

Document of
The World Bank

REPORT NO. ICR 00001008

IMPLEMENTATION COMPLETION AND RESULTS REPORT
(IBRD-74690)

ON

LOANS IN THE TOTAL AMOUNT OF

US\$500 MILLION

TO THE

REPUBLIC OF TURKEY

FOR A COMPETITIVENESS AND EMPLOYMENT DEVELOPMENT POLICY LOAN
(CEDPL)

APRIL 1, 2009

Private and Financial Sector
Turkey Country Department
Europe and Central Asia Region

TURKEY- GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of March 31, 2009)

Currency Unit	Turkish Lira (TL)
US\$ 1.00	1.6670 TL
YTL 1.00	0.59 US\$

WEIGHTS AND MEASURES

Metric System

ABBREVIATION AND ACRONYMS

BOP	Balance of Payments
BRSA	Banking Regulation and Supervision Agency
CAD	Current Account Deficit
CAE	Country Assistance Evaluation
CAS PR	Country Assistance Strategy Progress Report
CBRT	Central Bank of the Republic of Turkey
CEM	Country Economic Memorandum
CEN	European Committee for Standardization
CENELEC	European Committee for Electrotechnical Standardization
CIT	Corporate Income Tax
CMB	Capital Markets Board
CPI	Consumer Price Index
CPS	Country Partnership Strategy
DIS	Direct Income Support
DPL	Development Policy Loan
EA-MLA	European Co-operation for Accreditation - Multilateral Agreement
EBA	Execution and Bankruptcy Act
EC	European Commission
EIA	Environmental Investigation Agency
ERL	Economic Reform Loan
EU	European Union
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
FX	Foreign Exchange
GDP	Gross Domestic Product
GDPA	General Directorate of Public Accounting
GERD	Gross Expenditures on R&D
GFS	Government Financial Statistics
GNP	Gross National Product
HCP	High Council of Privatization
IAF-MLA	International Accreditation Forum –Multilateral Recognition Arrangement
IBRD	International Bank for Reconstruction and Development
ICA	Investment Climate Assessment
ICS	Investment Climate Survey
ICT	Information and Communication Technologies
IFRS	International Financial Reporting Standards
ILAC-MRA	International Laboratory Accreditation Cooperation –Mutual Agreement
IMF	International Monetary Fund
ISPA	Investment Support and Promotion Agency of Turkey
IPO	Initial Public Offering
IPPC	Integrated Pollution Prevention and Control
IPR	Intellectual Property Rights

ISE	Istanbul Stock Exchange
ISIC	International Standard Industrial Classification
ISO	International Organization for Standardization
IT	Information Technology
KOSGEB	Small and Medium Industry Development Organization
M&E	Monitoring and Evaluation
MEF	Ministry of Environment and Forestry
MFC	Mortgage Finance Corporations
MOF	Ministry of Finance
MYOs	Vocational Schools
NDP	Ninth Development Plan
NIS	National Innovation System
NQS	National Quality System
OECD	Organization for Economic Cooperation and Development
PA	Privatization Administration
PASB	Public Accounting Standards Board
PDEF	Provincial Directorates of Environment and Forestry
PEM	Public Expenditure Management
PFMC	Public Financial Management and Control
PFPSAL	Programmatic Financial and Public Sector Adjustment Loan
PIP	Public Investment Program
PISA	Program for International Student Assessment
PIT	Personal Income Tax
PPA	Public Procurement Agency
PPDPL	Programmatic Public Sector Development Policy Loan
PSSP	Privatization Social Support Project
R&D	Research and Development
SBA	Stand-By Arrangement
SDIF	Saving Deposits Insurance Fund
SDR	Special Drawing Rights
SME	Small and Medium Scale Enterprises
SOEs	State Owned Enterprises
SPA	Special Provincial Administration
SPO	State Planning Organization
TCA	Turkish Court of Accounts
TFP	Total Factor Productivity
TPE	Turkish Patent Institute
TSE	Turkish Standards Institute
TTGV	Technology Development Foundation of Turkey
TUBITAK	The Scientific and Technological Research Council of Turkey
TURKAK	Turkish Accreditation Agency
TURKSTAT	Turkish Statistical Institute
UHI	Universal Health Insurance
UHIF	Universal Health Insurance Fund
UME	National Metrology Institute
UNCITRAL	United Nations Commission on International Trade Law
VAT	Value Added Tax
VC	Venture capital
TL	Turkish Lira

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THE REPUBLIC OF TURKEY
COMPETITIVENESS AND EMPLOYMENT DEVELOPMENT POLICY LOAN
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MAP

A. Basic Information			
Country:	Turkey	Program Name:	Competitiveness and Employment Development Policy Loan (CEDPL)
Program ID:	P074181	L/C/TF Number(s):	IBRD-74690
ICR Date:	04/01/2009	ICR Type:	Core ICR
Lending Instrument:	DPL	Borrower:	REPUBLIC OF TURKEY
Original Total Commitment:	USD 500.0M	Disbursed Amount:	USD 506.4M
Implementing Agencies: Undersecretariat of Treasury			
Cofinanciers and Other External Partners:			

B. Key Dates				
Process	Date	Process	Original Date	Revised / Actual Date(s)
Concept Review:	03/16/2007	Effectiveness:		07/18/2007
Appraisal:	05/23/2007	Restructuring(s):		
Approval:	06/28/2007	Mid-term Review:		
		Closing:	09/30/2008	09/30/2008

C. Ratings Summary	
C.1 Performance Rating by ICR	
Outcomes:	Satisfactory
Risk to Development Outcome:	Moderate
Bank Performance:	Satisfactory
Borrower Performance:	Satisfactory

C.2 Detailed Ratings of Bank and Borrower Performance (by ICR)			
Bank	Ratings	Borrower	Ratings
Quality at Entry:	Satisfactory	Government:	Not Applicable
Quality of Supervision:	Satisfactory	Implementing Agency/Agencies:	Not Applicable
Overall Bank Performance:	Satisfactory	Overall Borrower Performance:	Satisfactory

C.3 Quality at Entry and Implementation Performance Indicators			
Implementation Performance	Indicators	QAG Assessments (if any)	Rating:
Potential Problem Program at any time (Yes/No):	No	Quality at Entry (QEA):	None
Problem Program at any time (Yes/No):	No	Quality of Supervision (QSA):	None
DO rating before Closing/Inactive status:			

D. Sector and Theme Codes		
	Original	Actual
Sector Code (as % of total Bank financing)		
Banking	13	13
Central government administration	15	15
General industry and trade sector	54	54
Housing finance and real estate markets	13	13
Sub-national government administration	5	5
Theme Code (Primary/Secondary)		
Export development and competitiveness	Secondary	Secondary
Personal and property rights	Secondary	Secondary
Regulation and competition policy	Primary	Primary
State enterprise/bank restructuring and privatization	Secondary	Secondary
Tax policy and administration	Secondary	Secondary

E. Bank Staff		
Positions	At ICR	At Approval
Vice President:	Shigeo Katsu	Shigeo Katsu
Country Director:	Ulrich Zachau	Ulrich Zachau
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F. Results Framework Analysis

Program Development Objectives (from Project Appraisal Document)

The CEDPL supports legal, institutional, and structural reforms that promote growth and the creation of more and better jobs in Turkey by helping (a) maintain the currently enabling macroeconomic framework; (b) improve the investment climate - including a large program of privatization of state owned enterprises (SOEs), (c) set the foundations for overhauling labor market regulations in the future, (d) increase access to investment capital, and (e) promote the generation of knowledge and innovation, the adoption of new technologies, and upgrading the skills of the labor force.

Revised Program Development Objectives (if any, as approved by original approving authority)

(a) PDO Indicator(s)

Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years
Indicator 1 :	Maintain Macroeconomic Stability			
Value (quantitative or Qualitative)				
Date achieved				
Comments (incl. % achievement)				
Indicator 2 :	Improve Investment Climate			
Value (quantitative or Qualitative)				
Date achieved				
Comments (incl. % achievement)				
Indicator 3 :	Increase employment			
Value (quantitative or Qualitative)				
Date achieved				
Comments (incl. % achievement)				
Indicator 4 :	Increase access to investment capital			

Value (quantitative or Qualitative)				
Date achieved				
Comments (incl. % achievement)				
Indicator 5 :	Promote the generation of knowledge and innovation, adoption of new technologies, and upgrading of labor force skills			
Value (quantitative or Qualitative)				
Date achieved				
Comments (incl. % achievement)				

(b) Intermediate Outcome Indicator(s)

Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years
Indicator 1 :	Consumer Price Index (% change)			
Value (quantitative or Qualitative)	9.23%	7.5%		10.06%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 2 :	Current account deficit (% GDP)			
Value (quantitative or Qualitative)	6.1%	Long term decline		5.7%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 3 :	Public Debt / GDP (%)			
Value (quantitative or Qualitative)	34%	Long term decline		29%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				

Indicator 4 :	FDI (in million USD)			
Value (quantitative or Qualitative)	20,185	Long term increase		22.046
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 5 :	FDI (% of GDP)			
Value (quantitative or Qualitative)	3.83%	Long term increase		3.36%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 6 :	Share of informal sector workers in total			
Value (quantitative or Qualitative)	47.1%	Long term decrease		43.4%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 7 :	Participation of SOEs in GDP (%)			
Value (quantitative or Qualitative)	1.89%	Reduction as a result of privatization		1.58%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 8 :	Budgetary support for SOEs (% of GDP)			
Value (quantitative or Qualitative)	0.69%	Decrease from 2006 ratio		0.29%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 9 :	Time for Registering Firms (days)			
Value (quantitative or Qualitative)	9	Declining trend		6
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				

Indicator 10 :	Number of procedures to acquire a license			
Value (quantitative or Qualitative)	25	Declining substantially		25
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 11 :	Share of Corporate Income Tax in Overall Tax Revenues (%)			
Value (quantitative or Qualitative)	8.2%	Increasing due to lower informality		9.2%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 12 :	Employment rates (%)			
Value (quantitative or Qualitative)	43.2%	46.8% (By 2013, CPS matrix)		44.3%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 13 :	Unemployment rates (%)			
Value (quantitative or Qualitative)	9.9	Declining over the longer term		9.9
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 14 :	Capital Adequacy Ratio (%)			
Value (quantitative or Qualitative)	21.60%	Maintain current ratio		17.53%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 15 :	Volume of housing finance (as % of GDP)			
Value (quantitative or Qualitative)	2.90%	Increase as a result of deeper financial markets		4.00%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				

Indicator 16 :	Non Performing Loans/Total Loans			
Value (quantitative or Qualitative)	3.60%	Maintain the current ratio		3.77%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 17 :	Number of patents			
Value (quantitative or Qualitative)	4,303	Increase from 2006		4,871
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				
Indicator 18 :	Industry-funded R&D in total R&D spending			
Value (quantitative or Qualitative)	46%	Increase from 2006		47.1%
Date achieved	12/31/2006	12/31/2008		12/31/2007
Comments (incl. % achievement)				

G. Ratings of Program Performance in ISRs

No.	Date ISR Archived	DO	IP	Actual Disbursements (USD millions)
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H. Restructuring (if any)

Not Applicable

1. PROGRAM CONTEXT, DEVELOPMENT OBJECTIVES AND DESIGN

1.1 Context at Appraisal

Country and Sector Background. Employment growth and long-term macroeconomic stability are key policy challenges for Turkey. After suffering a major macroeconomic crisis in 2001, the Turkish economy grew at an average of 6.8 % in the period 2002-2007. Output increased more than a third in this period—the strongest growth performance among OECD members. Growth also reduced poverty significantly. The reversal in economic performance was largely the result of five factors: first, broad political stability that helped assure policy continuity during that period; second, a macroeconomic policy framework centered on fiscal discipline and an independent monetary policy, which led to reduced public sector deficits, lower public debt levels, and helped anchor inflationary expectations; third, an improved investment climate associated with the implementation of a number key structural reforms (social security reform, financial sector reform, energy sector reforms, and an ambitious privatization program); fourth, a global economic environment of high liquidity benefiting emerging markets; and fifth, Turkey signaled commitment to improved policies by pursuing EU membership. On the latter, the government’s reforms geared towards raising competitiveness, improving financial intermediation, and expanding employment opportunities, which are being supported by the Bank, are fully consistent with the Lisbon Agenda.

After the recovery from the 2001 crisis, the country started addressing second and third generation policy issues. Against a background of low employment generation, declining employment ratios, high informality, and comparatively high unemployment, the authorities were determined to sustain rapid growth and to improve the quality of life of its citizens. In 2007, the overall employment rate for ages between 15 and 64 in Turkey was 45.8 percent, significantly lower than the 65.4 percent average in EU-27 countries and far from the Lisbon target of 70 percent by 2010. Unemployment and informality rates were comparatively high as well at around 10 and 47 %, respectively. Employment generation did not occur hand in hand with the growing economy partly due to the massive structural change the country is undergoing, with agriculture shedding large quantities of labor, and partly because of the lack of flexibility in the labor market. In response, the authorities adopted—and are implementing—a comprehensive long term program to modernize the economy: the 9th Development Plan (NDP). The NDP’s broad policy vision is “*a Turkey which grows in stability, shares her income more equitably, is competitive at a global scale, transforms into an information society and has completed the stage of legal harmonization for EU membership.*” In order to achieve this vision, the NDP comprises five “development axes” or strategic areas of action, namely: (a) Increasing Competitiveness, (b) Increasing Employment, (c) Strengthening Human Development and Social Solidarity, (c) Ensuring Regional Development and (d) Increasing Quality and Efficiency in Public Services.

Rationale for Bank Assistance. In line with the major challenges stated in the NDP, the Competitiveness and Employment Development Policy Loan (CEDPL) was designed to assist the Government in sustaining growth, increasing competitiveness and generating

more jobs. The CEDPL program was fully aligned with the NDP (Table 1). The CEDPL was also expected to contribute to the achievements of the outcomes outlined in the 2003 CAS and the 2005 CAS Progress Report (CAS PR), including: (a) making the economy more resilient to crises that disproportionately affect the most vulnerable; (b) making the business environment more attractive with increased emphasis in the knowledge economy, (c) contributing to sustainable economic growth that is critical to pull many of the poor out of poverty; and (d) promoting human development to create opportunities for the poor, including more and better jobs.

Reflecting the complexity and nature of reform processes, while designed as a free-standing operation, the CEDPL was embedded in a programmatic framework. More specifically, while the original intention was to prepare this operation as the first in a programmatic series, due to the political uncertainty at that time (to be discussed below), the Government and the World Bank agreed to proceed with it as a stand-alone operation in order to preserve the policy dialogue with the authorities while still acknowledging possible emerging risks to the sustainability of the reform effort and the achievement of the development objectives.

Table 1: Elements of the Ninth Development Plan (2007-2013) Supported by CEDPL

<i>Enhancing Export Competitiveness, FDI and the Investment Climate</i>
<ul style="list-style-type: none"> • Making macroeconomic stability permanent • Reducing informality in the economy • Increased investments in R&D • Simplification of the tax mechanism and transaction costs • Improved IPR implementation and enforcement • Continuation of the Reform Program for Improving the Investment Environment in an effective manner • Reduction in the share of SOEs in national income and employment as a result of privatization
<i>Improving Financial Intermediation</i>
<ul style="list-style-type: none"> • Increased depth of capital markets • Establishment of autonomous regulatory structure for all financial institutions • Improvement of accounting and supervision standards in the financial system • Activities to encourage corporate governance principles • Improvement of minority shareholder rights
<i>Expanding Employment Opportunities</i>

- Reduction of burden (costs) on employment
- Policies/programs to encourage participation of young and women
- Labor market with more flexible and active structure by joint evaluation of flexibility and job security
- Adoption of lifelong learning strategy geared to skill building

1.2 Original Program Development Objectives (PDO) and Key Indicators.

Based on the Program Matrix embedded in the CEDPL program document (See Annex 2), the following objectives and indicators were identified for the CEDPL:

Objectives

- Maintaining an enabling macroeconomic framework.
- Improving further the investment climate.
- Setting the foundations for overhauling labor market regulations as a way to increase employment
- Increasing access to capital and credit
- Promoting the generation of knowledge and innovation, the adoption of new technologies, and upgrading of labor force skills

Key indicators

Success in reaching the objectives mentioned above was expected to be gauged by the behavior of the following indicators:¹

- Macroeconomic stability:
 - Inflation (CPI)
 - Current account deficit
 - Public debt ratios
- Investment climate:
 - FDI flows (in US\$)
 - FDI flows (% of GDP)

¹ Because some of the indicators were defined in a vague manner, the team retrofitted the results framework. However, this does not preclude a proper assessment of whether outcomes were achieved.

- Share of GDP produced by SOEs
- Budgetary support for SOEs
- Time for Registering Firms (days)
- Share of Corporate Income Tax in Overall Tax Revenue (%)
- Labor markets:
 - Employment rates (%)
 - Unemployment rates (%)
- Increase Access to Investment Capital/Financial sector:
 - Capital Adequacy Ratio (%)
 - Non-Performance Loans as % of the Total
 - Mortgage financing (as % of GDP)
- Knowledge and Innovation:
 - Number of patents
 - Industry-funded R&D in total R&D spending

1.3 Original Policy Areas Supported by the Program (as approved)

In line with the objectives –and indicators—mentioned before, the CEDPL supported the authorities’ program in **five policy areas**:

- **The maintenance of an adequate macroeconomic framework**, such as the framework that had underpinned the rapid economic growth that had begun in 2002.
- **Improving the investment climate** to foster the investment and productivity increases required to maintain rapid growth and generate sufficient formal sector jobs to absorb the large supply of labor resulting from the country’s demographic dynamics and structural transformation.
- **Laying the foundations for changing labor market regulations**—including a diagnosis of labor markets and the discussion of policy options for such delicate reforms.
- **Consolidating the soundness of the financial sector** and increasing access to investment credit and other forms of investment capital.

- **Increasing the capacity of the private sector to innovate**, adopt new technologies and quality standards as well as a diagnosis of the policies needed for endowing the labor force with better skills, with a view of augmenting competitiveness over the medium and long.

2. KEY FACTORS AFFECTING IMPLEMENTATION AND OUTCOMES

2.1 Program Performance

To support measures in the previously mentioned areas, CEDPL included the following **prior, core policy actions**:

- The government maintained a **satisfactory macroeconomic framework**. Bank staff found the existing macroeconomic framework to be satisfactory. IMF Article IV consultations and the sixth review of the Stand-by arrangement had been completed successfully in May 2007.
- The Borrower had **privatized state owned companies** and sold state-owned assets with total privatization revenues amounting to the equivalent of US\$17.7 billion during 2005 and the first six months of 2006 (compared to \$6 billion in the five years prior), under **transparent competitive process** acceptable to the Bank and **with due regard to applicable environmental regulations**. These efforts were aimed at minimizing state involvement in economic activities, relieving the financial burden on the national budget, increasing competition, and developing domestic capital markets.
- The maximum **corporate income tax (CIT) bracket** had been **reduced from about 30 to 20 percent of taxable profits** and CIT allowances have been eliminated. CIT rates had been high and complex. Previous CIT investment allowances distorted relative prices of capital and labor in ways which provided artificial incentives to adopt capital intensive and labor saving technologies. The comparatively high CIT rates increased incentives for informality, decreased incentives to hire workers, and, everything else the same, affected FDI negatively.
- The authorities had **completed successfully a functional restructuring of the tax administration framework** including: (a) reform of the local tax offices; (b) establishment of a revenue administration responsible for tax collection and with direct authority over provincial and local collection offices; and (c) reforms to the Large Tax Payer Unit aimed at improving collection efficiency while reducing compliance costs for the firms targeted had been completed.
- In order to bring better access to investment capital in an environment of financial sector stability by reducing state ownership in the banking sector, the authorities had **completed an Initial Public Offering (IPO)** for about 25 percent of the outstanding shares of **Halk Bank**.

- **A new law on residential real estate mortgaging had been enacted.** The law was drafted following international best practices with the aim of increasing access to housing, boosting investment in construction, and helping banks manage their risks in financing the sector.
- The Government had taken steps to improve protection of Intellectual Property Rights (IPRs) and facilitate patent application by enacting **a law on adoption of the Agreement on Amendment to the European Patent Convention was enacted.**
- **TURKAK (Turkish Accreditation Agency) had been accepted as a signatory of European co-operation for Accreditation - Multilateral Agreement (EA-MU)** in the areas of calibration, testing, quality system certification and inspection and as a signatory of the International Laboratory Accreditation Cooperation – Mutual Agreement (ILAC-MRA) in the areas of testing and calibration. This measure was part of an effort to improve quality standards and thus increase productivity through simplification and rationalization of production and distribution processes.

There were other actions or elements included in the program which were not part of the core prior actions but nevertheless played an important role in the outcome of the CEDPL. Among them:

- IMF Stand-by supported program in place until May 2008.
- The top Personal Income Tax (PIT) rate reduced from 40 to 35 %. Taxation of wage and non-wage income unified. Number of tax brackets reduced from 5 to 4.
- A Review of existing business regulations and licensing requirements was undertaken.
- Curricula for five educational programs were reformed to reflect needed skills and competencies and have been implemented for all students in 9th and 10th grades in 2006/07.
- To consolidate the soundness of the financial sector, the Banking Regulation and Supervision Agency (BRSA) published and implemented 24 regulations required for the effective implementation of the 2005 Banking Law.
- Credit history evaluation and performance disclosure mechanisms were put in place.

2.2 Major Factors Affecting Implementation:

Government's commitment. Despite the difficult political environment when the CEDPL was designed and negotiated (see below), the government successfully implemented all prior actions, some of which were socially unpopular with selected organized groups (i.e. privatization of state-owned companies). This testifies to the government's commitment to its reform program. Moreover, the structural reforms completed and supported under the operation were by their nature difficult to reverse (privatization, mortgage law, tax administration), thus limiting the risk of backtracking reforms. Finally, the reforms

supported by CEDPL were fully consistent with the Government's own priorities in the areas of competitiveness and employment, thus reflecting a high degree of ownership on the Government's part.

Political environment. The CEDPL was negotiated just before the Parliamentary and Presidential elections of 2007 which had created a challenging environment for the government to implement socially difficult reforms, such as measures to increase the labor market flexibility. Labor market reforms were nevertheless implemented as part of the CEDPL 2 operation.

Analytical work. The 1993-2004 Country Assistance Evaluation found that little formal economic and sector analysis was carried out up to the late 1990s. Thereafter, the economic and sector analysis have become a larger part of the Bank's program. This approach has increased the effectiveness of the Bank involvement. As a result, CEDPL, and the specific measures supported by it, were informed by a large number of analytical work that contributed—and continues to contribute—to nourish a permanent and stable policy dialogue in the areas supported by the reform. Specifically, the Bank provided analytical support to the government's program through extensive economic and sector work on the program areas of the CEDPL, including through the: (a) Labor Market Study (2006), which identified flexibility and effective social protection as key policy elements for creating more and better jobs; (b) Country Economic Memorandum (2006), which examined the possible impact of lowering labor taxes on employment creation. (c) Investment Climate Assessment (ICA, in draft form at that time), which identified key constraints to higher investment flows and productivity gains (d) Joint Bank-Fund FSAP (2007), which identified remaining legislative and regulatory policy challenges, and (e) Education Sector Study (2006), which took an integrated view at the education sector, including how it prepares the young for the labor market and how skill mismatches can be reduced.

2.3 Monitoring and Evaluation (M&E) Design, Implementation and Utilization.

- ***Overall design.*** Given that this was a stand-alone operation, efforts were made to identify outcomes that could be measured shortly after program implementation. In this regard, the identified indicators were for the most part proxies for longer-term outcomes sought by the authorities. Moreover, the Bank team acknowledged that the attribution of overall development results to reforms supported by CEDPL needed to be fully assessed over time. A more meaningful measure of the program's success would therefore only be possible at the end of a prospective CEDPL 3, when the (CEDPL) program series is completed. Some indicators therefore can only fully assessed by then.²

² For example, indicators related to labor force skills (e.g., number of science and engineering graduates and post-doctoral fellows) and innovation (number of ISO 9001 certified firms and number of accredited testing and calibration laboratories) are linked to long-term horizon decisions by economic agents and thus only adjust to policy changes after some time lag. Short term impacts are marginal at best.

- *Other design issues.* Indicators were properly identified but some of them lacked specific targets and baselines, and at times were loosely defined. This made the task of assessing success unnecessarily difficult. Specifically, the supervision team needed to retrofit some of the indicators to allow for a proper evaluation of outcomes. To a large degree, this issue has been addressed during the preparation of a follow-on operation.

2.4 Expected Next Phase/Follow-up Operation:

The Second Competitiveness and Employment Loan (CEDPL 2) was approved by the Bank's Board in December 2008. CEDPL 2 builds on CEDPL and supports specific advances in the implementation of the government's competitiveness and employment agenda to a new stage. CEDPL 2 provides continuity to the CEDPL as evidenced by the implementation of key measures aimed at improving the investment climate, deepening capital markets and the enhancing employment opportunities:

- Enactment of the new research and development law, reform of customs administration, amendment to the Land Registry Law and satisfactory progress of the privatization program. These measures will improve the **investment climate** thus contributing to raising exports and FDI;
- Approval of the new Insurance Law and enactment of regulations to improve corporate governance in the capital markets to help **mobilizing domestic and foreign savings; and**
- Enactment of the first phase of the labor market reform and advances in defining competency-based occupation standards as part of the broader strategy to **improve employment opportunities**

3. ASSESSMENT OF OUTCOMES

3.1 Relevance of Objectives, Design and Implementation

The objectives, design and implementation of the CEDPL remain highly relevant with regard to Turkey's and the Bank's development objectives. While Turkey has made significant progress in putting in place a policy environment conducive of higher investment, productivity, employment and growth, the country still faces policy challenges in areas that are key to improving its investment climate, specifically in reducing the cost of starting a business, raising recovery rates from bankruptcy, reducing skills mismatches, and making its labor market more flexible. In this connection, the five policy pillars supported by the CEDPL have, if anything, gained importance in light of the global crisis. Moreover, employment growth—particularly formal employment—is likely to fall in the period to come, which would require a more determined effort to keep medium-term labor market reforms on track, specifically regarding increasing labor market flexibility and enhancing the protection of workers.

The CEDPL programmatic series is the corner stone of the Bank's support to the overall structural reform program of Turkey. The policy actions supported under this

program are directly linked to five of the development objectives spelled out in the CPS: (i) maintaining macroeconomic stability and sustaining economic growth, (ii) improving the investment climate and decreasing the informality of the economy, (iii) increasing labor market flexibility and improving skills, (iv) maintaining soundness of the financial system, and improving access to finance, and (v) enhancing technology adoption and innovation; The outcomes pursued by the CEDPL series fit into the broader results framework for the CPS.

CEDPL became the first in a series of operations designed to support the Government's competitiveness and employment policy reform agenda embedded in the NDP. The CEDPL 2 approved by the Bank's Board in December 2008 not only builds on the reforms supported by CEDPL, but also envisages Bank support for the next steps in the implementation of Turkey's competitiveness and employment agenda under a possible CEDPL 3. In this connection, the Country Partnership Strategy (CPS) discussed by the Board of Executive Directors in February 2008 is fully integrated with—and maps all planned Bank activities into—the Government's NDP. The CEDPL series therefore will continue to be an important instrument of the CPS.

3.2 Achievement of Program Development Objectives

Through the measures supported by the CEDPL series, Turkey has made significant progress in putting in place a policy environment conducive of higher investment, productivity, employment and growth. Major achievements in reducing the role of the state in economic activity (privatization) and reducing distortions (lower tax pressures) have made the economy more attractive for investment, particularly FDI. In that context, the overall results of the CEDPL as measured by the behavior of the identified indicators are broadly positive. Nevertheless, economic performance since the approval of CEDPL has been—and will continue to be—affected by global events beyond the authorities' control, most prominently: (a) a surge in commodity prices that lasted until mid-2008; and (b) the ramifications of the global credit crisis that started with the collapse of the housing sector in the United States. The flexibility built in the design of the CEDPL series as a programmatic series will nevertheless help shape the policies to be supported by the Bank in the future in the areas of employment generation and raising competitiveness.

A significant number of results indicators associated with the key objectives of CEDPL were identified (see Table II). 13 out of 19 indicators achieved results in line with the targets:

- **Policies to sustain macroeconomic stability were anchored to the IMF Stand-by arrangement that expired in May 2008.** The balance of payments current account deficit and the level of public debt declined in 2007, and most likely in 2008 as well. Inflation, which fell to 8.4 % in 2007 (from 9.7 % in 2006), increased again in 2008, mostly as a result of the surge in oil and food prices that reached a peak in mid-2008.
- **There was an improvement in the investment climate as measured by key related indicators.** FDI flows continued at high levels, though declined slightly

in terms of GDP. The significant package of privatization operations had an immediate effect on microeconomic performance, with the proportion of GDP attributed to SOEs production falling from 1.9 % of GDP in 2006 to 1.5 % in 2007. Perhaps more importantly, the amount of budgetary transfers to SOEs fell to a low of 0.34 % of GDP in 2007. Informal employment has declined in relative terms by about 4 percentage points from 2006 to 2007. Legal framework to start a business was improved to reduce the time needed to collect necessary documents and fulfill other requirements: the number of days to register a business was reduced from 9 to 6 days from 2006 to 2007³. In terms of operating a business, incentives to reduce informality were introduced. The reduction in the CIT rate led to an increase in the share of CIT in overall tax revenues from 8.2 % to 9.2 %.

- **Employment indicators point to only limited progress in labor market conditions.** The unemployment rate remained unchanged in 2007 from 2006 (about 10 %) and actually increased in 2008 to 12.3 percent as the economy began to suffer the effects of the global crisis. The challenge is formidable as the labor force in Turkey grows by about 4 % per year. A positive development was the approval by Parliament of a Labor Market Reform package in 2008. The Law included a 5 percentage point cut in employer's contributions for pensions, disability, and death insurance which now will be paid by Treasury. This reduces taxes on labor and, therefore, has a positive impact on employment. It also favors formal employment.
- **Financial markets have deepened despite international conditions.** Despite the international housing market collapse, the passage of the mortgage law had an immediate positive effect on housing finance, which went from less than 3 percent of GDP in 2006 to about 4 percent of GDP in 2008. Nevertheless, mortgage finance is still below comparable countries (In Mexico, for example, it represents 16% of GDP). Also, banking prudential indicators continue to show the relative strength of the domestic financial market, with capital adequacy ratios exceeding regulatory requirements by a large margin. Asset quality deteriorated very marginally despite a significant expansion in credit. The recent slowdown in the economy, however, is bound to affect more the quality of loan portfolios in the near future.
- **Promotion of knowledge and innovation is working.** The Law on Adoption of the Agreement on Amendment to the European Patent Convention was enacted and the Turkish Accreditation Agency was accepted as a signatory of the European co-operation for Accreditation. These improvements in the regulatory framework led to an increase in number of patents of about 10 percent in 2007, with a somewhat smaller increase in 2008. Funding of research and development by the industrial sector, that is, by the private sector, also increased, reaching 47 % of the total expenditures in research and development.

³ As measured by the Doing Business indicators in the 2007 and 2008 reports.

Table 2: Objectives, Indicators, Results and Contributing Measures⁴

Objective	Indicators	Results			Measure/s that contribute to Results
		Baseline (Generally as of end 2006)	Achieved (Generally as of end 2007)	Target (Taken from text or policy matrix of CEDPL)	
Maintain Macroeconomic Stability	Consumer Price Index (% change)	9.23%	10.06%	7.5% (Central Bank Target for 2009)	IMF Stand-By program in place until May 2008
	Current account deficit (% GDP)	6.1%	5.7%	Long term decline	
	Public Debt / GDP (%)	34%	29%	Long term decline	
Improve Investment Climate	FDI (in million USD)	20,185	22,046	Long term increase	<p>Maximum corporate income tax bracket reduced from about 30 to 20 % and capital investment CIT allowances eliminated</p> <p>Restructuring of the tax administration framework including reforms to the Large Tax Payer Unit aimed at improving collection efficiency while reducing compliance costs for the firms targeted</p> <p>Privatization of state owned companies and state-owned assets sold with total privatization</p>
	FDI (% of GDP)	3.83%	3.36%	Long term increase	
	Share of informal sector workers in total	47.1%	43.4%	Long term decrease	
	Participation of SOEs in GDP (%)	1.87%	1.51%	Reduction as a result of privatizations	

⁴ In some cases, the contributing measure is in the program but not as a core prior action.

	Budgetary support for SOEs (% of GDP)	0.69%	0.34%	Decrease from 2006 ratio	revenues amounting to the equivalent of US\$17.7 billion in the years 2005 and 2006, under transparent competitive process acceptable to the Bank and with due regard to applicable environmental regulations. Review of existing registration and licensing regulations with the view of unifying and streamlining procedures.
	Time for Registering Firms (days)	9	6	Declining trend	
	Number of procedures to acquire a license	25	25	Declining substantially	
	Share of Corporate Income Tax in Overall Tax Revenues (%)	8.2%	9.2%	Increasing due to lower informality	
Increase employment	Employment rates (%)	43.2%	43.1%	46.8% (By 2013, CPS matrix)	Personal Income Tax rate reduced from 40 to 35 %. Taxation of wages and non wages unified. Number of brackets reduced from 5 to 4 Maximum corporate income tax bracket reduced from about 30 to 20 and capital investment CIT allowances eliminated
	Unemployment rates (%)	9.9	9.9	Declining over the longer term	Review of existing regulations and licensing Curricula for five programs have been reformed to reflect needed skills and competencies and have been implemented for all students in 9 th and 10 th grades in 2006/07
Increase access to	Capital Adequacy Ratio	21.60%	17.53%	Maintain	The authorities completed an Initial Public Offering (IPO) for about 25 % of the outstanding shares of

investment capital	(%)			current ratio	Halk Bank
	Volume of housing finance (as % of GDP)	2.90%	4.00%	Increase as a result of deeper financial markets	A new law on residential real estate mortgaging enacted BRSA implementing 24 regulations supportive of the 2005 Banking Law, geared towards meeting international best practices
	Non Performing Loans/Total Loans	3.60%	3.77%	Maintain the current ratio	Credit history and performance disclosure mechanism functioning
Promote the generation of knowledge and innovation, adoption of new technologies, and upgrading of labor force skills	Number of patents	4,303	4,871	Increase from 2006	Law on adoption of the Agreement on Amendment to the European Patent Convention enacted TURKAK (Turkish Accreditation Agency) accepted as a signatory of European co-operation for Accreditation -
	Industry-funded R&D in total R&D spending	46%	47.1%	Increase from 2006	Multilateral Agreement (EA-MU) in the areas of calibration, testing, quality system certification and inspection and as a signatory of the International Laboratory Accreditation Cooperation –Mutual Agreement (ILAC-MRA) in the areas of testing and calibration

3.3 Justification of Overall Outcome Rating

Rating: Satisfactory

The development objectives of the operation were and remain highly relevant for Turkey's and the Bank's development agenda. Progress has been achieved in most key indicators, though in some cases the impact of designed policies has been so far modest. In any case, given the nature of the operation, results should also be judged by the consolidation of the reforms supported by CEDPL since they are expected to have full impact after certain time, possibly at the end of CEDPL 3. It is by then that we should

expect more definitive evidence on the success or not of the program as a whole. The current global crisis is nevertheless already having a significant effect on employment and economic welfare in general. The challenge for Turkey is to continue to pursue the appropriate reforms in this difficult environment.

4. ASSESSMENT OF RISK TO DEVELOPMENT OUTCOME

Rating: Moderate

The Turkish Government's proven commitment to its reform program provides comfort that the risks of a policy reversal or an interruption to the ongoing reforms are limited. Nevertheless, some of the remaining risks to the operation's development outcomes encompass: (i) external; and (ii) political risks.

Risks to the operation's outcomes encompass: (i) external; and (ii) political risks.

External Risks. High financing needs make Turkey vulnerable to a sudden reversal in capital flows, particularly at a time when global appetite for risk is at a low level. The main risk is worsening investor sentiment, whether due to domestic or external factors, leading to an abrupt capital outflow and real depreciation. Were this to happen, stronger fiscal accounts and strengthened financial sector should help Turkey avoid a systemic crisis, but growth and employment in the private sector could suffer a downturn.

Political Risks. The single-party Government and its strong parliamentary majority favor political stability and create a positive environment for reforms. Nonetheless, political risks to the reform program remain. These include (i) geopolitical events in neighboring regions; and (ii) slowdown in reforms if it is perceived that such course could ameliorate the impact of international crisis. Specifically, the authorities' appetite for implementing reforms in the area of increasing labor market flexibility might wane given the expected adverse impact of the global crisis on the economy.

5. ASSESSMENT OF BANK AND BORROWER PERFORMANCE

5.1 Bank Performance

(a) Bank Performance in Ensuring Quality at Entry

Rating: Satisfactory.

The operation made use of extensive existing analytical work in its design and policy dialogue. This operation was also much in line with stated government development objectives. The operation's identification and design were consistent with the 2003 CAS and the 2005 CAS PR, and closely reflected lessons learned identified in the 1993-2004 Country Assistance Evaluation, particularly as regarded the expected use of a wide set of existing analytical background work. Consistent with the CAS PR, the authorities and the Bank agreed that CEDPL would support key components of the NDP.

(b) Quality of Supervision

Rating: Satisfactory

Since this was a single-tranche operation with only prior actions but framed in a medium term program, a continued policy dialogue with the authorities in the areas of reform was a crucial element in the supervision effort. The supervision of this operation, therefore, was a continuing process that went beyond the ISRs as a formal requirement⁵. This paved the way for the approval of a follow-on operation (CEDPL 2). The Bank and the country have monitored performance based on agreed upon measures as well as the results framework included in the CEDPL Policy Matrix. However, the indicators and targets in some cases lacked specificity, thus making the task of evaluating outcomes more complicated.

(c) Justification of Rating for Overall Bank Performance

Rating: Satisfactory

This rating is based on the following: (i) the broadly positive results of the operation and the Bank's contribution to it; (ii) the quality of the operation's design, its strategic, long-term view and its support of the NDP, reflecting the fact that the operation was produced in full partnership with the Government; (iii) the extensive use of analytical material to design the operation and facilitate the policy dialogue; (iv) the fact that this operation set the basis for CEDPL 2; and (v) the continued policy dialogue and supervision helped attain most of the objectives of the operation so far. The only shortcoming relates to the inadequate quality of the monitoring and evaluation framework, which made supervision somewhat more difficult.

5.2 Borrower Performance

(a) Government Performance

See (c) below.

(b) Implementing Agency or Agencies Performance

See (c) below.

(c) Justification of Rating for Overall Borrower Performance

Rating: Satisfactory

⁵ An ISR was drafted but not submitted for approval.

The Government undertook a number of technically and political complex reforms in a difficult political environment. The program shows continuity and seems to have broad support. The technical preparations for the implementation of these reforms required a tight coordination effort across a number of government institutions. These efforts also reflected an effective and close collaboration between the Bank and the Treasury, and a continuous technical and policy dialogue between Bank staff and the relevant government agencies.

6. LESSONS LEARNED

CEDPL offers the following key lessons:

Some political difficulties at the time of CEDPL inception and negotiations may have called for a postponement of program negotiations, but looking in retrospect the decision to go ahead was appropriate. It was well supported: a) policy actions—all prior actions—constituted good public policy and were technically and politically difficult reforms; b) these policies were (and still are) difficult to reverse; and c) clearly the relationship with the Government would have been unnecessarily strained if a postponement had taken place, particularly as the Bank had already publicly expressed support for these reforms. The approval of a follow-on operation supporting additional policy actions under the Government's NDP validates this conclusion.

Gathering lessons and taking advantage of the dearth of knowledge from previous/ongoing analytical work, investment lending, and other DPLs has been important. Long time relationship with the country provides a good deal of knowledge and experience which has been taken into account when discussing with the authorities, designing the operation and conducting its supervision.

Establishing targets for indicators as specific as possible is of first order to monitor the program. The Program Matrix does provide a list of program outcomes and monitoring indicators. Many indicators are amenable to practical monitoring only at the end of the program. To the extent possible, targets should be stated more explicit in the program document. For example, the target of the deepening of financial market could have been more specific based on the experience of comparable countries.

7. COMMENTS ON ISSUES RAISED BY BORROWER/IMPLEMENTING AGENCIES/PARTNERS

Borrower/Implementing agencies

See Annex 3.

ANNEX 1 BANK LENDING AND IMPLEMENTATION SUPPORT/SUPERVISION PROCESSES

(a) Task Team members

Names	Title	Unit	Responsibility/ Specialty
Lending			
Rodrigo Chaves	Task Team Leader	ECSPE	
Mediha Agar	Economist	ECSPE	
Gokhan Akinci	Sr Invest. Policy Off.	CICIG	
Ayse Seda Aroymak	Sr Financial Management Specialist	ECSPS	
Dilek Barlas	Deputy Executive Secretary	IPN	
Pinar Baydar	Program Assistant	ECCU6	
Furuzan Bilir	Operations Officer	ECCU6	
Steen Byskov	Financial Sector Specialist	ECSPF	
Banu Demir	Consultant	LCSPE	
Michael Edwards	Lead Financial Sector Specialist	ECSPF	
John Gabriel Goddard	Economist	ECSPF	
Vinod K. Goel	Consultant	EASPR	
Kamer Karakurum-Ozdemir	Economist	ECSPE	
Selma Karaman	Program Assistant	ECCU6	
Maureen Anne McLaughlin	Lead Education Specialist	ECSHD	
Marialisa Motta	Manager	CICRA	
Zafer Mustafaoglu	Senior Economist	ECSPE	
Jean-Louis Charles Racine	Private Sector Development Specialist	ECSPF	
ICR			
Carlos E. Pinerua	Task Team Leader	ECSPF	
Irem Guceri	ETC	ECSPF	
Carlos Elbirt	Economist	ECSPF	

(b) Staff Time and Cost

Stage	Staff Time and Cost (Bank Budget Only)	
	No. of staff weeks	USD Thousands (including travel and consultant costs)
Lending		
FY03	21	157.74
FY04	20	174.36
FY05	48	270.96
FY06	51	372.61
FY07	65	436.21
FY08		0.00
Total:	205	1411.88

Supervision/ICR		
FY03		0.00
FY04		0.00
FY05		0.00
FY06		0.00
FY07		-0.23
FY08	13	45.93
FY09	6	27.27
Total:	19	72.97

ANNEX 2. PROGRAM MATRIX FOR THE CEDPL

Issue	CEDPL (Prior actions in bold)	Possible Future Policy Actions Under the Government's Medium-Term Plan	Expected Program Outcomes & Monitoring Indicators
Program area I: Macroeconomic Framework			
A stable macroeconomic environment is required for investment and growth.	The Government has maintained an adequate macroeconomic framework.	Maintaining an adequate macroeconomic framework.	A stable macroeconomic framework. To be monitored by the evolution of key macroeconomic variables— including (a) real interest rates, (b) inflation – CPI and PPI, (c) CAD, and (d) Public Debt/GNP.
Program area II: Investment Climate			
The provisions of the current Commercial Code, a key element of the business environment, could be improved by bringing them closer to international best practice and EU requirements.	A satisfactory draft Commercial Code broadly compliant with the provisions of the EU Acquis Communautaire on commercial matters was submitted to the Parliament for approval. The Ministry of Industry and Trade has issued a circular defining and classifying SMEs in compliance with EU Regulations and a website providing useful information for SMEs including applicable regulations and business opportunities has been created under the domain www.kobi.org.tr	Completing the process to put in place a Commercial Code broadly aligned with the provisions of the EU Acquis Communautaire on commercial matters.	Foreign and domestic investors have stronger incentives to invest in Turkey and to do business in the formal economy. To be monitored by the evolution of key variables—including (a) FDI flows/GNP, (b) a declining time and cost of registering firms, (c) increasing share of formal sector workers, and (d) decreasing number of licenses.
Registration and licensing procedures for business activities have been simplified and costs reduced but there is still room for bringing them closer to international best practices.	Reviews of existing registration and licensing regulations have been conducted with the view of unifying and streamlining licensing procedures for the entire country. A pilot test of electronic linking of government agencies in charge of	Implementing recommendations adopted by the authorities, if any, from the reviews of existing registration and licensing regulations.	

Issue	CEDPL (Prior actions in bold)	Possible Future Policy Actions Under the Government's Medium-Term Plan	Expected Program Outcomes & Monitoring Indicators
	company registration is underway in Ankara.	Progressing with electronic registration and trade registries offering a majority of their services to firms online.	
Economic performance has been hindered by the poor financial results, overstaffing, dependence on subsidies and unilateral budget transfers, and protected markets of state owned companies.	Turkey privatized state owned companies and sold major state-owned assets in the years 2005 and 2006 with a total value of sales amounting to US\$ 17.7 billion and under a broadly transparent process which was consistent with acceptable competitive practice and environmentally responsible.	Implementing a privatization program depending on market conditions.	While the performance of SOEs has improved, the risk of future poor performance has been reduced through privatization. Efficiency would be supported as private sector agents compete in an environment not distorted by the state as owner of industrial and service companies. To be monitored by a declining share of GNP produced by SOEs.
CIT has been high and complex while CIT investment allowances have created distorted incentives to adopt capital intensive and labor saving technologies.	CIT has been reduced from about 30 to 20 percent of taxable profits and capital investment CIT allowances have been eliminated.	Reducing and simplifying further CIT, if appropriate.	The new CIT regime reduces incentives for informality. To be monitored by the evolution of the share of CIT in overall tax revenue.
PIT has been high and complex, which has increased incentives for informality, especially for the self-employed.	PIT has been reduced from 40 percent to 35 percent of taxable income while the taxation of wage and non-wage income has been unified. The number of brackets has been reduced from 5 to 4 and the treatment of income from financial instruments has been harmonized.	Further reform of PIT, if appropriate.	The new PIT regime reduces incentives for informality. To be monitored by the evolution of PIT in overall tax revenue and the incidence of unregistered self-employment.
The tax administration could improve its enforcement of tax legislation and collection of tax	A successfully functional restructuring of the tax administration including (a) reform of the local tax offices; (b)	Developing a unified declaration form for taxes and social security contributions and an action plan to improve collection	Informality is reduced while tax collection increased.

Issue	CEDPL (Prior actions in bold)	Possible Future Policy Actions Under the Government's Medium-Term Plan	Expected Program Outcomes & Monitoring Indicators
payments which will reduce informality in the economy by making under-reporting of revenues and unregistered activity less attractive strategies.	establishment of a revenue administration responsible for tax collection and with direct authority over provincial and local collection offices; and (c) reforms to the Large Tax Payer Unit aimed at improving collection efficiency while reducing compliance costs for the firms targeted has been completed.	of social security contributions and arrears.	To be monitored by the evolution of direct taxes in overall tax revenue.
The total amount of state aid is not known and the legislation in place on the subject deviates from the EU Acquis Communautaire.	Satisfactory state aid control legislation in conformity with EU directives has been drafted.	Developing (a) state aid control legislation in conformity with EU, (b) an inventory of state aid and, (c) a plan for phasing out distorting state aid and keeping overall amounts in line with EU average.	Better incentives for investment due to less uncertainty and more competition which supports more efficiency and growth. To be monitored by the evolution of the amounts of tax expenditures and the number of state aid programs.
FDI in Turkey has been low which means that Turkey has not benefited from the increases in investment and productivity normally associated with higher levels of FDI.	An Investment Support and Promotion Agency of Turkey (ISPA) has been established and progress includes: (a) incorporation of the agency, (b) issuance of secondary legislation, (c) recruitment of staff, and (d) clear definition of goals and business model. A website providing comprehensive information for foreign investors has been created under the domain www.investinturkey.gov.tr .	Strengthening the ISPA.	The number and quality of jobs has benefited from stable and larger FDI flows. To be monitored by the evolution of annual FDI flows as percentage of GNP.
Program area III. Labor Markets			
The performance of labor markets has been characterized by (a) low rates of labor market participation— especially among	A program of labor market reform has been adopted as one of the five strategic priorities (development axes) of the NDP.	Pursuing a comprehensive labor market reform package including (a) making labor markets more flexible, (b) providing increased opportunities for	Turkey is utilizing a greater share of working age population, providing employment to more of those who do participate in the labor force, and

Issue	CEDPL (Prior actions in bold)	Possible Future Policy Actions Under the Government's Medium-Term Plan	Expected Program Outcomes & Monitoring Indicators
women; (b) comparatively high unemployment rates—especially among the young; and (c) there is a high incidence of informality.		increased labor market participation – especially for women and youth, (c) making labor a more attractive factor of production, and (d) increasing protection for all workers relative to the protection of existing jobs.	supplying more formal sector jobs affording protection to workers. To be monitored by the evolution of unemployment rates, labor market participation rates, and share of the labor force working in the formal sector.
Program area IV. Credit and Capital Markets			
Historically, the banking sector has dominated the entire financial sector and provided small amounts of investment capital to the productive sectors of the economy and has been a source of fiscal losses and/or macroeconomic instability.	<p>The authorities completed successfully an IPO for about 25 percent of the shares of Halk Bank.</p> <p>BRSA has adopted, published, and is implementing 24 of the regulations required for the effective implementation of the 2005 Banking Law.</p>	<p>Increasing private sector participation in the ownership and control of the state banks.</p> <p>Putting in place all regulations required for implementing the 2005 Banking Act and progressing in the implementation of the Basel II Banking Accord.</p>	<p>The financial sector continues supporting macroeconomic stability and credit and capital markets have developed in a way that contributes to investment and growth.</p> <p>To be monitored by the evolution of (a) soundness indicators for the financial sector, (b) measures of financial deepening and access to financial services, and (c) effective use of assets as collateral.</p>
		<p>Making the legislation for insurance markets and for the pension savings and investment system more compliant with the EU Acquis.</p>	
Another factor limiting access to credit services and equity markets is the underdevelopment of key institutional and legal elements for the functioning of modern financial services such as credit bureaus, good collateral laws, and protection of shareholders.	A system for disclosing credit history and performance of consumers (credit scoring or reporting) is functioning	Putting in place a system for disclosing the credit history and performance of corporate borrowers.	
	A detailed diagnosis of the regime for using movable assets to secure transactions has been prepared and its recommendations have been reviewed.	Establishing legislation for better using movable assets to secure transactions and the operation of an internet based filing archive for security interests.	

Issue	CEDPL (Prior actions in bold)	Possible Future Policy Actions Under the Government's Medium-Term Plan	Expected Program Outcomes & Monitoring Indicators
	A satisfactory new law on residential real estate mortgaging has been enacted.	Issuing sub-regulations required for the regulatory, supervisory, and institutional framework for secondary mortgage market institutions.	Increase in mortgage lending, lowering of spreads, and development of mortgage securitization.
The depth and functioning of capital markets and their ability to channel investment capital to the real sector depend significantly on the system for governing corporations and protecting shareholder rights. The country's capital markets are yet to realize their full potential because of areas where corporate governance could be improved.	A study of the observance of OECD Corporate Governance Principles with the collaboration of the relevant Turkish authorities and stakeholders has been completed.	Bringing about better observance with the OECD corporate governance principles.	Deepening of capital markets as measured by, for example, market capitalization to GNP ratios.
Program area V. Innovation, Knowledge, Technology Adoption, Labor Force Skills			
Low levels and quality of outputs of public and private R&D, limited R&D commercialization, low levels of technology absorption and low number of technical graduates and researchers constraint productivity of Turkish firms.		Promoting innovation and technology absorption through better (a) innovation infrastructure; (b) access to finance for innovation; (c) capacity to innovate at the university and firm level; and (d) regional utilization and impact of existing innovation programs.	Increasing innovation and use of technology by firms will improve firms' productivity and facilitate creation of new firms, in turn contributing to creation of more and better jobs. This outcome will be monitored by the evolution of key variables— including (a) industry-funded R&D, (b) joint projects between universities and private firms; (c) numbers of
A low number of patents filed by Turkish inventors nationally and internationally, incomplete alignment of IPR legislation with <i>Acquis</i> requirements, and inadequate IPR enforcement limit investments, innovation, and competitiveness of Turkish firms and thus employment potential.	A law on adoption of the Agreement on Amendment to the European Patent Convention has been enacted.	Developing IPR legislation aligned with the EU <i>Acquis</i> in areas including: (a) Patent and Intellectual Property Law, (b) Geographical indications Law, (c) Industrial Design Law, and (d) Trade Marks.	
Limited use of quality standards by Turkish labs and firms (particularly	TURKAK has been accepted as a signatory of EA-MLA in the areas of	TURKAK becoming a signatory of the EA-MLA in the areas of product	

Issue	CEDPL (Prior actions in bold)	Possible Future Policy Actions Under the Government's Medium-Term Plan	Expected Program Outcomes & Monitoring Indicators
<p>in the service industry and among SMEs), incomplete alignment of legislation on standards with EU requirements and institutional shortcomings in the NQS and Metrology Systems limit firms' export, creation of supply chains, competitiveness and growth and ultimately generation of high quality jobs in the modern sectors of the economy.</p>	<p>calibration, testing, quality system certification and inspection and as a signatory of the International Laboratory Accreditation Cooperation –Mutual Agreement (ILAC-MRA) in the areas of testing and calibration.</p> <p>A revised TURKAK law consistent with EU Acquis and EA-MLA requirements has been drafted.</p>	<p>certification and environmental management system certification and as a signatory of the International Accreditation Forum –Multilateral Recognition Arrangement (IAF-ML) in the area of quality.</p> <p>Establishing TURKAK legislation consistent with EU <i>Acquis</i> and EA-MLA requirements.</p> <p>TSE becoming a member of CEN and CENELEC.</p> <p>Enhancing the independence of the Standardization departments at TSE.</p>	<p>science & engineering graduates and post doctoral research fellows, (d) number of patents issued, (e) increased numbers of ISO 9001 certified firms, (f) number of accredited testing and calibration laboratories, and (g) proportion of UME's calibration services provided to laboratories and primary calibration services.</p>
<p>There is a mismatch between the set of skills demanded by the private sector and the set of skills acquired by the large majority of the working force in the country's educational system.</p>	<p>Curricula for five programs have been reformed to reflect needed skills and competencies and have been implemented for all students in the 9th - 10th grade in the 2006-2007 school years.</p> <p>The Vocational Qualification Authority Law was approved in October 2006 to link education and qualifications in technical and vocational fields with occupational needs and standards. The certificates developed through this process will be recognized in the EU.</p>	<p>Revising curricula in a number of secondary and vocational areas and implementing them in pilot schools for selected grades. Introducing curricula for programs for students in the higher grades of secondary school.</p> <p>Revising standards and certification requirements for a significant number of vocational and technical occupations.</p>	<p>Better employability of high school and MYOs graduates.</p> <p>There are efforts underway to assess the effects of revised curricula.</p>

ANNEX 3. THE GOVERNMENT'S CONTRIBUTION TO THE IMPLEMENTATION COMPLETION AND RESULTS REPORT TO CEDPL

Introduction

1. The Competitiveness and Employment Development Policy Loan (CEDPL) is the first in a series of programmatic loans in support of the Government's comprehensive reform program aimed to promote growth while generating employment, ensuring social inclusion and enhancing competitiveness. The CEDPL series constitute the essence of our collaboration with the World Bank (the Bank) in the areas of (a) maintaining an enabling macroeconomic framework; (b) improving investment climate, (c) reforming the labor market, (d) maintaining the financial sector stability and increasing access to investment capital and (e) generating knowledge and innovation, upgrading the skills of the labor force and strengthening the quality of education.

2. Our comments about the implementation of the structural reform program supported by CEDPL are as follows:

Macroeconomic Framework

3. A satisfactory macroeconomic framework has been maintained during the CEDPL program. The Government has implemented a series of macroeconomic and structural policies in order to increase the competitiveness of the economy and to achieve a sustainable and equitable economic growth.

4. These policies had a remarkable impact on Turkey's economic and social development in the past years. The economic growth averaged about 7 percent and poverty rate dropped by approximately 8.5 percentage points between 2002 and 2007.

5. Moreover, a combination of sustained stabilization efforts and steadfast implementation of structural reforms made it possible to keep the inflation under control, to improve the outlook for debt sustainability and to reduce macroeconomic vulnerabilities.

6. Having taken into account the downside risks stemming from the global crisis and slowdown in the world economy, Turkey's main focus is to mitigate the adverse impacts of this turmoil on our financial markets, real sector and fiscal stance. Therefore, the volatility in the global markets and its effects on Turkish economy is being closely monitored and policy responses are being designed and implemented.

Investment Climate

7. The Government gives utmost importance to a strong investment climate for sustaining economic growth. Therefore, improving the investment climate is one of the main strategic goals of our Development Plan.

8. Implementation of structural reforms to improve the investment climate is a necessary condition for increasing domestic and foreign direct investments. To this end,

the Government is aiming to improve the investment climate through, inter alia: (a) removal of administrative obstacles encountered by firms in all phases of investment process; (b) reducing and simplifying the Corporate Income Tax and Personal Income Tax (CIT and PIT) and improving effectiveness of the tax administration; (c) monitoring and adjusting state aid as necessary; (d) implementing a large program of privatization of state-owned enterprises; (e) establishment of the Coordination Council for the Improvement of Investment Environment in Turkey (YOİKK) and (f) improving corporate governance.

9. A significant progress has been achieved in these areas over the recent years which can easily be tracked by record-high FDI inflow figures and privatization revenues. Turkey has attracted USD 60 billion of FDI inflows for the last three years and privatization revenues amounted to about USD 26.7 billion between 2005 and 2008.

10. The Government will further enhance the investment environment to induce both domestic and foreign investors to invest more in Turkey. In this respect, the Committee for the Improvement of Investment Climate (YOİKK), which follows the implementation effectiveness of structural reforms and reports the progress to the Government, aims to rationalize the regulations about investments, develop policies to improve investment climate and remove obstacles faced by investors.

Labor Market

11. During 2002-2007 period, the Turkish economy grew by approximately 7 percent on average, whereas employment did not follow an increasing pattern; a situation which can be defined as “jobless growth”. This is mainly due to the decline in the rural employment in parallel to the structural transformation of the Turkish economy and to the shift from a labor intensive industrial production structure to a more capital intensive one.

12. Therefore, generating more and better jobs has been identified as one of the main priority areas of Turkey, as it is stated in the Ninth Development Plan. A comprehensive reform agenda on labor market has been designed to this end and the Government has already started implementation of the first phase of this agenda.

13. Within this framework, the enactment of the Labor Market Reform Law confirms the strong commitment to improve the labor market. The law aims to increase employment through, inter alia; reducing the financial and non-financial burdens on formal employment, encouraging the employment of women and young, strengthening active labor market programmes, designing vocational education policies based on the needs of labor market, and ensuring the employment in least developed regions. With the impact of both the reforms realized in the labor market and the active labor market policies being carried out, the future growth is expected to be reflected in employment.

14. Moreover, the Government increased its support to private sector and especially to SMEs by increasing the availability of financial sources and providing incentives for short-term employment. In this respect, Small and Medium Sized Industry Development Organization (KOSGEB) and Ziraat Bank (a State Owned Bank) have programs to provide concessional loans to SMEs and exporter SMEs. In addition, Turkey's Eximbank increased its funding and insurance programs targeted to exporters. The aim is to mitigate

the impacts of the global slowdown on the private sector, decrease their vulnerability to external shocks, and with the consideration of SME's share in employment (about 77 percent), prevent the lay-offs to the extent possible.

Credit and Capital Markets

15. The Government recognizes the importance of improving firms' access to finance and ensuring confidence and stability in financial markets in order to strengthen Turkey's competitiveness. In this respect, a comprehensive reform program has been implemented in financial sector through enhanced regulation and supervision.

16. The fluctuations in global markets are considered as a stress test for the financial sector. As a result of this stress test, it has been proved that our financial sector has preserved its strong outlook in financial stability, mainly due to measures taken after the 2001 economic crisis. The positive 2008 year-end figures released by banks prove that Turkish financial sector maintained its health even in the course of the global crisis. These figures have also enhanced confidence to the sector and increased the strength of Turkish banks by conveying the message that the Turkish banks were well prepared against the crisis and do not have liquidity problems. The capital adequacy ratios of Turkish banks also remain robust (at around 18 percent on the average as of end-2008) which is a key indicator that the Turkish financial sector will make it through 2009, maintaining its strength.

Innovation, Knowledge, Technology Adoption, Labor Force Skills

17. The Government acknowledges the need to base our growth dynamics on productivity increases and on creating new comparative advantages in order to sustain and strengthen our competitiveness on the global arena. To this end, placing an emphasis on innovation, increasing scientific and technological capacity, improving human capital, and effective usage of information and communication technologies are our priority areas.

18. In Turkey, the share of R&D expenditures in GDP was 0.71 percent in 2007, while it was 1.84 percent for the EU average in 2006. Our aim is to increase the share of R&D expenditures and reach at 2 percent of GDP in 2013. On the other hand, the weight of private sector in R&D investments is increasing. The rate of private sector's R&D activities in Turkey, which was 24 percent of the total in 2004, increased to 41 percent by 2007. However, this figure still lags quite behind the EU-27 average of 64 percent in 2006. Another issue is to overcome the shortage of researchers. In Turkey, ratio of R&D personnel to total labor force was 0.43 percent in 2006 which is well below the EU average of 1.33 percent in 2006.

19. In this respect, the enactment of the law on Research and Development is a very important step to encourage R&D investments which in turn will contribute to our international competitiveness. By implementing necessary policies related to R&D activities; it is aimed to increase the share of R&D investments in GDP, expand the production of high-value-added goods and services, decrease costs through productivity gains, support the employment of qualified research personnel, facilitate the inflow of

R&D based FDI, establish, and support pre-competition cooperation projects. Furthermore, several programs and projects have been initiated since 2005 to educate researchers inside and outside the country to overcome the shortage. Consequently, a substantial improvement has been observed in the (full-time equivalent) number of researchers from 39,9 thousand in 2004 to 63,4 thousand in 2007.

General Comments

20. We consider the design of CEDPL I to be very well in line with our development objectives and priorities that are embedded in our main policy documents. “Increasing competitiveness” and “increasing employment” being two of five development axes of the 9th Development Plan, illustrates this strong relationship.

21. Furthermore, the program areas of CEDPL I are well identified and their complementary nature is well established. “Improving the business environment”, “improving the financial system” and “improving R&D and innovativeness” are all sub-pillars of 9th Development Plan.

22. In this context, we extend our appreciation to the Bank for its support to our reform program through the CEDPL series. Furthermore, we commend the Bank for its approach in terms of customization and alignment, which are prerequisites for ensuring country ownership. Since the satisfactory implementation of the development policy operations depends on government-led initiatives, ensuring the country ownership is a critical aspect of the design process.

23. With respect to the design of the CEDPL I, another issue of importance is the structure of prior actions. The CEDPL I contains only eight prior actions that are considered to be the most critical policies to achieve its objectives. In this respect, we welcome the decrease in the number of prior actions of development policy loans, which is of great importance for an effective implementation.

24. We appreciate the analytical and advisory work of the Bank which significantly contributes to the policy dialogue in several reform areas supported by the CEDPL series. Strong links between analytical studies and Bank lending, provided the foundation for a well-designed development policy operation. Furthermore, the analytical framework served to provide a basis for the design of our reform program and its effective implementation.

25. The CEDPL series is a well designed development operation in its programmatic nature. As the government continued implementation of its reform agenda, the prior actions defined for the CEDPL II has been met and the agreement for the loan was signed on December 17, 2008. The CEDPL II can be considered as a good sign of continuity of a well designed and precise programmatic operation.

26. We would like to underline the importance of having a constant policy dialogue based on country’s needs and priorities. In this respect, we would like to have the continued support of the Bank on sectoral Development Policy Loans, in addition to on-going series of operations. We especially welcome the prospect of the CEDPL III which

will deepen the support of the Bank in the areas of enhancing competitiveness and increasing employment.