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From the ringside

Looking at reforms in Turkey

ISTANBUL: A seminar on cross-country reform experience arranged by the Turkish Industrialists and Businessmen Association (TUSIAD) on the eve of the annual meeting of the Board of Governors of the Asian Development Bank has brought me to Istanbul. Both Anne Krueger, First Deputy Managing Director of the IMF, and I are speakers at the event.

Turkey is clearly at the crossroads of history. Looking from the terrace of the Ciragan Palace Hotel on the banks of Bosphorus, one has a clear view of the Trans Asian bridge which links Europe and Asia. One moves from one continent to the other by simply driving over the bridge. However, Turkey has no aspiration to be seen as part of Asia and has been seeking closer ties with Europe from the 1960s.

Much earlier, the series of reforms known as TANZIMAT, introduced during the mid-19th century of the Ottoman empire, was based on European ideas of property rights, education and taxes. The reforms under General Mustafa Kemal, the folklore hero who created the Republic and was subsequently known as Attaturk (father of Turkey), drove Turkey firmly in the European direction. This aspiration never subsided.

Attempts began in 1963 when it was admitted as an associate member of the then European Economic Community. The country formally applied for full membership in 1987, but it was only in 1999 that it was officially recognised as a candidate country and was approved to undertake negotiations in December 2004. The commencement of these negotiations last December was hailed by the Turkish people as the ‘‘dawn for a better tomorrow’’. Since then, significant economic changes are well underway to meet the conditions for Turkish accession to the European Union.

It is somewhat ironic that while the country aspires to be part of Europe and the economic policy changes are clearly made with an eye to this future, the past still clings. Past economic mismanagement has forced Turkey to enter for the 19th time with an arrangement with IMF, this time for a $10 billion loan. The need for such a loan was brought after a severe financial crisis in 2001, and meeting IMF conditionalities since then has been a roller-coaster ride. The IMF conditions involved legislation for reforming social security, banking sector, tax administration and reining in controversial regional aid programmes. Prime Minister Erdogan and the Treasury Minister Ali Babacan hope for Parliamentary approval soon.

Uncertainty has been a feature of the Turkish economy — inflation after touching 110% in 1980 and again in 1986 to 110% and in 1995 at 85% has been brought down to 11.4% in 2004-05. Similarly, GDP growth has fluctuated wildly. Ricocheting from 7% in 1992 to minus 5% in 1994, and again minus 7% in 2000, Turkey’s growth rate has touched 9% in 2004-05 with a likely growth of 6.5% during the current year. Some of the challenges which the economy continues to face include the following:

• Sustaining fiscal correction and curtailing devolution to local bodies while improving the quality of their expenditure.

• Mainstreaming 30% of the ‘‘informal economy’’ by moderating tax rates and building a virtuous circle around improved compliance based on tax rationalisation. Many argue that Turkey is on the downward-sloping side of the Laffer curve — in which lowering tax rates will actually increase revenues.

• Re-starting the stalled privatisation programme (including sale of TUPRAS — the Oil Refinery, Turk Telekom, Petkim, a petro-chemical firm, the State-owned drinks and tobacco companies) as well as deregulating its Civil Aviation sector. The success of the privatisation programme would require not only the political will that seems to be available but also adequate international investor interest in order to ensure that fair prices are realised from their sale.

• In other areas of foreign investments, Turkey’s status as a potential EU partner does not seem to help much in attracting investor interest: from 1990 until last year, annual foreign investmnt averaged just $1 billion. A new law on foreign direct investment adopted in June 2003 guaranteeing equal treatment for domestic and foreign investors appears to have helped, as foreign investment improved to $2.6 billion in 2004. Nevertheless, the Chairman of YASEDI, the Foreign Investors Association, recognises change but still finds hurdles in legal and regulatory framework, tax reforms and bureaucratic red tape as serious obstacle.

• Inability of Motorola and Nokia, two mobile-phone companies, to recover $5 billion awarded to them by an American Court in damages and compensation from the powerful Ozan family highlights corruption as a dominant deterrence in investors’ psyche as also the opaqueness of regulatory and legal procedures. Turkey may not be the world’s most corrupt country but there are few parallels where corruption is routinely cited as a deterrent to foreign investment.

• Cohesiveness of economic reforms is contingent on income redistribution. The Economist survey on Turkey brings out that the gap between the countries rich and poor is vast with Istanbul and Ankara alone accounting for around 30% of GDP. The richest region of the country has a GDP per person which is six times of the poorest region around the cities of Karz, Agri and toward Mt. Ararat. A progressive fiscal policy with greater dependence on Direct Taxes instead of Indirect Taxes along with vastly improved quality of enforcement and tax administration is inescapable. Unless inequality is redressed, the consensus for economic change and reforms, on which depends accession to the EU and continued access to IMF recourse, could get jeopardised.

From India’s point of view, a lot of this may be quite familiar. However, our size, diversity and the federal nature of our polity makes comparison difficult.

The acceleration of Turkish reforms has been prompted by a clear and tangible external set of hurdles. It needs to clear them to secure access to the EU. Accession to EU has been accepted as a panacea to its multiple economic problems and the historical baggage of many failed policies. This aspirational urge has a strong political commitment.

India too, has aspirations to be an economic superpower for which a 8% growth rate is inescapable. There is, however, no set of benchmarks on this accepted growth trajectory. Nobody has clearly outlined what it takes to be an economic superpower. The revised Tenth Plan will have a timetable of action but no external compulsion to meet this deadline. At one level, this is comforting. It is both a boon and a curse. A boon because it allows all creativity, ingenuity and adaptation to local conditions, but it can be a curse because it does not give a clear target to focus coherently on the politically difficult measures on which national consensus is necessary.

The ‘‘aspirational anguish’’ of Turkey may be inapplicable to India, but equally, much greater policy coherence and even more accountability is necessary to meet our aspirations.

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