turkey mitigated the COVID-19 crisis in 2021, it continued to expand domestic credit and relax monetary policy. While this policy was effective in providing some short-term relief, it also further exacerbated the imbalances and increased inequalities. The Lira depreciated significantly in the last quarter of 2021, with increased market volatility and, a steep rise in inflation.

The Commission has conducted an independent analysis of the Turkish economy to identify the key structural challenges to boosting competitiveness and inclusive growth. This analysis drew on the Turkish ERP itself, discussions with the authorities, as well as other sources. It shows that Turkey is experiencing a number of structural weaknesses across many sectors. Besides the need to secure long-lasting macroeconomic stability, which ultimately underpins prospects for inclusive and durable growth, the Commission considers that the main challenges in terms of boosting competitiveness and long-term and inclusive growth are:

- (i) increasing employment, in particular of women and young people, and formalising employment;
- (ii) raising the performance level of education; (iii) improving transparency and predictability in the regulatory and institutional environment affecting businesses; and (iv) implementing ambitious climate and environmental policies. Turkey's analysis of key challenges focuses on (i) enhancing the quality of the labour force;
- (iii) enhancing the quality of the education system; and (iii), raising the share of high value-added production in industry.

Turkey needs to improve the rule of law and the independence of the judiciary, and to strengthen institutions in order to promote competitiveness. On the green transition, Turkey needs to step up implementation of climate and environmental policies. Addressing these fundamental concerns is a prerequisite for successfully transforming the economy.

Key challenge 1: Raising the level of skills in order to increase employment, in particular of women and young people

The strong economic growth since the early 2000s helped moving people out of informal employment in agriculture into formal urban employment in services. However, this trend has come to a halt and rates of declared employment have stagnated. The natural

population growth is seeing substantial changes with around 800 000 new jobseekers every year, the influx of 3.6 million Syrian refugees under temporary protection and the labour market impact of the COVID-19 pandemic have left their traces on the labour market.

The ban on layoffs and the job retention schemes aimed at countering the impact of the COVID-19 pandemic expired at the end of June 2021, but the labour market remained stable and is showing recovery. The employment rate (15+) in the third quarter of 2021 grew by 2.8 pps. compared to the third quarter of 2020 to 45.4% (TURKSTAT), surpassing pre-pandemic levels. The activity rate (20-64) reached 52.6% in the third quarter of 2021, an increase of 2.3 pps. compared to the same quarter of the previous year (TURKSTAT). According to TURKSTAT, 2.6 million more people were employed in 2021 than in the previous year, resulting in a net increase of 738 000 people compared to the third quarter of 2019. The unemployment rate (15-74) continued to decrease, reaching 11.7% in the third quarter of the third quarter of 2021 (TURKSTAT) (EU 6.9%), signifying a 1.6 pps. decrease compared to the same period in 2020 and a 2.4 pps. decrease compared to the third quarter of 2019. The massive roll out of short-time work schemes, which involved a total of 6.2 million beneficiaries, the ban on layoffs and the obligation to grant unpaid leave for those not entitled to short-time work benefits in 2020 and 2021 proved effective in protecting formal jobholders in the labour market from a more severe impact. At the same time, workers in the informal economy and the self-employed received only ad hoc cash support, while these groups were among the hardest hit by the pandemic¹ (OECD 2021).

Women's potential on the labour market continues to be underutilised. Despite women's higher educational attainment, their labour force participation rate (15+) continues to be structurally and significantly below men's. In the third quarter of 2021 it stood at 33% compared to men's which was at 70.3%, showing a vast gap of 37.3 pps. In the third quarter of 2021, the employment rate of women (20-64) was 28.2%, less than half that of men (63%), resulting in a significant 34.8 pps. gender employment gap. Policies aimed at getting women into the labour market have so far had limited results. The most important policy initiative to increase employment and labour force participation among women has been a subsidy system to incentivise employers to hire female employees, first introduced following the 2008 global financial crisis. More recently, Turkey introduced a number of Social Security Institution (SSI) pilot projects. In 2019, two further programmes started, which support childcare provision but they only involve 14 000 working mothers. These measures are commendable but remain limited in scope and impact. The lack of childcare facilities (see below), the lack of appropriate work-life balance policies which would stimulate working-time flexibility and low potential wages to be earned continue to hinder female labour force participation. In addition, at 10%, part-time work is less developed in Turkey compared with the EU average of 19%. Last but not least, traditional gender stereotypes do not see women as part of the labour force. The low rate of women's labour market participation results not only in their social and economic dependence on men, but also limits Turkey's economic growth outlook. According to a McKinsey study conducted in cooperation with the Turkish Industry and Business Association (TÜSİAD)², Turkey's GDP would increase by 20% if it were to reach the OECD activity rate average of women (53.1% in 2019) within 10 years.

¹ <https://www.oecd.org/economy/surveys/TURKEY-2021-OECD-economic-survey-overview.pdf>

² <https://tusiad.org/en/reports/item/9642-women-matter-turkey-2016-report-turkey-s-potential-for-the-future-women-in-business>

Early childhood education and care services and elderly care services continue to be very limited in Turkey, which is a significant barrier for women's prospects of entering the labour market their position therein, as well as for children's early educational development. Early childhood education and care is still only available in big urban centres and the enrolment rate for children up to 3 years-old is very low. The number of people above 65 years-old increased from 6.6 million to 8.2 million between 2016 and 2021, while elderly care service provision remains limited. As childcare and elderly care are primarily taken on by women, this has direct, negative implications on female labour market participation. Measures have been put in place, but it is unsure whether they are achieving their desired effect. Kindergarten is attended by 54% of children and 71% of 5 year-olds were enrolled in pre-school education. Full enrolment of 5 year-olds in pre-school education was initially scheduled for 2023, but has now been pushed back.

In an effort to address the 2021 policy guidance to 'continue to roll out mandatory pre-school education and advance further towards a 100% enrolment in primary and secondary education with updated curricula', Turkey included *measure 5 on 'Access to pre-school education will be provided based on equal opportunity principle'*, a measure updating measure 14 from the previous ERP, and *measure 6 on 'Specialised Institutional Guidance and Inspection branches will be established depending on school and programme types'*. Both of these measures are ambitious and are expected to contribute to the implementation of the above-mentioned 2021 policy guidance. Furthermore, *measure 16 on 'Preparing the digital contents of the courses taught in Open Education Schools and presenting them to the students through the Education Information Network (EBA) platform and preparation of digital contents of course-certificate-authorisation programmes organised for individuals within the scope of lifelong learning'* is expected to further increase access to education for all, including during the pandemic, through a digital education platform.

Turkey's young people continue to be disadvantaged on the labour market. The rate of young people (15-29) not in employment, education or training (NEET) increased to 32% in 2020, a 2.5 pps. increase compared to 2019. While the NEET rate improved slightly by the third quarter of 2021 (15-24) to 26% (TURKSTAT) compared to 26.9% in the same quarter in 2020, it remains more than 2.5 times the EU-27 average (10.3%) for the same age range. The NEET rate of young women is around twice as high as that of men. Youth unemployment (15-24) stands at 22.1% in the third quarter of 2021, almost twice the overall unemployment rate. The slight decrease in the labour force participation rate in the age group 15-24 to 41.6% in the third quarter of 2021 compared to 42.1% in the same quarter in 2020, suggests that the labour market situation of young people has not yet started to improve. The natural population growth that results in hundreds of thousands of people joining the labour market every year and the inflow of young Syrian refugees increase the pressure on the labour market since the economy does not generate an equivalent number of jobs. The Eleventh Development Plan and Priorities (2019-2023) sets out to provide decent job opportunities to youth and includes plans to activate NEETs. After nearly a decade, Turkey updated its Youth Strategy and adopted the National Youth Employment Strategy and Action Plan (2021-2023) in October 2021 which was developed with input from relevant public and private stakeholders. It is expected that the adopted Strategy and Action Plan will contribute to systemically addressing the barriers faced by NEETs.

In line with above strategic documents and in response to the 2021 policy guidance on addressing 'high youth unemployment and NEET rates through better access to education and improved VET', *measure 3 on 'Youth employment will be increased by strengthening vocational training centres'* aims to increase employment rates among young people by strengthening vocational training centres, including through cooperation with the private

sector. To address skills mismatches on the labour market, specifically targeting young people, Turkey included *measure 2 on ‘Professions of Future’* in its ERP. This measure, rolled over from the previous year (measure 22 in the 2021-2023 ERP), focuses on information and communication technologies and R&D, and via vocational education and on-the-job training is expected to boost skills development in a digital era. The measure identifies a need for qualified workforce in fields such as data analysis, software, cyber security, robotic applications and digital business processes.

Progress has been made on improving the labour-market relevance of education and training policies, while employers still face difficulties in finding employees with the right profiles at the current wage levels. According to a survey³, 51 out of 100 companies in Turkey state that they cannot find the right talent (Manpower 2019). While data is sparsely available on this, the emigration of high-skilled labour force seems to have increased in recent years, which is expected to further exacerbate skilled labour shortage. There is often a mismatch in cross-sectoral skills such as ICT and oral and written expression. The low level of average problem-solving skills in technology-rich environments coincides with lower proficiency in literacy and numeracy among adults and low upper-secondary attainment. A comprehensive strategy on a socially-just transition to a changing world of work, with reskilling and upskilling programmes, is lacking. However, the implementation of the Education Vision for 2023 has progressed, for example with the setting up of VET Centres of Excellence together with the private sector, which aim to: (i) create better practical linkages to businesses as a practical innovative solution to economic issues; (ii) develop VET policies and measures to provide the skills needed for all sectors of industry; and (iii) enhance VET’s responsiveness to support innovation, including at higher VET levels. The latter policy also aims to include learners from the widest range of social backgrounds, including people who have not succeeded in general academic education and migrants. Within the Education Vision 2023 reforms, and with the support of the EU programmes, the work has started to improve and to update the skills of vocational teachers. It also includes an infrastructure reform, with a focus on priority areas (such as educational function, teachers and administrators, school environment and governance).

Measure 1 on ‘Job Clubs’, rolled over from last year (measure 19 in the 2021-2023 ERP), is an overarching measure aiming to provide intensive job and vocational counselling programmes, with special attention to people that are disadvantaged in the labour market, including women, young people, persons with disabilities, long-term unemployed and migrant workers. This remains a relevant measure and is expected to contribute to addressing the key structural challenge in Turkey.

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

The institutional and regulatory framework remains fragile, particularly its predictability, transparency and efficiency. The judicial system’s serious backsliding in recent years continues to undermine businesses’ trust in its efficiency and independence. Effective measures to strengthen the rule of law, to ensure adequate and timely contract enforcement and improve the availability and functioning of dispute settlement mechanism remain key factors for improving the business environment. Even though alternative dispute resolution

³ Survey by Manpower, an HR solutions provider: https://go.manpowergroup.com/hubfs/Talent%20Shortage%202019/2019_TSS_Infographic-Turkey.pdf.

mechanisms have been promoted, commercial judicial processes are slow and there is a substantial backlog of commercial court cases. The increased State interference in the economy and the lack of State aid controls hinder the market-based consolidation of a level playing field for economic actors. Limited access to finance is an obstacle to companies' investment and growth prospects especially given the need to recover economically from the COVID-19 pandemic, and to the realisation of Turkey's industrial policy ambitions. However, the 2022 ERP does not include specific measures on improving the business environment.

The New Economy Programme 2021-2023 recognises the need for reform and puts forward a set of initiatives reflecting the course of the Judicial Reform Strategy. These include the establishment of specialised jurisdictions in various sectors, the specialisation of judges, a reform of the notary system and its expansion to cover non-contentious cases, the promotion of arbitration systems and the increased use of digital technologies for judicial procedures. In November 2021 specialised courts were established for tax offences, IT crimes and financial crimes. Such steps may improve procedures technically; however, they do not address overarching concerns, in particular with regard to the independence and professionalism of the judicial system.

Effective measures to strengthen the rule of law, to ensure appropriate and timely contract enforcement and to improve the availability and functioning of dispute settlement mechanisms remain key factors for improving Turkey's business environment. To improve dispute resolution, mediation practices began in the field of commerce, consumer law, banking and finance, intellectual property, energy and mining, health, sports, insurance and construction. Nonetheless, commercial judicial processes are slow and there is still a substantial backlog of commercial court cases. The bankruptcy system is expected to register a wave of restructuring in the near future. The system has started to be reformed but implementation is delayed and procedures are still costly and slow, with a low recovery rate. In 2020 the average duration of bankruptcy and insolvency proceedings was 1280 days.

The unpredictable regulatory environment is a major obstacle to competitiveness. The regulatory environment ranks among the weakest dimensions in the latest available editions of notably the IMD Competitiveness Index, the INSEAD Global Innovation Index and the IMF country report. The number of regulatory changes in numerous sectors, in particular due to the transition from a parliamentary to a presidential system, has significantly increased in the last 5 years. There are no systematic mechanisms in place for consultations with businesses and social partners on legislative initiatives. Consultations are held through consultative boards, councils, working groups and technical committees set up by a few ministries; yet neither a clear calendar for these meetings nor their conclusions are publicly available. Despite a legal framework already being in place for regulatory impact assessments (RIA), such studies are rarely carried out. In practice RIA is not being conducted for primary legislation, and is only conducted for subordinate legislation on an ad hoc basis, at the discretion of the Presidency.

Market interventions by the State hinder competition and the capacity of economic operators to implement long-term business plans. Strengthening the legal framework for State intervention by making it more transparent, accountable and predictable is a key requirement for a more favourable business environment. Legislation to implement the law on State aid has been pending for almost a decade. Recent changes to the administrative set-up for State aid have led to an oversight structure that is neither complete, nor independent, nor operational. Turkey continued the implementation of the general incentive package (2012 Incentive Scheme), the Project Basis investment programme and the support programmes provided by TUBITAK (Scientific and Technological Research Council of Turkey) and KOSGEB (SME Development Organisation of Turkey). In 2021, KOSGEB rolled out "fast support" programmes targeting the most impacted sectors by the COVID. This was co-

financed by the World Bank and JICA. The objective was to retain and increase the employment level of enterprises in the most impacted sectors.

State interventions in price-setting mechanisms in key product areas hamper the free functioning of product markets. The price level of more than a quarter of the goods in the consumer price inflation basket is directly set or strongly influenced by public authorities. In the energy sector, commercial and industrial clients who do not reach a consumption threshold are required to buy electricity from an assigned supplier at a price set by the regulatory authority. The gradual phasing-out of this obligation is still ongoing, but no end-date has been set.

The Turkey Wealth Fund and the Savings Deposits Insurance Fund (TMSF) are largely exempt from transparency requirements and competition. The Turkey Wealth Fund was created under a special law in 2016 and is fully owned by the government. According to its consolidated financial statements at the end of 2020, its total assets amounted to TRY 2169 bn. The Fund was granted immunity, notably from the Law on the Protection of Competition, the Turkish Commercial Code and the Law on Capital Markets, and it is vested with unlimited borrowing capacity. The Fund is also exempt from certain taxes and charges such as the stamp duty, income and corporate taxes, tax deductions and the Istanbul stock exchange fees. These exemptions are problematic from a competition perspective with regard to the Fund's operations, despite the welcomed publication of its activity reports and financial statements for the years 2019 and 2020. The TWF is audited by an independent audit firm and by auditors appointed by the President. The acquisition and management of companies under the trusteeship of the Savings Deposits Insurance Fund (TMSF) remains non-transparent. As of the end of 2020, the management of 796 companies based in 38 provinces across Turkey with a total asset value of TRY 70.3 billion (EUR 7.8 billion) and with a total of 40 061 employees, remained under the trusteeship of the Fund. Neither a schedule for resolving the release of all companies from trusteeship nor appropriate, effective and timely means of legal redress are in place.

Another factor disrupting the smooth functioning of the market is widespread distortion in the allocation of government contracts and assets. Turkey lacks preventive and anti-corruption bodies while severe flaws in the anti-corruption legal framework allow undue political influence in the allocation of public resources. Public procurement is especially prone to corrupt activities on account of a number of exceptions allowed under public procurement law. Tender procedures covered by exceptions have significantly increased in recent years, while the number of contracts awarded via open auctions has fallen relative to the total number of contracts awarded. The lack of transparency in the selling of public assets by agencies such as the Housing Development Administration and the Saving Deposits Insurance Fund poses serious concerns about the political influence exerted over these bodies.

The informal economy also continues to distort the level-playing field for businesses and thus undermines competitiveness. The informal sector accounts for a considerable share of economic activity, well above the OECD average. Turkey has been implementing the action plan and strategy for the fight against the informal economy (2019-2021) but the results are difficult to measure, since no concrete performance indicators were identified. There are plans to extend the focus on reducing unregistered employment (ERP 2022, **Measure 4, rolled over from the previous year, “Reducing unregistered employment by focusing on increasing audit capacity in non-agricultural sectors”**), but no targets have been set. There is no comprehensive longer-term approach for addressing the informal economy, including aspects of employment and the business environment that dis-incentivise formalisation, which would allow for sustained progress in addressing these issues.

The government has started to address the very low level of foreign direct investment (FDI) in Turkey. Potential investors are discouraged by a number of obstacles, such as difficulties in getting approvals, weak enforcement of industrial and property rights and hidden market restrictions. To attract more investments, Turkey's FDI Strategy (2021-2023) entered into force in June 2021. As part of the ERP measure on investment procedures (ERP 2020, Measure 9, “*Creating guidelines for investment procedures in various sectors*”) the additional action of a virtual one-stop-shop portal for information about investment support per sector and province provided by the Ministry of Industry and Technology has been set up and is operational (www.yatirimadestek.gov.tr). The procedural guidelines are still to be initiated (ERP 2021, Measure 8, Preparing new legislation for easing private sector investments).

Recent changes in capital market and banking laws are welcome steps for the further development and deepening of capital markets. They include the easing of loan securitisation, offsetting up a single public insurance company, and a board of debt instrument holders, the concept of security trusts, project bonds, and project finance funds, and, the expansion of the areas of activity of development and investment banks.

Limited financial resources hamper business development and the growth of companies. While emergency support has been provided to businesses to cushion the impact of the COVID-19 pandemic on economic activity, access to finance remains limited, especially for SMEs. Analysis from the United Nations and the World Bank highlights the fact that business continuity of micro and small enterprises has been disproportionately put under strain by the COVID-19 pandemic. Such businesses are facing difficulties in maintaining employment and payments with limited operational liquidity, and are thus more likely to close permanently. Despite significant increases in the capacity of Credit Guarantee Fund (since early 2017), the 2019 Enterprise Survey shows that two thirds of Turkish firms are credit-constrained, compared to an average of 52% in higher middle-income countries. Most of the constrained firms are those that were discouraged from applying for a loan. The main source of discouragement being high borrowing costs.

Non-bank financial instruments are available and utilised across the economy, while efforts have been stepped up further to develop venture capital and crowdfunding, with various state-supported and private venture capital funds operational.

The government has introduced stimulus packages to support business continuity, protect jobs and keep cash flowing to workers and businesses. The government support measures included a deferral of tax and social security payments, additional loan guarantees, extended cash transfers to low-income households and extended employment benefits. KOSGEB supported SMEs by extending the maturity date and covering interest costs of loans disbursed under the SME Loan Interest Support Regulation.

Key Challenge #3: Supporting the green transition of the economy

Turkey faces critical environmental and climate challenges, both in terms of mitigation and adaptation. Due to the strong economic and demographic growth and the use of a high-carbon energy mix, greenhouse gas emissions have increased by more than 150% since 1990. Air quality, water pollution and pollution generally are a major concern, especially in large cities and industrialised regions. Global warming combined with Turkey's semi-arid climate causes the depletion of water resources. Therefore, more ambitious climate and environment policies need to be introduced to create the necessary enabling environment. Turkey ratified the Paris Agreement on 6 October 2021 and committed to limiting its net greenhouse gas

emissions. Shortly afterwards, the Environment and Urbanization Ministry was renamed as Environment, Urbanization and Climate Change Ministry. Turkey also released a “Green Deal action plan” on 16 July 2021. While this roadmap demonstrates the willingness of the Turkish government to deal with green transition, it does not set a time-bound and clear overall objective. **Measure 11 “Technical Assistance for the Green Deal action plan”** included in the ERP looks more like an awareness-raising action. A more ambitious set of activities rather than a continuation of a series of meetings and the organisation of surveys could have been planned for the upcoming years. Only the establishment of a clear and legally binding strategy, with cross-cutting and concrete measures, substantial investment and stronger administrative capacity will enable Turkey to start its transition to a modern, resource-efficient and competitive economy.

Following a strategy of maximising the use of domestic and renewable energy sources, the share of the country’s renewable energy in the electricity generation reached 44% in 2020. The ratio of renewable energy installations in the total installed power generation capacity increased from 45% in 2019 to 51% in 2020. Encouraging further the development of renewable energy installations (in full respect of Turkey’s Customs Union obligations) can break energy dependency and create new opportunities for businesses. Moreover, the National Energy Efficiency action plan (2018) proposes to put in place a national energy efficiency financing mechanism in order to achieve the objectives set out in the country’s Energy Efficiency strategy. Nevertheless, this financing mechanism was not implemented.

The ability to adapt to climate change and to move from a linear to a circular and sustainable use of resources is key for ensuring the future competitive advantage of businesses. As proposed in the Turkish “Green deal action plan”, establishing an ETS system, aligned with the European system and fostering the circular economy can contribute to the decarbonisation of the economy and prepare for the implementation of the EU Carbon Border Adjustment Mechanism. Eco innovation is emerging in Turkey, especially in the automobile and energy sectors. A first Climate Council was held in February 2022 to establish a road map in line with the Paris Agreement to reach net-zero emissions by 2053. **Measure 10: “Support mechanism will be established for the replacement of inefficient electric motors used in industry with more efficient ones” was carried over from the 2021 ERP (Measure 4).** It is commendable, but remains modest to address the challenges mentioned above. It is hardly a structural reform measure.

Further developing green finance, notably by strengthening the legal framework and working on green taxonomy, is crucial to encourage private investments in innovative and green industries. R&D activities also need to be supported to enable the development and the dissemination of green production technologies. According to a recent OECD analysis, SMEs in Turkey have access to a broad range of financial support for their greening efforts, in particular to improve energy efficiency and invest in eco-innovation (in the form of grants, subsidised loans and similar).

Finally, green transition require developing new activities and skills to turn these challenges into economic opportunities. Addressing corresponding employment and professional training needs is key to ensure a smooth transition to a resource efficient and low carbon economy.

Box: Monitoring performance in light of the European Pillar of Social Rights⁴

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 key principles and rights on equal opportunities and access to the labour market, fair working conditions and social protection and inclusion for the benefit of citizens in the EU. The European Pillar of Social Rights Action Plan, adopted on 4 March 2021, aims at rallying all relevant forces to turn the principles into actions. Since the 20 principles provide a compass for upward convergence towards better working and living conditions in the EU, they are equally relevant for candidate countries and potential candidates.

Relative to the EU-27 average, there is scope for improvement in most available indicators of the Social Scoreboard supporting the European Pillar of Social Rights.

Turkey's labour market indicators continue to deteriorate, indicating structural deficiencies in the labour market, especially for young people and women. The employment rate has been deteriorating since 2018 reaching 51.0% in 2020, 20.7 pps below the EU average, although by December 2021 employment rate reached 57.2% surpassing pre-2018 levels, according to TURKSTAT. The unemployment rate rose by nearly 3 pps from 2018 to 2019 and slightly improved in 2020 by 0.5 pps to 13.2% which is nearly twice the EU average of 7.2%. While long-term unemployment has slightly deteriorated in the past years to 3.3% in 2020, it is not significantly worse than the EU of 2.5%. The rate of youth NEETs was among the highest in the region with 32% compared to the EU average of 13.7% and the gender employment gap is the highest in the region (10 pps above the second highest rate in the region) at 38.1 pps, compared with the EU average of 11 pps. A significant proportion of the female population never enters the formal labour market.

TURKEY		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Worse than EU avg., improving
	Individuals' level of digital skills (basic or above basic)	Worse than EU avg., improving
	Youth NEET (% of total population aged 15-29)	Worse than EU avg., deteriorating
	Gender employment gap	Worse than EU avg., improving
	Income quintile ratio (S80/S20)	Worse than EU avg., deteriorating
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-64)	Worse than EU avg., deteriorating
	Unemployment rate (% of population aged 15-74)	Worse than EU avg., deteriorating
	Long term unemployment rate (% of population 15-74)	Worse than EU avg., deteriorating
	GDHI per capita growth	N/A
Social protection and inclusion	At risk of poverty or social exclusion (in %)	Worse than EU avg., deteriorating
	At risk of poverty or social exclusion rate for children (in %)	Worse than EU avg., deteriorating
	Impact of social transfers (other than pensions) on poverty reduction	Worse than EU avg., improving
	Disability employment gap	Better than EU avg., improving
	Housing cost overburden	Around EU avg., no change
	Children aged less than 3 years in formal childcare	Worse than EU avg., trend N/A
	Self-reported unmet need for medical care	Around EU avg., improving

Skills mismatches and limited reskilling opportunities continue to limit labour market improvements. Overall, education outcomes remain low. Individuals' level of digital skills is improving, but it remains significantly below the EU average at 34% compared to 55%. While primary education is nearly universal, there are low enrolment and high dropout rates in secondary education. Enrolment figures for pre-primary and primary education slowly improved, but the quality of education remains a challenge, as indicated in the results of PISA testing.

The impact of social transfers on poverty reduction remains very low. It accounts for only 9.45% (EU average 32.68%), although the figures are improving slowly but steadily. The rate of people at risk of poverty or social exclusion (AROPE) continues to deteriorate. 34.1% of the population and 43.4% of children are AROPE, compared to the EU average of 21.9% and 24.2% respectively. Income distribution remains the most uneven in the region with the income quintile ratio at 9.20 compared to the EU average of 5.24.

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

⁴ The table includes 16 headline indicators of the Social Scoreboard, used to compare the performance of EU Member States (<https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators>). The indicators are also compared for the Western Balkans and Turkey. The assessment includes the country's performance in relation to the EU-27 average (performing worse/better/around the EU-27 average; generally 2020 data are used for this comparison) and a review of the trend for the indicator based on the latest available 3-year period for the country (improving/deteriorating/no change). For data see Annex B. NEET: not in employment, education or training; GDHI: gross disposable household income.

5. OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2021

Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey has adopted targeted policy guidance (PG) for all partners in the region. The guidance represents the participants' shared view on the policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale of the PG is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. Implementation of the PG is evaluated by the Commission in the following year's ERP assessments. The following table accordingly presents the Commission's assessment of the implementation of the 2021 policy guidance jointly adopted by the EU and the Western Balkans and Turkey at their Economic and Financial Dialogue at Ministerial level on 12 July 2021.

Overall: Partial implementation (38.2%) ⁵	
2021 policy guidance	Summary assessment
<p>PG 1:</p> <p>Maintain the fiscal policy stance consistent with the aim of supporting disinflation and lowering vulnerabilities, while increasing support to the most vulnerable households</p> <p>and providing adequate allocations for capital expenditure and active labour market policies.</p> <p>Adopt a 2022 budget together with a plan for a gradual fiscal consolidation over the medium term.</p>	<p>There was substantial implementation of PG 1.</p> <p>1) Partial implementation: The government tightened its fiscal policy in 2021 and achieved a better budget performance than expected. A number of fiscal measures have been adopted to reduce the adverse effects of inflation. Turkey had maintained sufficient fiscal room which could have been used in a more effective and targeted manner to increase support to vulnerable households and businesses. Through different channels, the government has increased its support to them (such as temporary tax reductions and deferrals, cash aid support, etc.). Furthermore, the central government budget allocated for the 'protection and strengthening of the family', 'the protection and development of children' and 'fight against poverty and social assistance' has been increased between 2021 and 2022, though their overall share in the budget has increased only marginally.</p> <p>2) Partial implementation: Capital expenditure execution in 2021 was above initial plans. The allocation for capital expenditure has also increased in 2022 as compared to 2021, but its share in overall spending has not changed significantly. The budget allocated for active labour market policies has also increased.</p> <p>3) Substantial implementation: The government adopted the 2022 budget, with a planned budget deficit of 3.5% to the GDP. A gradual fiscal consolidation is expected over the medium term, with a projected budget deficit of 3.2% of GDP in 2023 and 2.9% in 2024.</p>

⁵ For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's overview and country assessments of the 2017 Economic Reform Programmes available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

<p>Increase the share of local currency in new borrowing.</p>	<p>4) Substantial implementation: The Ministry of Treasury and Finance had committed in several policy documents to reduce the share of foreign currency-denominated debt in total debt stock. Indeed, some efforts have been made and the share of lira-denominated new domestic borrowing increased from 63% to 72% in 2021. However, due to foreign FX borrowing and the weaker lira, the share of foreign currency in the total debt stock increased from 56.2% to 66%, while the share of lira-denominated debt fell from 43.8% to 34% between 2020 and 2021.</p>
<p>PG 2:</p> <p>Expand the tax base by developing a plan to streamline gradually tax exemptions and reductions.</p> <p>Reduce expenditure arrears and improve their monitoring and control.</p> <p>Adopt the new framework legislation on Public Private Partnerships in order to improve their management and monitoring.</p>	<p>There was limited implementation of PG 2.</p> <p>1) No implementation: No such plan was developed and the tax base was weakened further by new measures.</p> <p>2) No implementation: No steps were taken to address this recommendation.</p> <p>3) Limited implementation: According to the Economic Reform Package announced in March 2021, the government expected the completion of the proposal on the single public private partnership framework law at the end of 2021. The law has not yet been adopted, but the legislative preparation has advanced.</p>
<p>PG 3:</p> <p>Maintain a sufficiently tight monetary policy stance, at the central bank’s own discretion in line with instrument independence, as well as a transparent operational framework needed to reduce inflation and bolster market confidence.</p> <p>Maintain a strong financial sector regulatory framework in line with international and EU best practices, ensure sound credit risk management, a transparent display of asset quality and adequate provisioning.</p>	<p>There was limited implementation of PG 3.</p> <p>1) No implementation: The monetary policy stance was not sufficiently tight throughout most of the year and was even loosened further as of autumn, triggering high market volatility, currency depreciation and exacerbating inflation amid deeply negative real interest rates. The unexpected dismissal of the central bank governor in March and of three members of the Monetary Policy Committee in October, including two deputy governors, has renewed concerns over the central bank’s ability to determine the monetary policy stance at its own discretion. Moreover, the absence of a clear nominal anchor and the increased complexity of the operational framework add to the uncertainty about the future direction of monetary policy and increase the risks to price and financial stability.</p> <p>2) Partial implementation: Pandemic-related forbearance measures were lifted as of October, although with a transition period and after being extended twice. Restrictions on dividend distributions remain and are only relieved under pre-agreed conditions. Several forbearance measures remain in place, while the frequently changing and complex regulatory framework lacks transparency and allows for unwarranted flexibility, deviating from international standards. The authorities conduct regular stress tests, but do not consider an independent third-party Asset Quality Review. The extension for 2 years of the Financial Restructuring Framework Agreement will further delay NPL recognition, while reporting on restructured loans is not mandatory. The banking system maintains high levels of provisioning and the coverage ratio also increased slightly in 2021.</p>

<p>Continue to improve legal, institutional and regulatory frameworks to foster swift and efficient NPL resolution, including the further development of the NPL market.</p>	<p>3) Partial implementation: The authorities introduced regulatory amendments and guidelines covering loan classification procedures, monitoring practices, distressed asset resolution and the activity of asset management companies. Regarding the latter, banks are now able to sell stage 1 and 2 loans in addition to NPLs, while asset management companies are now allowed to establish funds to issue asset-backed securities (which can only sell asset-backed securities to offshore investors). Further to the recent amendments to the bankruptcy law, strengthening firm insolvency frameworks remains warranted.</p>
<p>PG 4:</p> <p>With the aim to improving the business environment, further strengthen the rule of law and the regulatory environment and improve consultation mechanisms with business organisations and social partners on relevant new legislation.</p> <p>Implement legislation and enhance transparency regarding state aid.</p> <p>Finalise the legislation on easing private investments and prepare its implementation.</p>	<p>There was limited implementation of PG 4.</p> <p>1) Partial implementation: Shortcomings in the independence of regulatory authorities have not been addressed. However, some important steps were taken in the judicial system. The government took actions with the specialisation of civil courts to render decision-making more efficient. The Singapore Convention was ratified providing an international legal framework for the enforcement of the settlement agreements resulting from commercial mediation. Turkey also adopted amendments to the bankruptcy law helping easier liquidation and market exit. To increase transparency, access to court decisions has been provided.</p> <p>However, in terms of consultation with stakeholders, implementation remains limited. Turkey does not have a clearly defined, regular mechanism with guidelines and criteria for such consultations. Regulatory impact assessment tools are not in use. Only two specific examples of consultations have been provided in the ERP document, which remains disproportionately low as compared to the number of adopted legislative acts. Moreover, in the legislative process Turkey does not make sufficient use of existing social dialogue mechanisms, such as the Economic and Social Council which remains inactive.</p> <p>2) No implementation: According to the economic reform package (announced in March 2021), the government envisaged the adoption of a single framework State aid legislation, which ensures an impact assessment. The Ministry of Treasury and Finance (March 2021) committed to collect comprehensive data instantly on all support programmes in a single centre, and provide access to all support schemes more easily, quickly and effectively from a single platform until the end of 2021. The deadline set for this action was not met. Furthermore, <i>“there is a continued lack of State aid implementation rules, enforcement and transparency, while the institutional set up remains incomplete”</i> as also highlighted in the 2021 Country Report.</p> <p>3) Limited implementation: According to the Economic Reform Package (announced in March 2021), the government aimed at finalising and putting into practice a new system for the protection of private sector investment by the end of 2021. The draft legislation is being revised in light of the feedback</p>

	from stakeholders, who voiced concerns offsetting up investment coordination units within the Ministries and the establishment of an investment ombudsman system (with the power of making legally binding decision).
<p>PG 5:</p> <p>Increase the provision of active labour market policy measures for young people.</p> <p>Incentivise further female labour participation through legislative and fiscal measures and provision of appropriate and affordable childcare infrastructure beyond the big urban centres of Turkey.</p> <p>Intensify and diversify policy tools in order to increase the transition to formal employment in the labour market in the aftermath of the pandemic, including for the migrant workers and the workers under temporary protection.</p>	<p>There was partial implementation of PG 5.</p> <p>1) Partial implementation: The high unemployment rate for young people and the NEET rate, particularly for women, are still major challenges. Active labour market policy measures have been adopted in line with the National Youth Employment Strategy and Action Plan (2021-2023). However, the Strategy lacks well-developed result indicators for the actions. İŞKUR has continued to provide active labour market measures to young people in 2021, but their scope remained limited.</p> <p>2) Limited implementation: Gender gaps in the labour market continued. Employment subsidies, with a longer eligibility duration for women and young people, have been implemented. No significant progress has been achieved in terms of appropriate and affordable childcare infrastructure in Turkey. Legal limitations over the establishment of municipal day cares remain. Pre-primary classrooms will be established under IPA funded project.</p> <p>3) Partial implementation: To promote formal employment, the government continued to pay social security premiums and taxes over the minimum wage for each worker to be recruited until the end of 2022. As of January 2022, income tax applying up to minimum wage is paid by the State, reducing the relative tax burden on formal employment. Cross-audits have intensified and the audit capacity is increasing. However, these measures alone may not necessarily help the most vulnerable employees or the self-employed engaged in undeclared work.</p>
<p>PG 6:</p> <p>Continue to roll out mandatory pre-school education and advance further towards a 100% enrolment in primary and secondary education with updated curricula.</p> <p>Address high youth unemployment and NEET rates through better access to education and improved VET, as well as outreach to young NEET.</p> <p>Increase offers and participation in lifelong learning measures and step up re- and upskilling possibilities for the labour force.</p>	<p>There was a partial implementation of PG 6.</p> <p>1) Limited implementation: The COVID-19 pandemic had a negative impact on school attendance and access to education. Early childhood education at age 5 has not become compulsory so far, although target of a 100% enrolment rate is announced for 2023. A participation fee remains in place limiting access to education, although most public schools continued to reimburse fees for children from disadvantaged families. The Presidency of the Republic announced the construction of 3 000 pre-schools and 40 000 pre-primary classrooms by the end of 2022.</p> <p>2) Partial implementation: The high youth unemployment and NEET rate, particularly for women, remained a major challenge. Some measures have been adopted for young people and NEETs, including improved access to VET in line with the National Youth Employment Strategy and Action Plan (2021-2023).</p> <p>3) Substantial implementation: There are 995 public education centres and 24 maturation institutes in Turkey, providing general and vocational courses in the</p>

	context of lifelong learning. Vocational Training Centres provide on-the-job training, as well as re- and upskilling through tailor-made trainings. The participation rate in lifelong learning remained low. To encourage enrolment, the Apprenticeship and Vocational Education Law was amended to provide insurance against occupational diseases and a minimum wage guarantee. The adoption of the amendment led to a sharp increase in enrolment at the centres.
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ANNEX A: ASSESSMENT OF THE AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE 2022-2024 ERP

Energy

As part of the green energy transition, Turkey aims to: (i) increase energy efficiency in industry, buildings and energy production and transmission; (ii) increase the share of renewable energy in its energy mix and support the utilisation of hydrogen; and (iii) integrate and digitalise the energy systems to provide sustainable and uninterrupted energy supply and a resilient energy market.

To strengthen the Turkish electricity sector and to support long-term security of supply, the legislative basis for the electricity futures market (EFM) was enacted. The EFM will enable market participants to preserve their positions and protect themselves from market price fluctuations. The electricity futures market was opened by Energy Exchange Istanbul (EXIST) on 1 June 2021.

The ratio of renewable energy installations in the total installed power generation capacity increased from 45% in 2019 to 51% in 2020. The share of thermal power is decreasing even while for gas, Turkey has built excess capacity of 360 cubic metres per day with a target of 400 cubic metres per day by 2023. Increasing the share of renewable energy in the energy mix will help achieve carbon neutrality by 2053 target. The share of the country’s renewable energy in electricity generation in 2020 reached 47%, 33.3% of which came from hydropower. The increase in Turkey’s installed renewable energy capacity is driven mainly by private investments benefiting from a preferential feed-in-tariff mechanism, that was rolled over in January 2021. As before, the State will provide financial support for the first 10 years of operation to all renewable energy power plants installed by 2025. The major difference is that the new mechanism is based on the local currency (i.e. the Turkish lira). In general, the new feed-in-tariff mechanism offers lower support than the previous support mechanism (e.g. 25% lower for hydropower, 40% lower for wind and 67% lower for solar power). The practice of granting state financial support for the use of domestic equipment in renewable energy installations continues to be of concern to the EU since such a local content requirement is not considered compatible with the EU-Turkey Customs Union.

Agriculture

The ERP identifies the need to change the legislation on agricultural statistics to make data submission mandatory for agriculture rather than voluntary. Under the EU’s common agriculture policy, only participation in, and provision of data to the Farm Accountancy Data Network System (FADN) is voluntary, not statistical data collection. The FADN system has been operating in Turkey since 2009 and is currently used in 81 provinces. However, the (confidential) data collected through FADN are used for different purposes, particularly for determining and monitoring the annual agricultural incomes of enterprises and measuring

their performances. Although the ERP recommends changing from a voluntary system to a mandatory one, the FADN cannot be mandatory if harmonisation with EU practice is pursued.

Measure 14: “Improvement of data collection processes and increasing the capacity of evaluation in agriculture statistics” (ERP (2021-2023) Measure 3)

The ERP, as in 2021, identifies the need to change the legislation on agricultural statistics to make data submission for agricultural holdings mandatory rather than voluntary. However, as stated in 2020, it lacks information on what (if anything) was done in 2021 to introduce and/or adapt these legislative changes to provide more reliable data.

This measure has been rolled over-from the previous three ERPs. The ERP states that one online and three face-to-face trainings took place on different topics and 250 data collection and system entry supervisors were trained. However, it is not clear if the impact of these trainings was measured. It is important to see whether data collection has actually started.

Industry

Turkey’s industry, having struggled to maintain its competitiveness in the years before COVID-19, faces a severe double challenge of recovery and preparation for the green and digital transformation in a worsening business and investment environment. Industry, (minus construction) has raised its share of gross value added in the second half of the last decade by around 10%, keeping its contribution to employment more or less constant. The domestic producer price index for industry has shot up by 80% during this period. The high dependency on foreign energy sources and raw materials has hardly diminished. Labour productivity has increased to almost 80% of the EU average. Key structural weaknesses compared with the EU are made apparent by the low number of top R&D spending enterprises and the employment share of medium to high-technology manufacturing and knowledge-intensive services that can be part of manufacturing value networks. Manufacturing exports are predominantly of low and medium technology intensity, with each accounting for around 40% of manufacturing exports, followed by resource-based goods at almost 17% and the high-technology share having surpassed 3% in 2018. Foreign direct investment (FDI) in manufacturing was mostly in the chemical and the ICT industries in 2019. The EU is Turkey’s largest export destination and FDI source. The automobile and the machinery industries account for most of the manufacturing exports to the EU. Among the manufacturing industries, the machinery industry is particularly characterised by small family-run enterprises. The productivity gap between large companies and SMEs has accelerated, except for start-ups. The commercialisation of R&D remains hindered by the low capacity of Turkish SMEs to adopt process innovations. Turkey implements policies to increase the proportion of high technology in its industry. The next industry and technology strategy is expected to have a strong emphasis on green transition. The predominantly low-technology manufacturing in Turkey’s less-advanced regions would benefit from services specific to upgrade their products and processes.

Turkey adopted a comprehensive economic reform package in March 2021, which contains measures to further digitalise public and business services for enterprises, enhance digital skills and reform State aid and similar incentives. It also aims to support the internationalisation of SMEs as well as, the green transformation of industry, notably a circular economy plan.

ERP measures 7 and 9 focus on adoption and the growth capacity of SMEs adding impetus to the existing measures. They have the potential to address the most apparent needs, if they

specifically target SMEs likely to be threatened by the twin transformation or the low-technology trap. However, more systemic responses are needed if Turkey wants to fulfil its economic ambition.

Services

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

With the pandemic receding, and strong growth in 2021, the outlook for 2022 is good. Tourism is performing well, with spill-over effects to some services and manufacturing sectors. Exports and tourism revenue is expected to drive the economy in 2022.

Measure 15: “Increasing tourism market share and brand value” (ERP (2021-2023) Measure 6)

This measure has been rolled over from the previous ERP. The tourism sector has been one of the sectors the most affected by the COVID-19 pandemic. Tourism revenues contribute significantly to the development of the economy, the improvement of the trade balance and thus to the reduction of the current account deficit. Therefore, the roll-over of this measure from the previous ERPs is justifiable.

The measure still focuses on marketing and branding actions, but its scope has been broadened. As part of the efforts to diversify Turkey's tourism products and destinations and enhance their competitiveness, tourism training activities are being carried out to keep the tourism service quality and skills at high standards, which is considered as a positive initiative. However, there is a discrepancy between the scope of the measure and the activities planned for 2022, 2023 and 2024, as they focus mostly on the marketing and branding activities and do not refer to these training activities. The same applies for enhancing the tourism infrastructure in particular in the regions that lag behind despite their remarkably important natural, historical and cultural assets (such as the Black Sea, and Eastern and South Eastern Anatolia). There is no clear budget allocation for the activities.

Research, development and innovation

Turkey's new industry and technology strategy has set ambitious targets for increasing expenditure on R&D to 1.8% of GDP and for increasing full-time-equivalent staff in R&D to 300 000 by 2023. Although there has been some progress since 2018, the gap between actual figures and the 2023 targets remains significant, as does the gap with the EU-27 averages.

Turkey dropped a category to 'emerging innovator' in the 2021 European Innovation Scoreboard. Turkey's strengths are in digitalisation, sales impacts and linkages. Its top-3 scores are for job-to-job mobility of human resources in science and technology, Government support for business R&D, and Broadband penetration.

Its strong decline in innovation performance in 2021 is due to reduced performance on the indicators using innovation survey data, namely (i) enterprises providing ICT training; (ii) job-to-job mobility of human resources in science and technology; (iii) patent and design applications, and (iv) environment-related technologies. To raise the export capacity of

Turkish SMEs, the country would need to prioritise concepts such as the digital single market and smart specialisation.

Measure 7: “Enhancing the R&D and innovation activities of SMEs” (ERP (2021-2023) Measure 11)

Measure 7a “Prioritizing technological product investments to increase the technology level and export capacity of SMEs and supporting the commercialization of R&D projects – roll-over (ERP (2021) Measure 11a)”

This measure is rolled-over. As it has been in place for some years now, it could include impact-related indicators and not only output-based indicators such as the number of SMEs supported. Instead, indicators with economic data should be included such as increase in value-added, increase in the share of high technology products in SMEs' exports, increase in patent applications and patents etc.

Measure 7b “Enhancing the R&D and innovation activities of SMEs; and the development and implementation of mechanisms to encourage and facilitate technology based and innovative SMEs access to finance, participation in mentoring and cooperation networks –roll-over (ERP(2021) Measure 11b)”

This is a continuation of measure 11b in the previous ERP (2021-2023) and is based on TUBITAK calls/programmes for enhancing research, development and innovation activities of in particular the SMEs. These programmes are comprehensive and reach out almost all the stakeholders in the research and innovation ecosystem. They are positive in terms of supporting the innovation activities of SMEs for accessing to finance, know-how and networks. Some of these calls under this measure will prioritise projects that contribute to EU Green Deal goals, which is considered to be a positive step.

Generally on R&D and innovation, Turkey could conduct an impact assessment of TUBITAK and KOSGEB R&D supports and give more emphasis on enhancing the national and regional smart specialisation policies. Recently, the Ministry of Industry and Technology (DG for Strategic Research and Productivity) carried out impact assessment for some TUBITAK and KOSGEB support measures (such as TUBITAK’s 1507 and BIGG programmes). These studies could be extended to cover all R&D supports and could be the basis for measures on future implementation. This study (in Turkish) is available at: <https://www.sanayi.gov.tr/assets/pdf/birimler/SAVGM6550KanunRapor2.pdf>

Measure 8: “Supporting competent research infrastructures on a performance basis within the new legal framework” (ERP (2021-2023) Measure 12)

This measure (i.e. implementation of Law No. 6550 to support research infrastructures) is again rolled over, and is in line with the 11th development plan.

The Ministry of Industry and Technology (DG for Strategic Research and Productivity) conducted an impact assessment for the research institutes supported through Law No. 6550. Its conclusions could provide lessons for future implementation. The study (in Turkish) is available at: <https://www.sanayi.gov.tr/assets/pdf/birimler/SAVGM6550KanunRapor2.pdf>

As Turkey embarks on the green transition, the positive impacts on environment and climate change could have been better explained since the selected research institutions and the potential results are expected to contribute to green and sustainable growth.

Measure 9: “Establishing Model Factories (SME Competency and Digital Transformation Centres) and Innovation Centres to increase the efficiency of SMEs and their digital transformation” (ERP (2021-2023) Measure 5)

This measure is rolled-over from last year as it continues to be relevant. As the measure has been in place for some years now, some impact-related indicators can be added, such as (i) increase in total factor productivity; (ii) increase in value-added in production of the serviced SMEs; and (iii) increase in the share of exports with high technology content. Currently all indicators are about the provided service itself and not about the real objective of the measure. Furthermore, on the expected impact of the measure it is stated: "It is anticipated that companies will make serious improvements in resource use and waste production". This should be based on a measurable and objective target, the word "serious" is subjective.

Measure 12: “Increasing the secure sharing and accessibility of public sector data with new data strategy”

This measure is new and is a positive development given the importance attributed to the digital transformation of the economy. However, the scope of the measure could be further developed. The measure does not provide clear clarification on how public data will be shared with the non-public institutions. The regulatory framework for data sharing with these non-public structures is unclear. Furthermore, no details are provided on the content of the trainings planned for the public and stakeholders (for instance, on issues such as cybersecurity, encryption of data and the sharing of good practices by EU Member States).

Measure 13: “Update of Turkey-EU Customs Union” (ERP (2021-2023) Measure 13)

The ERP once again includes the prospective modernisation of the Customs Union as a ‘reform’ measure under the economic integration heading. It has been repeatedly underlined by the Commission that it could, at best, be a trade policy objective. As in the previous years, the ERP document does not provide an account of the actual structural problems that inhibit Turkey’s closer integration into global value chains or that reduce its external competitiveness. Most importantly, it fails to present any autonomous measures that Turkey could take to address them. Instead, it refers to a few problems that can arguably be due to Turkey’s under-utilisation of the benefits of the Customs Union. Due to its improper implementation of this measure, Turkey’s backsliding in this area actually damages the level of integration enabled by the existing Customs Union.

Green transformation

This area and reform measures 10 and 11 are analysed above in Section 4, under key challenge #3.

Education and skills

This area and reform measures 5, 6 and 16 are analysed above in Section 4, under key challenge 1.

Employment and the labour market

This area and reform measures 1, 2 and 3 are analysed above in Section 4, under key challenge 1.

The rate of unregistered employment remains high. Apart from economic costs such as lower productivity and tax revenues, there are considerable social costs generated by informality. Workers in the informal economy are subject to social exclusion, and the absence of social security contributions and taxes weakens social security and tax revenues of the State budget. In Turkey, tax revenues account for 25% of GDP compared to the EU average of around 40%. Low levels of taxation limit the administration's capacity to provide basic public services, especially for the most vulnerable groups, and thus reduce the intergenerational transmission of poverty. It is difficult to break this vicious circle, which limits Turkey's growth potential. To bring informality rates down further, the country has submitted a draft law to parliament, which provides for the waiving of fees and penalties if employers formalise workers. In addition, social security contributions for workers will be subsidised. This measure incentivises the creation of formal employment, and is thus a step in the right direction. Additional steps should follow, notably for refugees under temporary protection, who largely work in the informal economy.

Reform measure 4: ‘Reducing Unregistered Employment by Focusing on Increasing Audit Capacity in Non-Agricultural Sectors’

This measure has been rolled over from the previous ERP. It aims to increase audit capacity in non-agricultural sectors, which is still relevant considering the rate of unregistered employees and the workload analysis made by the Social Security Institution. The planned activity on recruiting assistant social security controllers is relevant and feasible. The estimated cost from central budget is mentioned and seems realistic. However, measures to perform the audits electronically using technical infrastructure and data sharing are not clear. Furthermore, no indicators are provided or details on the budget allocated for these activities. Since measures on the use of IT in audit systems have been in place for some years now, activities and indicators to follow up the results and measure impact could be developed further.

Social dialogue

The bipartite and tripartite social dialogue is remains weak. Turkey continues to have a very low private sector trade union affiliation (13.8% of registered workers) and collective bargaining coverage (11% of registered workers). Only the public sector has a high organisation rate with 66.7%. The Economic and Social Council has not convened since 2009 and other social dialogue mechanisms are either not used or lack active involvement. As a result, bipartite and tripartite social dialogue is weak and is not an enabling factor for fair and inclusive growth.

Social protection and inclusion

The rate of people at risk of poverty or social exclusion (AROPE) was already very high prior to and continued deteriorating as a result of the COVID-19 pandemic. In 2020, 34.1% of the population and 43.4% of children were at risk of poverty or social exclusion, compared with the EU averages of 21.9% and 24.2% respectively. This can be partly explained by the very weak impact of social transfers on poverty reduction which slowly improved in 2020 to reach an estimated 9.45%, which was still far below the EU average of 32.68%. Income distribution remains the most uneven in the region with the income quintile ratio at 9.20 compared to the EU average of 5.24.

Reform measure 18: ‘Dissemination of Family-Oriented Social Services Model’

This measure has been rolled over from the previous ERP and concerns social services for children at risk of falling into institutional care. It envisages the expansion of two government-led schemes: (1) the socio-economic support scheme for families of children at risk (due to economic deprivation); and (2) foster care services.

The measure is likely to reduce child poverty and help children receive care in a community-based setting (instead of institutional care), improving their well-being. However, there is a need to provide associated social services for the children and families benefiting from these schemes. An impact assessment of the SED programme needs to be conducted to determine its effectiveness and efficiency for a set of child-centred indicators. The programme is limited and does not have a transparent selection procedure, so it is unclear whether the current budget levels can cover all families in need. For foster care, families would need to receive necessary guidance and counselling services. Overall, the measure is not very ambitious but realistic in terms of result indicators.

Reform measure 17: ‘Raising Awareness of Hygiene, Healthy Eating, Nature Protection, Food Waste Prevention in Schools and Institutions’

Classroom learning restarted at all levels of education in Turkey on 6 September 2021, with certain COVID-19 precautions in place. Hygiene being a key priority, the Ministry of National Education (MoNE) sent directives to schools on rules and regulations for on-site learning. The MoNE prepared a certification programme called ‘My School is Clean’ in line with the ‘Guidelines on Improving Hygiene Conditions and Infection Prevention Control in Educational Institutions’ in cooperation with the Turkish Standards Institute, and prepared guidelines for inspection. These programmes/guidelines were implemented in all provinces of Turkey, under the coordination of the provincial directorates of the MoNE. Many schools received a ‘My School Clean’ certificate in 2021, and there are plans to audit these schools in 2022. This measure is important for ensuring safe on-site education, especially during the COVID-19 pandemic.

Healthcare

Turkey has a comprehensive health insurance system, aiming for universal coverage, however, about 10% of the population is still not covered, despite the generally affordable premiums. Due to overcrowded university medical programmes, the quality of medical training suffers. And despite the overcrowded programmes, Turkey still faces a shortage of doctors. This factor, combined with a lack of a referral system, results in long waiting times and does not allow doctors to devote sufficient time to patients. The national development plan, published in 2019, focuses on improving the quality and efficiency of primary care and on improving financial sustainability by putting in place incentives to join complementary health insurance schemes. The COVID-19 pandemic has been a serious setback for Turkey’s economy and in terms of human casualties. It also impacted the capacity of the healthcare system to continue delivering essential services.

In its 2022-2024 economic reform programme, Turkey introduced three measures to improve the healthcare system, although it remains to be seen whether the below measures can successfully address structural deficiencies in the system.

Reform measure 19: ‘Supporting Clinical Trials on Vaccines and Drugs’

This measure is rolled over from measure 25 of ERP (2021-2023). To support the development of vaccines and drugs for COVID-19, the EU granted a total of EUR 8 million to TUBITAK-TUSEB consortium for this measure. Although the measure began on 8 July 2021 no discernible progress has been made.

Reform measure 20: ‘Strengthening of the Ministry of Health’s COVID-19 Response Capacity’

This measure has been rolled over from the previous ERP. There is a lack of information on what has been achieved so far, and the deficiencies mentioned in last year’s assessment persist. The scope of the measure should be revisited/ revised with details provided on planned activities and indicators.

The project is considered to be going very well. It has helped enhance the genome sequencing capacity of the National Virology laboratory to process viral disease samples and further data in a shorter period. A strategy for using rapid antigen tests (Ag-RDT) to detect COVID-19 quickly is missing. This element should be included in the national testing strategy to improve the screening, diagnosis and treatment capacity of the health system against potential epidemic threats.

Turkey has successfully implemented this reform measure. Therefore, it no longer needs to be rolled over beyond 2022.

Reform measure 21: ‘Increasing the Access of Syrian Nationals under Temporary Protection to Health Services’

This is a new measure. It aims to increase access to healthcare services for Syrians under temporary protection, and is expected to have a significant impact on public health. It envisages the employment of over 4 000 healthcare staff in 190 Migrant Health Centres as well as construction (65) and renovation (52) of Migrant Health Centres to enable sustainable primary healthcare services. For secondary healthcare services, the employment of 800 bilingual patient guides and 50 translators is envisaged. The Migrant Health Centre model is sufficient to provide appropriate quality healthcare services for migrants; however it is mainly financed by the EU. By mid-2021 a total of EUR 842 million (including ECHO-managed projects) had been contracted under the EU-financed Facility for Refugees in Turkey for projects in the health sector, representing approximately 14% of the total amount of EUR 6 billion contracted under the Facility to date. Further integrating Migrant Health Services into the Turkish health system through structural reforms is necessary to ensure the continuation of services. Establishing a Migration Health Scientific Board may be considered in light of the Ministry of Health’s commitment to ensure sustainability and their agreement to develop new policies and regulations.

No measure presented in:

- **Public Finance Management**

No measure was presented in this area in this ERP (2022-2024) and the section dedicated to the public finance management only focuses on the transition made to the performance-based programme budget system. It fails to present the main challenges such as the need to revise the public procurement legislation, the adoption of the new framework legislation on Public Private Partnerships or to strengthen budget transparency and accountability (improving for instance ex-post monitoring and reporting).

- **Business Environment**

No measure was presented in this area in this ERP (2022-2024). The finalisation of the preparation of the legislation on the private sector investment (subsequently its adoption and implementation) (presented in the previous ERP (2021-2023)) is considered essential for the improvement of the business environment. Meanwhile, some measures related to Turkey’s FDI Strategy (2021-2023) could have been also included in the ERP document.

- **Energy Market Reforms**

No measure was presented in the energy market area in this ERP cycle. The section on energy market reforms is well developed, addressing the main challenges in the sector. Note that the amendment of the Natural Gas Market Law made at the end of 2021 did not include any revisions on the unbundling of the state petroleum corporation BOTAS. Despite expectations, the adopted amendments did not change the dominant position BOTAS has on the gas market in Turkey, or reduce the State's market share, or lift fossil fuel subsidies.

- **Transport Market Reforms**

No measure was presented on the transport market. The section on transport market reforms failed to take into account energy dependency on fossil fuels as one of the key structural challenges of the Turkish economy. (90% of all transport sector is dependent on fossil fuels and it is a key input for electricity (67%))

Critically, decarbonising the transport sector can:

- alleviate the import dependency on fossil fuels;
- improve the transport sector's carbon footprint contributing to the net zero targets of Turkey;
- ease Turkey's energy bill (hence freeing up valuable financial sources).

The increasing volatility in the prices of natural gas and petroleum can significantly affect Turkey's economy. We would strongly encourage Turkey to include energy dependency among the key structural challenges and to consider decarbonisation among the reform measures to be taken in the transport sector.

Information provided under 'main obstacles' is on the results of decade's long policies, rather than an actual analysis of the main obstacles. Turkey's national transport master plan, which was also supported by the IPA I EU financing, includes good analysis as well as concrete targets until 2037.

Meanwhile, Turkey committed to the Stockholm Declaration targets to reduce fatalities and serious injuries from road crashes by 50% by 2030. The road safety action plan (the backbone of which was prepared under the EU funded Road Safety Vision Zero study from IPA I) should be presented in the targets of the reform programme.

The analysis of main obstacles should focus on:

- why the railways market share is not increasing despite significant investments in the last decade?
- how to establish better market conditions especially in the freight sector?
- Putting the decarbonisation of railways is on the agenda of TCDD.

Railways could become a serious alternative for medium to long-range hauls. Moreover, the new EU smart and sustainable mobility Strategy supports a high share of railways capacity being used for passengers. Turkey's strategic potential as a transit country to the Middle East, Central Asia and China can only be realised on the shoulders of an efficient and effective railways sector. In this respect, inter-modal integration with the key airports, road and ports is needed.

The ERP could also focus more concretely on Turkey's maritime decarbonisation ambitions, given the recent adoption of the Paris Agreement. A recent study revealed that many regulatory reforms are needed to ensure supply of liquefied natural gas and electricity as marine fuels in Turkey. Another key question is whether Turkey is

considering to include the maritime sector in the likely establishment of the emission trading scheme.

Low carbon or zero carbon alternative fuels infrastructure at airports (biofuels, hydrogen) could be also considered among the key priorities and challenges. Turkey as a key country in the EU aviation market has a role to play in providing alternative fuels. Moreover, Turkey can also consider including the aviation sector in the emission-trading scheme, if adopted.

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

Area/Sector	2016	2017	2018	2019	2020	EU-27 Average (2020 or most recent year)
Energy						
Energy imports dependency (%)	75.5%	77.2%	73.8%	70%	70.6%	57.5%
Energy intensity: Kilograms of oil equivalent (KGOE) per thousand Euro	175.03	175.30	167.69	168.42	162.79	110.18
Share of renewable energy sources (RES) in final energy consumption (%)	13.7% ^w	12.8% ^w	13.7% ^w	N/A	N/A	22.09%
Transport						
Railway Network Density (meters of line per km ² of land area)	12.920 ^w	13.081 ^w	13.219 ^w	13.305 ^w	13.30	49.0 ⁽²⁰¹⁸⁾
Motorization rate (Passenger cars per 1000 inhabitants)	142	149	151	150	157.5	519 ⁽²⁰¹⁸⁾
Agriculture						
Share of gross value added (Agriculture, Forestry and Fishing)	7.0%	6.8%	6.4%	7.1%	71.5%	1.8%
Share of employment (Agriculture, Forestry and Fishing)	19.5%	19.4%	18.4%	18.1%	17.6%	4.3%
Utilised agricultural area (% of total land area)	4.91%	4.89%	4.90%	4.84%	4.84%	40.6%
Industry						
Share of gross value added (except construction)	22.2%	23.3%	24.9%	24.2%	25.6%	19.5%
Contribution to employment (% of total employment)	19.5%	19.1%	19.7%	19.8%	20.5%	18.2%
Services						
Share of gross value added	61.2%	60.3%	60.8%	62.7%	60.9%	73.1%
Contribution to employment (% of total employment)	53.7%	54.1%	54.9%	56.6%	56.2%	71.0%

Business Environment						
Rank in Global Competitiveness Index (Source: World Economic Forum)	51	53	61	61	N/A	N/A
Estimated share of informal economy in GDP (as % of GDP) (Source: IMF)	Up to 29.6%	N/A	N/A	N/A	N/A	N/A
Research, Development and Innovation						
R&D intensity of GDP (R&D expenditure as % of GDP)	0.94%	0.95%	1.03%	1.06%	1.09%	2.32%
R&D expenditure – EUR per inhabitant	93.6€	90.8€	83.5€	88.1€	N/A	694.60€
Digital Economy						
Percentage of households who have internet access at home	76%	81%	84%	88%	91%	91%
Share of total population using internet in the three months prior to the survey [NB: population 16-74]	58.3% ^w	64.7% ^w	71% ^w	73.98% ^w	78%	88%
Trade						
Export of goods and services (as % of GDP)	23.1%	26.0%	31.2%	32.7%	28.7%	46.7%
Import of goods and services (as % of GDP)	25.2%	29.7%	31.3%	29.9%	32.5%	42.9%
Trade balance (as % of GDP)	-6.5%	-8.9%	-7.0%	-4.1%	-6.7%	N/A
Education and Skills						
Early leavers from education and training (% of population aged 18-24)	34.3%	32.5%	31.0%	28.7%	26.7%	9.9%
Young people neither in employment nor in education and training (NEET) (% of population aged 15-29)	27.8%	27.5%	27.6%	29.5%	32.0%	13.7%
Children aged less than 3 years in formal child care (% of under 3-years-olds)	NA	N/A	N/A	N/A	N/A	35.3% ⁽²⁰¹⁹⁾
Individuals who have basic or above basic overall digital skills (% of population 16-74)	28%	34%	N/A	36%	N/A	56% ⁽²⁰¹⁹⁾

Employment and Labour Market						
Employment Rate (% of population aged 20-64)	54.4%	55.3%	55.6%	53.8%	51.0%	71.7%
Unemployment rate (% of labour force aged 15-74)	10.9%	10.9%	10.9%	13.7%	13.2%	7.1%
Long term unemployment rate (% of labour force aged 15-74)	2.2%	2.4%	2.4%	3.2%	3.3%	2.5%
Gender employment gap (Percentage points difference between the employment rates of men and women aged 20-64)	42.3 pps.	41.6 pps.	40.8 pps.	38.8 pps.	38.1 pps.	11.0 pps.
Disability employment gap (Percentage points difference in employment rates between people with and without a disability)	18.8 pps.	20.3 pps.	19.4 pps.	19.5 pps.	18.9 pps.	24.5 pps.
Real gross disposable income of households (Per capita increase, Index = 2008)	N/A	N/A	N/A	N/A	N/A	107.23
Social Protection System						
At-risk-of-poverty or social exclusion rate (AROPE) (% of population)	26.6%	32.3%	32.4%	33.2%	34.1%	21.9%
At-risk-of-poverty or social exclusion rate of children (% of population 0-17)	35.6%	41.9%	42.5%	43.3%	43.4%	24.2%
Impact of social transfers (Other than pensions) on poverty reduction	7.69%	8.64%	7.88%	8.94%	9.45%	32.68%
Income quintile share ratio S80/S20 for disposable income by sex and age group (Comparison ratio of total income received by the 20% with the highest income to that received by the 20% with the lowest income)	8.65	8.68	8.66	8.35	9.20	5.24
Housing cost overburden (% of population)	10.1%	9.5%	9.7%	10.5%	10.2%	9.9%

Healthcare						
Self-reported unmet need for medical care (of people over 16)	3.8%	2.6%	2.9%	3.0%	1.9%	1.8%
Out-of-pocket expenditure on healthcare (% of total health expenditure)	16.47%	17.38%	17.49%	16.89%	N/A	15.57% ⁽²⁰¹⁸⁾

w: data supplied by and under the responsibility of the national statistical authority and published on an "as is" basis and without any assurance as regards their quality and adherence to EU statistical methodology'

Source of data in Annex B: EUROSTAT, unless otherwise indicated.

ANNEX C: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM THE 2021-2023 ERP

Measure 1: Increasing share of renewable energy regarding electricity generation

Turkey's performance in this area is considered very good. Turkey has achieved an impressive share of renewable energy in its overall energy generation and continues to increase that share. Due to the successful implementation of this reform measure, it no longer needed to be rolled over to the next period.

Measure 2: Development of financial mechanisms regarding energy efficiency

Performance is considered insufficient, i.e. no national financing mechanism for energy efficiency has been developed, although drafts have been prepared. Progress has been made on the National energy efficiency action plan. This measure stopped being rolled over, as it has reached its limits.

Measure 3: Improvement of data collection processes and increasing the capacity of evaluation in agriculture statistics

The stage of reform implementation does not seem to fully reflect the actual progress made. The previous ERP indicated that trainings could not be organised in 2020 due to COVID-19 and several activities remained limited. According to the current ERP, only four training courses were organised and 10 more are planned for 2022. This means that capacity building training activities are only at mid-stage of implementation and have not progressed as desired.

The ERP also points to advances in terms of information systems improvement studies and development of business intelligence, decision support and reporting systems, but information on these activities is limited.

Measure 4: Support mechanism will be established for the replacement of inefficient electric motors used in industry with efficient ones

Agreeing with the reporting and scoring.

Measure 5: Establishing Model Factories (Capability and Digital Transformation Centres) to increase the efficiency of SMEs and to enable their digital transformation

This measure was rolled-over from previous years and is already at an advanced stage of implementation. However, reporting on the measure is insufficient and is not based on progress towards indicators, particularly for indicators like the number of businesses served and number of Turkish and Syrian citizens employed under the project. In addition, the employment indicator had been changed to 'the number of companies supported by KOSGEB' in the rolled-over version (measure 9 in the new ERP). This employment target has probably not been met and the indicator has now been changed. Furthermore, according to the 2021-2023 ERP, the target for the number of businesses to be served was 500 for 2021, whereas in the new ERP the actual number for 2021 is 250. The measure's completion score can therefore not be considered a "4".

Measure 6: Increasing tourism market share and brand value

For this measure, information is missing on the progress made on the activities planned for 2021. The scoring could therefore be an overestimate, and could be lowered to "3".

Measure 7: Establishment of SME Guidance and Counselling System

The system seems operational as it can be tested on KOSGEB's website (i.e. it is possible to apply online to become a technical consultant). However, it is unclear whether the ambitious targets of 1250 technical consultants authorised and 750 SMEs serviced have been met. In any case, it is not considered an appropriate measure for business environment. Although the measure can be excluded from the document, there is not enough information to confirm that it has been fully implemented.

Measure 8: Preparing new legislation for easing private sector investments

The Commission agrees with the reporting and scoring.

Measure 9: Reducing Unregistered Employment by Focusing on Increasing Audit Capacity in Non-Agricultural Sectors

The level of reform implementation is low. Only 50 social security controllers were recruited in 2021, which is below the target. The score is overestimated and should be lowered to "3".

Measure 10: Increasing the number and efficiency of business development, incubation and accelerator centres in order to support innovative entrepreneurship

The measure can be excluded from the ERP, in its current shape. This decision is not based on the completion of the measure but on the fact that Turkey considers the measure's actions to be continuous and regular services that do not correspond to a reform measure. The Commission does not agree that the measure, as an objective/target, is completed, i.e. it is not clear if the business development, incubation and accelerator centres are made more efficient.

Measure 11a: Prioritizing technological product investments to increase the technology level and export capacity of SMEs and supporting the commercialization of R&D projects

The information provided on the implementation is insufficient. There is no information on indicators.

Measure 11b: Enhancing the R&D and innovation activities of SMEs; and the development and implementation of mechanisms to encourage and facilitate technology-based and innovative SMEs access to finance, participation in mentoring and cooperation networks

The Commission agrees with the reporting and scoring.

Measure 12: Supporting competent research infrastructures on a performance basis within the new legal framework

This measure was given a score of "4", which means that implementation is advanced. The 2021-2023 ERP envisages that three new research infrastructures will be supported through the implementation of Law No. 6550. However, it seems that this target was not achieved in 2021. The number of supported research institutions remains the same (i.e. 7). Although the progress in the initial years is commendable, a slowdown was observed in 2021. The overall score could be "4" but if the score only relates to 2021, then it should be lowered to "3": implementation ongoing with some initial results.

Measure 13: Update of Turkey-EU Customs Union

"Update of the Turkey-EU Customs Union" is not considered a reform measure.

Measure 14: Dissemination of pre-school education

The Commission agrees with the implementation of the activities planned for 2021. However, pre-school education was not necessarily rolled out in Turkey in 2021. This can only be confirmed by official school attendance figures. The score is overestimated and should be lowered to '4'.

Measure 15a: Increasing the reading culture

The Commission agrees with the scoring.

Measure 15b: Increasing the reading culture (Z-libraries)

The Commission agrees with the scoring.

Measure 17: Updating of curricula in vocational and technical education

The Commission agrees with the scoring. The implementation of this measure is well advanced.

Measure 18: Expansion of occupational health and safety activities in schools and institutions

The Commission agrees with the scoring.

Measure 19: Job clubs

The Commission agrees with the reporting and assessment. Of the nine new job clubs planned, only five were actually opened. Job club leadership training was provided for 50 job and vocational counsellors by the end of October 2021, while the target was 100.

Measure 22: Professions of the future

Agreeing with the reporting, implementation ongoing with some initial results (3). The activities were implemented, but the targets have not been realised.

Measure 24: Dissemination of family-oriented social services models: Foster family service

The score of '3' is appropriate, but the description should include the number of children benefiting from these programmes compared to a year ago as this would show if any real progress has been made. More details are also needed on the quality of the services.

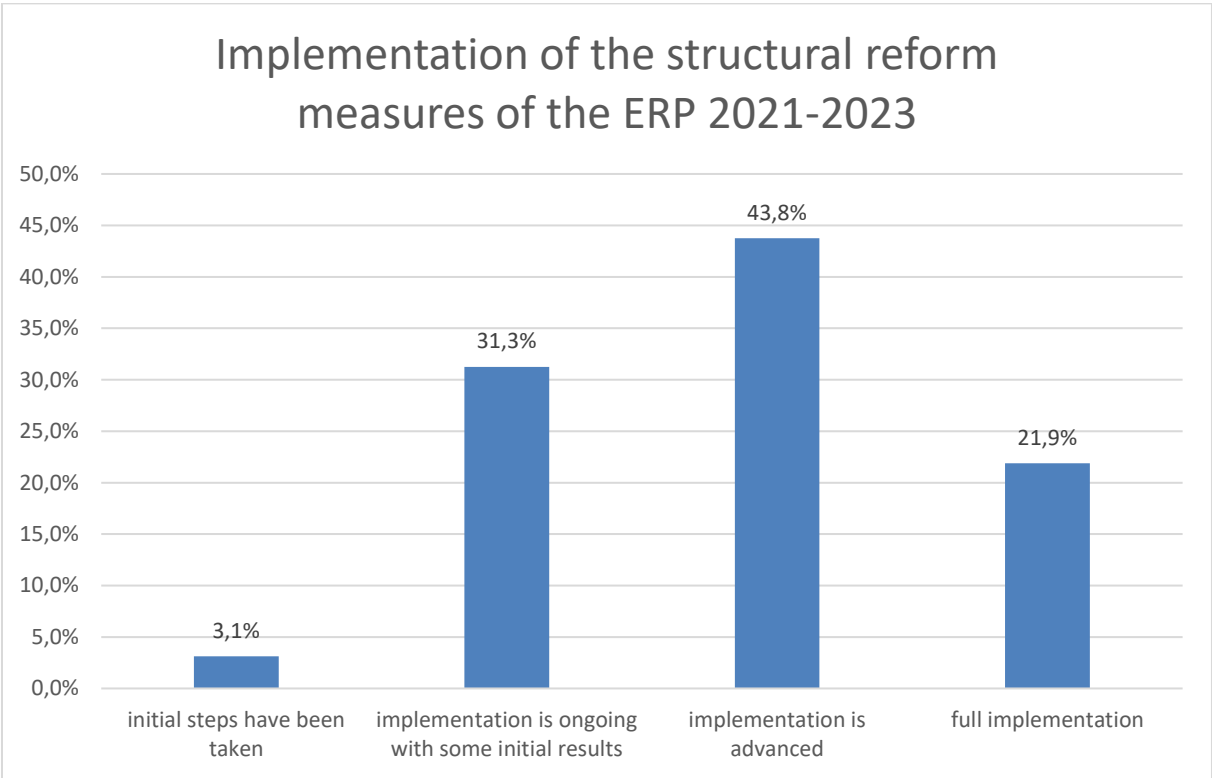
Measure 26: Strengthening the Ministry of Health's COVID-19 response capacity

In general, Turkey has successfully implemented this measure and delivered good results. However, there is a discrepancy between the initially planned activity (where emphasis is placed on the production of the rapid antigen test kits) and the actual reported implementation (rapid antigen kits were purchased and not produced as initially planned). In light of this discrepancy, the score is overestimated and should be lowered to '4'.

The average score for implementing the measures in 2021 is 3.8 out of 5, which is better than the previous year (2.4).

As to Turkey’s reporting on the activities carried out, the level of detail varies still between measures. A detailed scoring for the planned activities in 2021 has been provided for only one measure.

For seven measures, full implementation of the steps foreseen in the measure for 2021 can be noted; these fall in the areas of renewable energy, SME guidance, innovative entrepreneurship, pre-school education and vocational training. The measure related to the EU-Turkey Customs Union is not considered as a structural reform in the context of the ERP, since its implementation does not depend on Turkey alone.



ANNEX D: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The 2022-2024 ERP was submitted to the Commission on 31 January 2022. Overall, it has followed the Commission's guidance note.

Inter-ministerial coordination

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

Stakeholder consultation

The ERP is based on the 11th Development Plan (2019-2023) approved by the Turkish Parliament on 18 July 2019. Furthermore, it was prepared in line with the 2021-2023 New Economy Programme and the 2021 Presidential Annual Programme, which are both implemented upon Presidential Decision. The Development Plan was developed in a broad consultation process with stakeholders and experts, involving working groups and ad hoc committees. However, the reports established by the working groups have not been made public. No specific consultation of external stakeholders on the draft ERP took place and no draft was made available to the public before its adoption.

Macroeconomic framework

The chapter on the macroeconomic framework broadly follows the outline provided in the guidance note. It succinctly covers nearly all of the required elements with one important exception – it does not present an alternative scenario. This omission is repetitive and is a major drawback, especially in view of the high domestic and global uncertainty. The analysis would have benefited from further improving the links between the macroeconomic and fiscal framework sections and with the macro-relevant structural reforms. The presentation and analysis of risks could also be expanded and deepened.

Fiscal framework

The chapter on the fiscal framework closely follows the outline provided in the guidance note. It covers all major elements and provides extensive information on the 2022 budget. It is less detailed on the medium-term plans and the underlying measures. The section on contingent liabilities could be expanded to systematically cover all sources of liabilities. The section on public finance risks could be further developed. The fiscal framework chapter could be expanded to cover elements related to fiscal rules and the medium-term budgetary framework.

Structural reforms

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

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