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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

TÜRKIYE
(2023-2025)

COMMISSION ASSESSMENT

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The economic reform programme (ERP) was submitted on 31 January 2023, before the two devastating earthquakes that hit Türkiye on 6 February 2023. The earthquakes constitute, first and foremost, a humanitarian crisis. As a consequence of this tragedy, more than 50 000 people died and more than 100 000 were wounded; around 3 million have been displaced and more than 1.5 million lost their homes. However, from an economic standpoint, the full impact of the earthquakes is yet to be assessed. The earthquakes affected 11 provinces accounting for 16% of the country's total population, 9.8% of its GDP and 5.2% of tax revenues. The GDP per capita of the affected provinces is around 60% of national average. While the extent of capital destruction is still being evaluated, it is clear that most of it was residential housing. The losses are in the range of tens of billions of euro. This year's economic reform programme assessment, based on a set of assumptions from before the earthquakes, must therefore be read in conjuction with Türkiye's revisited priorities following these events. Fully aware of the implications of the disastrous events on the Turkish society and economy, the European Commission believes it is worthwhile going ahead with this year's analysis in the spirit of a constructive technical dialogue.

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1. EXECUTIVE SUMMARY

Although slowing down, Türkiye's economic growth remained strong in 2022. Real GDP grew by 5.6% in the year as a whole, but after a strong first half of the year, the rate decelerated in the second half. The economic reform programme (ERP) predicts a relatively robust growth performance but, in view of the built-up imbalances, this scenario appears optimistic. Moreover, despite the tragic loss of life and significant destruction of capital assets, the 6 February earthquakes are likely to dampen economic growth only slightly in 2023. In the current circumstances, priorities in the country are fully focused on recovery and offering help to all people in need. From an economic point of view, the reconstruction activities could have a positive impact on economic growth in the following years. The current policy mix favours economic growth over macroeconomic stability, sustained by increasingly disruptive policy measures. Following a series of interest rate cuts since the autumn of 2021, the central bank has maintained deeply negative real interest rates despite soaring inflation and tightening global financial conditions. Despite the outstanding export performance in recent years, the trade deficit remained significant and even expanded last year as gold imports tripled and high energy prices doubled the value of energy imports. The banking sector has remained resilient so far, navigating multiple shocks since 2018 and, after repeated capital injections in state-owned banks, entering 2023 with sound capital adequacy and liquidity ratios.

Following a strong fiscal boost expected in 2023, an election year, the ERP aims for a mild fiscal consolidation over the medium term. The government was already planning to increase the overall deficit in 2023, even before any support for the earthquake-hit regions was considered. In view of the significant reconstruction needs, the initial plan to tighten fiscal policy in the next 2 years would need to be reconfirmed and supported by new measures. The quality and credibility of the medium-term consolidation plan suffer from the lack of detailed measures in the ERP to back it up and from the continued withholding of productive capital expenditure. Earthquake-related reconstruction will likely add to public spending pressures, even though the authorities' initial response was to try to accommodate such costs within the 2023 budget. The ERP projects that the government debt-to-GDP ratio will decline steadily, to 32% in 2025. Heavy-handed regulatory measures affected the government securities market, lowering reliance on external debt and lengthening maturity, but did not fundamentally address debt vulnerabilities. Most debt stock remains denominated in foreign currencies and the country risk premium is very high. The relatively good budget performance in recent years masks an underlying trend of rising fiscal pressures and risks. Reflecting these risks, Türkiye's long-term sovereign rating was lowered further to non-investment-grade by all major rating agencies in 2022. Successive crises and shocks also triggered the adoption of numerous ad-hoc measures with budgetary effects that have strained public finance management. Fiscal governance would benefit from the introduction of fiscal rules and the setting up of an independent oversight body.

The main challenges facing Türkiye are the following.

- **The key challenge is to find a better balance between pursuing high economic growth, bringing down the very high inflation, reducing external imbalances, keeping exchange rate risks in check and maintaining buffers.** Overly loose monetary policy has led to very high inflation. Highly disruptive regulatory and macro-prudential measures hamper medium-term growth prospects and increase vulnerabilities. Addressing these challenges will require a tighter monetary policy stance, compatible with achieving price stability, a careful and gradual unwinding of the web of regulatory measures under a transparent monetary policy framework, and consistent communication.

- **Pre-election fiscal largesse is challenging the authorities' commitment to fiscal discipline and undermines efforts to reduce imbalances.** The fiscal stance is set to loosen and the composition of public expenditure to worsen in 2023 amidst rising spending pressures linked to the electoral cycle. Ad hoc policy measures have become more frequent. A credible medium-term fiscal consolidation plan and a return to primary surpluses, supported by improvements in public finance management, could help curtail fiscal risks.
- **Türkiye needs to upgrade the skills level of its working-age population in order to strengthen human capital and increase employment, in particular for women and young people.** Türkiye also needs to further increase the enrolment of children aged 5 and below in early childhood education and care in order to improve educational outcomes and allow women's participation in the labour market. The Turkish labour market has recovered from the COVID-19 pandemic and the employment rate (for those aged 15+) increased to 45.2% in 2021, from 42.7% in 2020. However, despite this recovery and the overall economic rebound, the gap between male and female employment remains significant, with activity and employment rates for women less than half the rates of men. In 2021, the employment rate for men was 62.8% against only 28% for women. Similarly, the transition of young people into the labour market remains a challenge. The youth unemployment rate (15-24) decreased from 24.9% in 2020 to 22.6% in 2021. The rate of young people not in employment, education or training improved but is still high. Finally, there is a need to address the persistent mismatch between the requirements of the labour market and the skills acquired in the education system and prepare the labour force for jobs of tomorrow such as in the green transition sectors.
- **Türkiye should speed up efforts on connectivity, green transition and adaptation to climate change which would also help the country to become more energy-independent.** A credible and concrete roadmap is needed to upgrade the country's energy infrastructure, notably to lower greenhouse gas emissions (including methane), with a view to peaking emissions as close to 2030 as possible and drastically accelerating the green transition. Türkiye should update its Nationally Determined Contribution under the Paris Agreement with a 2030 objective that is compatible with the ambition to reach net-zero in 2053. Cost-effective decarbonisation implies concrete steps to implement and roll out in 2024 an EU-compatible emission trading system. Additionally, with a view of meeting the national decarbonisation objective, Türkiye should promote more actively energy efficiency, the steady growth of renewables (both traditional and hydrogen-based), a phase-down of coal use in its energy mix to avoid the risk of stranded assets, and a phase-out of fossil fuel subsidies. Steps towards the green transition would also help to reduce Türkiye's dependency on external energy supplies, in particular natural gas imports from Russia, that is still very significant. Finally, in order to adapt to climate change – and taking into consideration the reconstruction efforts that will follow the devastating 6 February earthquakes – Türkiye should prioritise the highest standards in terms of green and resilient building and infrastructure.
- **Further efforts are needed to nurture competitiveness, and address informality and the digital transition.** Structural challenges remain for State aid, competition and the efficiency of the judiciary, where specialised courts for business and IP law do exist, but their number needs to increase and their efficiency needs to improve. Businesses continue to be affected by a lack of transparency and predictability in the way business-related legislation is adopted, which is only slowly improving. Türkiye's policy mix with regard to the country's 3.5 million SMEs would also need to be rationalised and streamlined. With the aim of improving the business environment, Türkiye should strengthen the rule of law and, in order to increase policy predictability, improve the regulatory environment and

consultation mechanisms with business organisations and social partners on relevant new legislation. Additionally, Türkiye should implement legislation and enhance transparency regarding State aid to achieve a meaningful level-playing field in the spirit of the Customs Union.

The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2022 has been limited. The policy mix remained unbalanced, with an overly loose monetary policy and a tight fiscal policy in 2022. The government increased its support for households and firms via multiple channels (such as minimum wage hikes, support for energy bills, support for students, government-backed loans, etc.). Contrary to the commitments expressed in policy documents, tax restructuring and capital repatriation became established practice. Parliamentary approval of the public-private partnership (PPP) framework legislation is still pending, and public procurement procedures and exemptions have not been simplified. The implementation period of the foreign exchange (FX) value guarantees on lira time deposits and the incentives applied to the scheme have been extended. The central bank further reduced its key policy rate and the authorities are increasingly relying on macro-prudential measures to achieve their monetary policy goals. The recommendations on carbon pricing and resource efficiency have not materialised into concrete legislative changes to date, although some preparations are ongoing. Some reform measures have been announced on the business regulatory environment and the green transition, but these fall short of addressing core problems in these areas. Concrete steps have been undertaken to streamline business disputes and to set up an ETS system, but a realistic timeline and concrete milestones are needed to progress on both fronts. Some measures have been adopted for young people and those not in education, employment or training (NEET), for example to improve quality and access to vocational education and training (VET). As regards the rate of participation in early childhood education and care the offer is not developed enough to allow for more female employment. This and active labour market policies aimed at getting women into the labour market have had little structural impact.

The key structural challenges identified in the ERP largely correspond to those identified by the Commission, but the analysis is incomplete. The analysis of structural obstacles does not examine key sectors of the economy, notably industry and services (except tourism). While the analysis of the green transition does examine some of Türkiye's challenges, on which a specific measure is included, the shared European growth model involving green and digital transition needs to be further strengthened, especially in the current geopolitical context. In line with the EU strategy for the digital agenda, reform of the development of broadband infrastructure is expected to positively affect the economy. The reform measures largely address the identified key challenges. However, the ERP includes no measures to improve the quality of higher education.

2. ECONOMIC OUTLOOK AND RISKS

Although decelerating, Türkiye's economic growth remained strong in 2022. Real GDP grew by 5.6%[1], above the authorities' expectations, but after a strong first half of the year it decelerated in the second half. Net exports made a positive contribution to growth, despite a

(1) Macroeconomic and fiscal estimates and forecasts covering the period 2022-25 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2022 have been taken from the relevant national sources (national statistical office, ministry of finance, central bank).

rapid loss in export momentum and a pick-up in imports by the end of the year. A notable increase in technology-intensive and export-oriented sectors drove industrial production up to record-high levels on average in 2022. The growth in household consumption was particularly strong, sustained by robust job creation, large increases in the minimum wage, and deeply negative real interest rates. Inventories continued to fall and very weak construction investment pulled down total investment, while investment in machinery and equipment maintained a robust rate of expansion.

The ERP forecasts steady annual economic growth of around 5% over the medium term. While headline growth projections remained largely unchanged from last year's programme, the growth composition shifted slightly away from domestic demand towards net exports. Nevertheless, domestic demand is expected to remain the main driver of growth with a strong contribution from private consumption and investment. Despite the tragic loss of life and significant destruction of capital assets, the 6 February earthquakes are likely to dampen economic growth only slightly in 2023, while reconstruction activity could have a positive impact on growth in the following years. According to ERP projections, good export and industrial performance will continue, in line with the authorities' plan (the 'Turkish Economic Model') implemented since the autumn of 2021. This plan aims to achieve a positive current account balance, reduce dependency on (short-term) external financing, and increase the role of the lira in the economy, while keeping interest rates low and directing credit to tradable and high-value-added sectors. The plan also assumes the prolongation of complex and sometimes disruptive macroprudential and other regulatory measures and the possible introduction of new ones. The reliability of estimates on the cyclical position of the economy has been affected by the high economic volatility in recent years and major structural changes, triggered first by the COVID-19 crisis and later by the spillover from Russia's war of aggression in Ukraine. Nevertheless, the ERP estimates the output gap to have been positive in 2022 and forecasts it to continue to widen throughout the duration of the programme. By factors of production, economic growth in 2023-2025 is expected to be driven mainly by capital (2.1 percentage points (pps) per year on average), with sizeable contributions from employment (1.7 pps), and total factor productivity (1.5 pps).

Table 1

Türkiye - Comparison of macroeconomic developments and forecasts

	2021		2022		2023		2024		2025	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	11.4	**11.4**	5.0	**5.0**	3.5	**5.0**	3.0	**5.5**	n.a.	**5.5**
Contributions:										
- Final domestic demand	11.1	**11.4**	8.2	**8.3**	3.1	**3.9**	2.6	**4.9**	n.a.	**4.7**
- Change in inventories	-6.3	**-4.9**	-5.0	**-5.7**	0.0	**0.1**	0.0	**-0.1**	n.a.	**-0.1**
- External balance of goods and services	6.4	**4.8**	1.9	**2.4**	0.4	**0.8**	0.5	**0.6**	n.a.	**0.9**
Employment (% change)	7.9	**7.9**	6.5	**6.5**	2.6	**2.8**	1.8	**2.9**	n.a.	**2.8**
Unemployment rate (%)	11.8	**12.0**	10.5	**10.8**	10.5	**10.4**	10.5	**9.9**	n.a.	**9.6**
GDP deflator (% change)	29.0	**29.0**	74.4	**76.5**	69.4	**32.3**	54.7	**19.1**	n.a.	**11.0**
CPI inflation (%)	19.4	**19.6**	71.7	**72.3**	54.1	**31.6**	40.4	**19.7**	n.a.	**11.9**
Current account balance (% of GDP)	-1.7	**-0.9**	-5.9	**-5.9**	-3.3	**-2.5**	-2.6	**-1.4**	n.a.	**-0.9**
General government balance (% of GDP)	-1.1	**-2.6**	-3.5	**-3.2**	-4.0	**-3.5**	-3.5	**-2.4**	n.a.	**-1.4**
Government gross debt (% of GDP)	41.8	**41.8**	39.4	**36.7**	38.3	**35.2**	37.2	**33.6**	n.a.	**32.1**

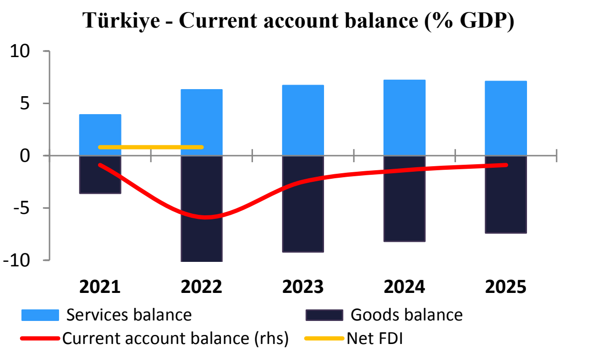
Sources: Economic Reform Programme (ERP) 2023, Commission Autumn 2022 forecast.

The macroeconomic scenario appears rather optimistic in view of the built-up imbalances and the complex and disruptive policy measures. The key challenge is to find a balance between pursuing high economic growth and bringing down the very high inflation, reducing external imbalances, keeping exchange rate risks in check and maintaining buffers.

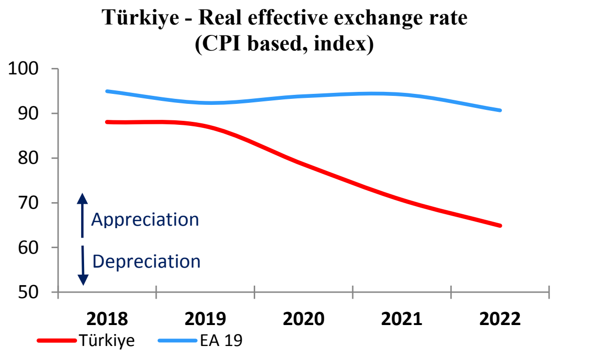
The planned growth path is likely to be increasingly difficult to follow as intrusive regulatory actions skew incentives and strain resources in the economy, undermining medium-term growth potential. Growth volatility is likely to remain a feature of the economy, closely linked to policies that stimulate domestic demand, which are in turn connected to the 2023 elections and the earthquake recovery. While the export profile seems plausible, it will largely depend on the growth performance of major trading partners in the EU, in a highly uncertain geopolitical environment, and the ability to hold on to competitiveness gains. On the positive side, Türkiye stands to gain from the shortening of global supply chains and nearshoring (transferring business operations to nearby countries) but it has yet to realise its full potential in attracting foreign direct investment. The macroeconomic and fiscal outlook continue to be affected by high degree of uncertainty related to the further economic fallout from Russia's war of aggression against Ukraine, in particular on energy supply and inflation. However, Türkiye has also benefited from expanding its trade with Russia and from preferential conditions on some of its energy imports. With the balance of risks tilted to the downside, the failure to present an alternative scenario is a drawback of the programme.

Bringing down the very high inflation in a sustainable manner is an uphill battle. The inflation targeting regime and the free-floating exchange rate nominally pursued by the central bank are effectively no longer the guiding framework for monetary policy. The monetary policy transmission mechanism is broken, with limited responsiveness of key market interest rates to the central bank policy rate. After depreciating by 40% against the US dollar in the first three quarters of 2022, the lira remained broadly stable up to early March 2023. Inflation peaked at 85.5% in October 2022 and declined steeply in the following months on the back of sizeable base effects. The ERP forecasts that inflation will fall steadily to 24.5% by the end of 2023 and enter single digits in 2025, which appears optimistic unless the policy stance tightens substantially. The earthquakes may also have a certain inflationary impact via the disruption of supply chains, increased domestic demand, and looser policies. The central bank has maintained deeply negative real interest rates since the fall in 2021 and has cut its key policy rate by another 550 basis points (bps) to 8.5% in February 2023 (the last 50 bps were delivered after the earthquakes), despite very high inflation and tightening global financial conditions. To sustain this policy and alleviate its many contradictions, the authorities have introduced an increasingly complex web of regulatory and macroprudential measures to reduce dollarisation, support the lira, lower inflationary pressures, ration and direct credit, and limit interest rates. While this set of measures achieved some short-term results, it failed to address the fundamental drivers of high inflation, namely deeply negative real interest rates, the lack of an effective policy anchor, and the weakened institutional independence of the central bank and key agencies. As relative prices adjust, inflation is thus likely to remain high at above 40% in 2023, driven by unanchored expectations, inertia, and bouts of exchange rate volatility.

External competitiveness and current account



Source: Economic Reform Programme (ERP) 2023.



Source: Economic Reform Programme (ERP) 2023, Central Bank, ECB.

Türkiye's trade openness increased further to a record high level, but imbalances widened mainly due to increased global energy prices. Exports rose further, reaching new highs in 2022, benefiting from a sizeable depreciation of the lira – the average real effective exchange rate has depreciated by around 30% since 2018. Despite outstanding export performance in recent years, the trade deficit remained significant and even expanded in 2022 as non-monetary gold imports tripled (reflecting increasing demand for gold as a financial asset) and high energy prices doubled the value of energy imports. As a result, the current account deficit grew from less than 1% of GDP in 2021 to above 5% of GDP in 2022, while the non-energy, non-gold current account recorded a surplus. The ERP forecasts a steep reduction in the current account deficit, expecting energy prices, and with it the energy import bill, to decline in 2023, and the export of tourism services to continue growing after their best-ever performance in 2022. However, after the earthquakes this scenario is largely outdated and in addition is subject to non-negligible risks from global commodity prices, the tourism sector's vulnerability to geopolitical tensions, and more frequent extreme weather events. Historically, external imbalances have also been very sensitive to policy-induced volatility from overly expansionary domestic policies, while the appreciation of real exchange rate since last summer has somewhat reversed price competitiveness gains.

The ERP outlines an intention to move towards more stable, long-term foreign financing, but results have been paltry so far. In view of Türkiye's recent past and future development ambitions, the goal of becoming less reliant on volatile foreign inflows seems well warranted. However, the new economic model has been only partially successful so far in repelling some of the so-called 'hot money,' while, despite an uptick in 2022, foreign direct investment remains below its historic highs. In addition, around half of the current account deficit financing in 2022 came from unexplained sources. The larger-than-usual errors and omissions may have been partially driven by a return to the banking system of deposits withdrawn during the depreciation of the lira in December 2022, unrecorded repatriation of foreign assets by Turkish residents, and cash inflows linked to Russian immigrants. Türkiye also secured a large deposit from Russia's Rosatom and a swap (in non-SDR basket currencies) from the central bank of the United Arab Emirates in 2022, and a USD 5 billion deposit from Saudi Arabia in March 2023. These non-market and politically-driven inflows have boosted foreign exchange reserves, though they are still dwarfed by the large foreign financing needs (the current account deficit and short-term debt on remaining maturity basis totalled nearly USD 240 billion or around 25% of GDP at the end of 2022). External debt remained broadly unchanged in nominal terms and declined slightly as a percentage of GDP, to around 53% in 2022. However, the unorthodox domestic policy setting has increased perceived risks and has generally shifted external borrowing from long-term to short-term maturities, in particular for non-financial companies. These companies have remained largely resilient and managed to reduce their open net foreign exchange position, while further building up their positive short-term position (above USD 70 billion). Despite higher costs, banks have managed to roll over their external obligations, but their increased exposure to foreign currency swaps with the central bank raises economy-wide foreign currency liquidity concerns.

The banking sector has remained resilient so far. Türkiye's commercial banks have been the authorities' preferred channel for demand management and are of vital importance for the rest of the economy. The sector has navigated multiple shocks since 2018 and entered 2023 with sound capital adequacy (19.5%) and liquidity ratios. In 2022, supported by large net interest revenues, return on assets reached 3.7% and return on equity 49.9%, but due to the very high inflation real return was deeply negative. The non-performing loan ratio fell to its lowest level in years (2.1%) and loan-loss provisioning increased further. However, headline asset quality indicators remain blurred by expansive forbearance measures, although the biggest of these, the use of the end-2021 exchange rates, was tightened substantially in early 2023 with the move to end-2022 exchange rates. The banking system's duality (diverging behaviour of public and private-sector banks) intensified as state-owned banks expanded further in 2022, reflecting their role as the main conduit for delivering credit at below-market rates at the expense of generally weaker capital and profitability positions. Türkiye remains on the Financial Action Task Force grey list and is working on implementation of an action plan to ensure effective regimes for anti-money laundering and countering the financing of terrorism, in line with the Task Force's recommendations.

Far-reaching prudential and regulatory measures have disrupted the functioning of financial markets and increased risks. Reducing interest rates and keeping them down is the revealed policy 'anchor', which necessitated follow-up actions to mitigate its fundamental contradictions in a high-inflation environment. A succession of measures providing incentives or imposing restrictions have been introduced since late 2021 covering: deposits (Turkish-lira-denominated deposits protected against depreciation losses; required shares of Turkish-lira-denominated deposits); reserve and security requirements; collaterals in swap and interbank money markets; tax exemptions; FX surrender requirements for exporters; capital adequacy ratios; risk weights; and commercial loans (see the text box for further details). Many of these measures negated and replaced price signals with quantitative targets or directly socialised risk with a view to providing incentives to market players that offset the impact of the monetary policy stance. Such a complex financial repression system distorts price signals and incentives, creates inefficiencies, is difficult to manage, increases financial sector risks, leads to sizeable public liabilities, and has major, often overlooked, distributional consequences. Moreover, exiting such measures will not be simple in view of the many interlinkages and vulnerabilities, and future monetary policy normalisation carries certain (interest rate) risks for the banking sector.

Main policy measures taken since December 2021

Date	Field	Measure
December 2021	Interest rate	Policy rate (one-week repurchase agreement (repo)) cut by 100 bps to 14%.
December 2021	Deposits	Introduction of FX-protected return for converting foreign exchange (FX) and gold deposits into lira deposits (applied to domestic real persons).
December 2021	Loans	Maturity restriction on consumer loans for mobile phones
January 2022	Deposits	FX-protected return scheme extended to legal persons' deposits.
January 2022	Taxation	Tax exemption of gains from the FX-protected deposits.
January 2022	FX	Exporters required to sell 25% of their FX earnings to the central bank.
January 2022	Swaps	A swap agreement with the Central Bank of the United Arab Emirates (AED 18 billion and TRY 64 billion; USD 4.9 billion).
January 2022	Minimum wage	Monthly net minimum wage increased by 50.6% from TRY 2,825.00 to TRY 4,253.40.
February 2022	Deposits	FX-protected return scheme extended to non-resident Turkish citizens.
February 2022	Budget	Central bank decided to pay advance dividends from its 2021 profit.

Continues...

Main policy measures taken since December 2021 (continued)

Date	Field	Measure
February 2022	Loans	Loan-to-value and maturity restrictions on vehicle loans.
March 2022	State-owned banks	The Turkey Wealth Fund injected TRY 51.5 billion of additional capital into several state-owned banks, including the biggest – Ziraat, Vakıfbank and Halkbank.
April 2022	Reserve requirements	Reserve requirements (10%) imposed on banks and financing companies' lira-denominated commercial cash loans, except for some loans (SMEs, export, investment, tradesmen, agricultural, state-owned enterprises (SOEs), financial institutions, commercial credit cards); banks with a loan growth rate above 20% by 31 May 2022 compared to 31 December 2021 are subject to a higher reserve requirement.
April 2022	Reserve requirement	Additional reserve requirement of 500 bps for banks with a conversion rate of real person's FX accounts to TRY accounts below 5%, and 300 bps for banks with a conversion rate between 5% and 10%.
April 2022	Deposits	Commission fee of 1.5% if banks cannot reach the FX deposits conversion targets.
April 2022	FX	Exporters required to sell 40% of their earnings to the central bank.
April 2022	Reserve requirement	Lira-denominated required reserves lowered to 0%.
May 2022	Loans	The risk weight for commercial Turkish lira-denominated cash loans increased to 200% (except for agricultural loans, SME loans, export and investment loans, loans to public institutions organizations and SOEs, corporate credit cards and loans to banks or financial institutions)
June 2022	Budget	Revised budget adopted with unchanged deficit target of 3.5% of GDP.
June 2022	Government securities requirement	Commercial banks required to maintain additional Turkish lira long-term fixed-rate government securities for foreign currency deposits/participation funds (minimum of 45% of collateral in swap/interbank money market transactions to be in domestic government bonds).
June 2022	Reserve requirement	Loans reserve requirement increased from 10% to 20%.
June 2022	Government securities requirement	Commercial banks required to hold fixed-rate government bonds with a maturity of at least 5 years, and with at least 4 years left to maturity, against their foreign currency deposits (3% or 10%, depending on the conversion rate of FX into lira deposits).
June 2022	Loans	New lira loans restricted to companies with FX cash over TRY 15 million (USD 0.8 million), and more than 10% of total assets or annual revenues.
June 2022	Loans	Minimum payment limit on credit cards with a card purchasing limit over TRY 25 000 raised from 20% to 40%. The risk weight of commercial cash loans extended to domestic residents (except for banks and financial institutions) who carry out derivative transactions with non-residents increased to 500%. Loan-to-value restrictions on housing loans.
July 2022	Government securities requirement	45% swap collateral raised to 50%.

Continues...

Main policy measures taken since December 2021 (continued)

Date	Field	Measure
July 2022	Minimum wage	Monthly net minimum wage raised by 29.3% from TRY 4 253.40 to TRY 5 500.35.
August 2022	Interest rate	Policy rate (one-week repo) cut by 100 bps to 13%.
August 2022	Government securities requirement	20% loans reserve requirement replaced by securities maintenance requirement (30%).
August 2022	Government securities requirement	Securities requirement holding set at 20% of the loan amount if at an annual compound interest rate 1.4 times higher than the CBRT-released annual compound reference rate; 90% if the interest is 1.8 times higher.
August 2022	Required reserves	Additional reserve requirement of 500 bps for banks with a conversion rate of FX deposits lower than 10% and 300 bps for conversion rate between 10% and 20%.
September 2022	Interest rate	Policy rate (one-week repo) cut by 100bps to 12%.
September 2022	Deposits	Commission fee if banks cannot meet FX deposits conversion targets (share of lira deposits less than 50% of total deposits) raised from 1.5% to 3%.
October 2022	Interest rate	Policy rate (one-week repo) cut by 150bps to 10.5%.
October 2022	Government securities requirement	Securities maintenance ratio revised to 5%. From 2023 securities to be maintained based on targets for lira deposits share, instead of conversion rate.
November 2022	Interest rate	Policy rate (one-week repo) cut by 150bps to 9.0%.
December 2022	Government securities requirement	Securities maintenance regulation extended to other financial institutions and the scope of assets and liabilities subject to it expanded.
January 2023	Loans	Maturity restrictions on mobile phone loans unchanged, but the threshold for consumer purchases raised from TRY 5 000 to TRY 12 000.
January 2023	Government securities requirement	Securities maintenance ratio raised to 10%. Banks with lira deposits between 60% and 70% of total to get a 5-point discount, and those above 70% a 7-point discount on the securities maintenance ratio.
January 2023	Required reserves	Required reserves for lira deposits longer than 3 months and for the increase in FX liabilities with maturities longer than 6 months provided directly from abroad set at 0%.
January 2023	FX	Companies selling FX obtained from abroad to the central bank and depositing funds (after selling at least 40% of their FX) in FX-protected conversion accounts to receive 2% conversion support.
January 2023	Minimum wage	Monthly net minimum wage raised by 54.6% from TRY 5 500.35 to TRY 8 506.00.

Table 2					
Türkiye - Financial sector indicators					
	2018	**2019**	**2020**	**2021**	**2022**
Total assets of the banking system (EUR million)	641	676	678	628	724
Foreign ownership of banking system (%)	26.8	26.0	25.0	25.9	24.9
Credit growth (aop)	21.3	6.5	28.4	22.7	56.0
Deposit growth (aop)	22.9	18.8	36.4	28.0	78.3
Loan-to-deposit ratio (eop)	1.18	1.03	1.04	0.85	0.79
Financial soundness indicators (%, eop)					
- non-performing loans to total loans*	3.9	5.4	4.1	3.2	2.1
- regulatory capital to risk-weighted assets	17.3	18.4	18.8	18.4	19.5
- liquid assets to total assets	10.7	10.0	9.4	13.3	11.6
- return on equity	14.7	11.5	11.4	15.5	49.9
- forex loans to total loans	39.9	38.0	34.0	42.2	32.6

* including the impact of write-offs.

Sources: National Central Bank, IHS Markit.

3. PUBLIC FINANCE

The fiscal stance tightened as budget outturn continued to outperform expectations in 2022. The central government ended the year with a budget deficit of TRY 139.1 billion (0.9% of GDP), significantly below the original budget target, the revised budget target of 3.4% (of September 2022), and the previous year's deficit of 2.8% of GDP. Preliminary estimates also point to a marked fall of the general government deficit to around 1.0% of GDP, instead of the expected 3.2% of GDP. The better-than-planned budget outturn is not fully reflected in the ERP analysis due to the late availability of the data, but it materially changes some of its conclusions. Very high inflation and good corporate profits boosted the revenue side and total budget revenue increased to an estimated 20.7% of GDP, or 2 pps above the initial budget. Despite a significant increase in transfers and lending to contain the pressures from high energy prices and support the liraisation strategy, overall government spending growth was restrained, and total spending even declined to 21.7% of GDP mainly due to lower personnel expenditure and social transfers. The stable exchange rate since the summer of 2022 also brought tangible savings as expenditure on the FX-protected deposits scheme turned out lower than planned. The financial repression measures that forced domestic banks to increase their holdings of government bonds helped to lower interest payments as a share of GDP, more than offsetting the effects of the weaker lira. With an estimated positive and growing output gap, the actual fiscal stance had become strongly counter-cyclical, and the structural balance turned to surplus.

Following a widening of the budget deficit in 2023, even before the recent earthquakes, the ERP targets a mild consolidation over the medium term. The fiscal stance is expected to become pro-cyclical as government expenditure, both structural and one-off, is set to increase strongly in 2023, influenced by the election cycle. Earthquake-related public reconstruction spending will add to the expenditure pressure. However, the authorities' initial response was to try to accommodate reconstruction costs within the 2023 budget, by redirecting and prioritising appropriations. They have also raised donations from the central bank, state-owned banks, and state-owned enterprises, and declared that they stand ready to raise additional revenue if needed. Foreign donors also pledged substantial amounts for reconstruction efforts at the donors' conference organised by the European Commission and the Swedish Presidency of the Council in March. After deteriorating in 2023, the primary balance is planned to improve by 1.9 pps in 2024-2025 to a surplus of 1.5% of GDP, which is close to the level achieved in 2022. The medium-term consolidation plan is expenditure-driven, while the revenue-to-GDP ratio is set to decline marginally. The expiry of one-off and other temporary measures and lower public consumption is expected to contribute to a total fall in spending by 2.5 pps. Government investment is set to remain at a very low level (2.5% of GDP), while interest payments are set to increase to around 3% of GDP. The quality and credibility of the medium-term consolidation plan are affected by a lack of detailed measures in the ERP to back the plan up and from the continued suppression of productive capital expenditure.

Table 3

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

	2021	2022	2023	2024	2025	Change: 2022-25
Revenues	30.9	29.5	30.8	30.5	30.4	0.9
- Taxes and social security contributions	24.5	23.9	25.1	25.0	25.0	1.1
- Other (residual)	6.4	5.6	5.6	5.5	5.4	-0.2
Expenditure	33.5	32.8	34.3	32.9	31.8	-1.0
- Primary expenditure	30.9	30.3	31.2	29.8	28.9	-1.4
of which:						
Gross fixed capital formation	2.6	3.0	2.5	2.5	2.5	-0.5
Consumption	14.4	13.4	13.8	13.4	13.3	-0.1
Transfers & subsidies	6.8	5.8	7.2	6.2	6.1	0.3
Other (residual)	7.1	8.1	7.7	7.7	7.0	-1.1
- Interest payments	2.6	2.5	3.1	3.1	2.9	0.4
Budget balance	-2.6	-3.2	-3.5	-2.4	-1.4	1.8
- Cyclically adjusted	-2.3	-3.7	-3.9	-2.7	-1.7	2.0
Primary balance	0.0	-0.7	-0.4	0.7	1.5	2.2
- Cyclically adjusted	0.3	-1.1	-0.7	0.4	1.3	2.4
Gross debt level	41.8	36.7	35.2	33.6	32.1	-4.6

Sources: Economic Reform Programme (ERP) 2023, Commission calculations.

Pre-election fiscal largesse is challenging the authorities' commitment to fiscal discipline and is undermining efforts to reduce imbalances. The parliament approved the 2023 central government budget on 16 December, planning a deficit of TRY 659.4 billion (3.5% of GDP). The budget is based on the rather optimistic macroeconomic assumption of 5% real GDP growth and 24.9% average consumer price inflation. Total revenue is planned to increase by 36.0% and expenditure by 52.0% in comparison to the 2022 budget outturn. The large increase in expenditure in an election year would support domestic demand at a moment when the economy is already overheating and inflation is significantly above the central bank target. It would also make it harder to lower inflationary pressures and external imbalances, while exacerbating an environment of continued macro-financial volatility, and most likely triggering additional distortionary regulatory measures.

The 2023 budget introduced some new measures but failed to fully exit the 'crisis mode' of ad hoc decisions. On the revenue side, the 2% accommodation tax adopted 2 years ago started to be applied at the beginning of the year. The corporate income tax rate has been lowered as planned to its standard rate of 20%. The ERP, however, did not clarify the status of the numerous tax reductions and exemptions introduced to fight inflation and support the lira, and other temporary measures, which had significant impact on budget revenues in 2022. On the expenditure side, the budget continues to underwrite costly and poorly targeted measures to support the lira and cushion the impact of high energy prices, although lower-than-expected international gas prices are likely to provide some relief and lead to sizeable savings. The budget will also finance subsidised loan programmes and a new social housing construction project that were announced last year. Some measures with large budgetary impact, increasing non-discretionary expenditure, were finalised after budget adoption and are not fully reflected in the budget. These include a 54.7% increase in the net monthly minimum wage, a hike in civil servant salaries and pensions by 30% (above the level prescribed by existing rules), and the removal of the age requirement for early retirement (affecting more than 2 million people and likely adding up to 1% of GDP to budget expenditure in 2023). The budget also did not take into consideration new tax amnesty legislation (revenue-restructuring and outright forgiveness for small obligations to the state) that was adopted at the beginning of 2023.

Debt dynamics

Türkiye

Composition of changes in the debt ratio (% of GDP)

	2021	2022	2023	2024	2025
Gross debt ratio [1]	**41.8**	**36.7**	**35.2**	**33.6**	**32.1**
Change in the ratio	2.1	-5.1	-1.5	-1.6	-1.5
Contributions [2]:					
1. Primary balance	**0.0**	**0.7**	**0.4**	**-0.7**	**-1.5**
2. “Snowball” effect	**-8.5**	**-15.8**	**-6.7**	**-3.8**	**-1.8**
Of which:					
Interest expenditure	2.6	2.5	3.1	3.1	2.9
Growth effect	-3.2	-1.1	-1.3	-1.5	-1.6
Inflation effect	-8.0	-17.2	-8.5	-5.3	-3.1
3. Stock-flow adjustment	**10.6**	**10.1**	**4.9**	**2.9**	**1.8**

[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) 2023, Commission calculations.

The ERP projects that government debt will decline steadily, to 32% of GDP in 2025. The debt ratio peaked at 42.3% of GDP in early 2022 but came down strongly by the end of the year, to 31.7% of GDP, below even the ERP estimate of 36.7%. Net debt also declined. The strong denominator effect from the very high inflation was the main reason for the steep fall in the debt-to-GDP ratio in 2022. Although deteriorating in 2023, the primary balance is expected to return to surplus in 2024 and to be a stabilising factor for the government debt ratio. High inflation is projected to remain the main driver of debt reduction, but its contribution is set to decrease substantially, in line with the ERP’s sanguine assumptions about the pace of disinflation. Forecast real GDP growth is expected to cover around half of the debt-increasing effects from interest payments. The debt-increasing contribution from stock-flow adjustments, stemming mainly from the depreciation of the lira, is projected to subside rapidly in 2023 due to the expected relative stability of the exchange rate.

Heavy-handed regulatory measures affected the government securities market but did not fundamentally address debt vulnerabilities. The authorities introduced requirements for commercial banks to increase their holdings of government debt denominated in lira. As a result, yields on government bonds fell across the board to levels close to those on foreign exchange-denominated securities, despite the much higher domestic inflation rate. The banking sector’s share in domestic debt reached 76.9%, up nearly 30 pps over the last 5 years, as corporate investors reduced their exposure and non-residents left the market entirely (their share was below 1%), further shrinking the investor base. Concerted 'liraisation' efforts increased the share of new domestic borrowing in lira to 90% in 2022. Nonetheless, because of its depreciation, the lira's share in government debt stock went up only marginally from 34.0% to 34.5% in 2022, while close to two thirds of the debt stock was still denominated in foreign currencies. The weighted average maturity of domestic borrowing increased further from 53.5 to 70 months, raising the average time to maturity for domestic debt to 3.6 years. However, the average time to maturity for the total debt stock remained unchanged at 5.4 years, as external debt maturity decreased for a fifth year in a row to 7.1 years. After peaking at historically high levels (above 900 bps) in the summer, affected by changing domestic and global financial and geopolitical conditions, Türkiye's 5-year credit default swap spread declined by around 400 bps but remained very high at above 500 bps. Reflecting increased macro-financial risks, Türkiye's long-term sovereign rating was lowered by all major rating agencies in 2022.

Although fiscal policy has been tight, risks are growing. The relatively good budget performance in recent years masks an underlying trend of rising fiscal pressures, which escalated further in the run-up to the election. Some crisis-related measures, like FX-guaranteed lira deposits and energy-crisis-related transfers and lending, had a direct and sizeable impact on the budget. The FX-guaranteed deposits also remain a potentially significant source of budget liabilities, above the amounts envisaged in the 2023 budget. Some policy decisions, like subsidised and directed lending via state-owned banks, ultimately also have a bearing on the budget via lost tax revenue and the need for frequent recapitalisations. Systematic public information on expenditure arrears is lacking. The government's liquidity preference remained high, with public sector deposits and other financial assets persistently above 5% of GDP since mid-2020. In addition, the 2023 budget also contains large reserve appropriations (0.5% of GDP) and other buffers, the latter partly stemming from interest payments, which are likely overestimated in the current financial repression context.

After some improvements in recent years, the quality of public finance deteriorated. Successive crises and shocks triggered the adoption of numerous ad-hoc measures with budgetary effects that have strained public finance management. Economic volatility and additional demands on the budget have also led to recurring budget revisions, derailing the regular budget process. Despite a limited increase in capital spending in 2022, investment in human and physical capital is low and is expected to remain so over the duration of the programme. The multiple tax exemptions and reductions undermine tax bases and complicate planning (tax expenditures are sizeable), while successive tax amnesties have now become the rule rather than the exception, despite official policy declarations. The planned new single, consolidated framework for all public-private partnerships has yet to be adopted. The framework is to be fully integrated in the budget process and should be designed to improve management and monitoring. The government continued to use the negotiated procedure in its procurement deals, which allows contracting authorities to limit competition and transparency by referring to discretional criteria that cannot be objectively measured.

The fiscal framework lacks strong anchors. Even though the fiscal performance has been consistently robust in recent years, there are still no national fiscal rules or 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. Macroeconomic forecasts underpinning budgetary planning remain biased, repeatedly underestimating domestic and external imbalances. Some steps have been taken to strengthen the system of public internal financial control by updating the relevant legislation and improving administrative capacity.

4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES

Türkiye benefits from a strategic geographical position, a strong and entrepreneurial business sector, a large domestic market and a young population. It also has privileged access to the EU market for goods through the customs union with the EU. Since the early 2000s, the Turkish economy has relied on credit growth and foreign financing to provide jobs for the many new entrants to the labour market. As a consequence, structural imbalances worsened, amplifying the economy's vulnerability. As Türkiye 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 has fuelled record-high inflation and strained economic fundamentals.

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 Türkiye 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. raising the level of skills in order to increase employment, in particular among women and young people;

ii. improving transparency and predictability in the regulatory and institutional environment affecting businesses; and

iii. improving energy security, primarily by supporting the economy's green transition and increased energy efficiency.

Overall, Türkiye needs to improve the rule of law and the independence of the judiciary, and strengthen institutions to promote competitiveness and attract foreign investments. On the green transition, Türkiye needs to swiftly and decisively step up implementation of climate, clean energy and environmental policies. Addressing these fundamental concerns is a prerequisite for successfully transforming the economy.

Furthermore, the country should proactively implement the Energy Community's Decarbonisation Roadmap to achieve the agreed climate and energy targets, and strive towards establishing a carbon pricing instrument compatible with the EU ETS.

Impact of the earthquakes of 6 February 2023 on the analysis of structural challenges and overall priorities

The earthquakes of 6 February 2023 constitute, first and foremost, a humanitarian crisis. However, from an economic standpoint, the full impact of the earthquake is yet to be assessed. The 11 provinces affected by the recent events account for around 16.5% of Türkiye's overall population, and around 10% of Turkish GDP. In the World Bank's Post-Disaster Damage Estimation Report ([2]), direct damages from the earthquakes are estimated at approximately USD 34.2 billion (equivalent to 4% of Türkiye's 2021 GDP).

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(2) The World Bank Group, Global Rapid Post-Disaster Damage Estimation (GRADE) Report, 6 February 2023 Kahramanmaraş Earthquakes, Türkiye Report, 20 February 2023.

More than 105 000 low-rise houses and multi-story apartment buildings have been reported as severely damaged, including 9 432 buildings reported as collapsed. In line with these staggering figures, damages to residential buildings, put at USD 18 billion, account for the greatest share – 53% – of the total direct damages. Damages to non-residential buildings, (USD 9.7 billion) account for 28%, and damages to infrastructure (USD 6.4 billion) for the remaining 19%.

The World Bank estimates the cost of readying Türkiye's existing buildings to earthquakes at around USD 465 billion, or 55% of GDP. With the increased awareness towards earthquakes, households, firms and government should be expected to allocate a significant amount of their investment budgets to renew and fortify the existing real estates and infrastructure. While such expenditures must be made at all costs to save lives and economic assets, compared to a counterfactual scenario where all those investments would go to creating additional productive capacity, the short to medium term growth potential of the country would be lower.

It is clear, therefore, that this year's ERP assessment of structural challenges, which is based on a set of assumptions preceding the earthquakes, needs to be read in conjunction with Türkiye's priorities following these disastrous events. While the European Commission believes it is worthwhile going ahead with this year's analysis, it is obviously aware of the implications of the recent events for Turkish society and for the economy. The analysis outlined in this section should therefore be read in the spirit of constructive cooperation with Türkiye that underlies the ERP, despite the obvious shift in the Turkish government's priorities.

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

Türkiye's labour market has rebounded strongly from the COVID-19 crisis. Labour market indicators show a positive trend and an increased employment rate (among those aged 15+) from 42.7% in 2020 to 45.2% in 2021, improving further to 47.5% in 2022. The unemployment rate (15+) decreased from 13.1% to 12% in 2021 and stood at 10.4% in 2022. The unemployment rate for women decreased to 13.4% (14.7% in 2021). However, despite this recovery and the overall economic upturn, the gap between male and female employment remains significant, with female activity and employment rates less than half the male rates. In 2022 the employment rate for men was 65% against only 30.4% for women, leading to a gender employment gap of 34.6 pps. Female labour force participation rate recorded a slight increase but remained low at 35.1%. Barriers in certain occupations, patriarchal views and traditions, and lack of skills all restrict female labour force participation. The lack of adequate childcare facilities and the fact that state schools are often only open on a half-day basis makes working especially difficult for women with children. Policies aimed at the activation of women in the labour market have so far yielded limited results.

Active labour market policies aimed at getting women into the labour market have had little structural impact. 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. In 2019, two further programmes started which support childcare provision, but they only involve 14 000 working mothers. These measures are commendable but, given the size of the Turkish labour market, they remain limited in scope and impact. Part-time work – often appropriate for working mothers – is less common in Türkiye than in the EU (10% versus 19%). The low rate of women's labour market participation limits

Türkiye's economic growth outlook. According to a McKinsey study conducted in cooperation with the Turkish Industry and Business Association (TÜSİAD) ([3]) in 2016, Türkiye's GDP would increase by 20% if it were to reach the OECD average activity rate for women (53.1% in 2019) within 10 years. This still holds true. A higher labour force participation of women is a cornerstone for improving Türkiye's economic growth potential.

Due to natural population growth and immigration, the workforce will further increase in the coming years. Hundreds of thousands of people will join the labour market every year. According to estimates, the population could reach 100 million by 2040. To reap the benefits of the growing workforce and to avoid informal employment, under-employment and unemployment, Türkiye needs to address its structural weaknesses such as low female labour participation, school-to work transitions and human capital development.

Young people continue to have difficulties entering the labour market. The youth unemployment rate (aged 15-24) decreased from 22.6% in 2021 to 19.4% in 2022. But the rate of young people not in employment, education or training (NEETs) is still structurally high at 24.7% in 2021. With the adoption of the national youth employment strategy and action plan, Türkiye is aiming to reduce the NEET rate to 20% by end of 2023. Türkiye needs to upgrade its school, tertiary, and vocational training system to be able to bring the NEET rate closer to the EU average of 13.1% (2021). Most of the NEETs in Türkiye are again young women, which entrenches women's disadvantaged position on the labour market as they have even less chance than men to upgrade their professional skills with on-the-job-learning. According to some estimates*,* 82% of Turks between the ages of 17 and 30 would move abroad if they could. This is a clear mandate for stepping up efforts to provide more economic opportunities for young people in Türkiye. Türkiye's Public Employment Service of organises *virtual fairs* (reform measure 2) to bring job-seekers and employers together. This is a commendable measure and has the potential to facilitate school-to-work transitions to some extent. In order to bring Turkish NEET rates closer to the EU average, active labour market measures and activation schemes inspired by the EU Youth Guarantee, targeting young people not in education, employment or training would be needed.

The informal economy continues to compromise the state's tax and social security revenues. As the country has industrialised and the economic significance of agriculture has shrunk, the number of informally employed people has been decreasing over the years. However, around 28% of all workers still have no social security protection against illness, accident and old age. Undeclared work among refugees and Syrian nationals under temporary protection is even more common. They often work for less than the minimum wage and faced considerable hardship in 2022 as soaring inflation made basic goods and services unaffordable. Türkiye cannot afford to leave them behind and should pursue its formalisation policies with enhanced labour and tax inspection. Ensuring occupational health and safety at work also remains a priority for Türkiye, even more so in sectors where more accidents are recorded such as the construction sector, metallurgy and mining. In the context of the debris removal and reconstruction process after the dramatic earthquakes of February 6th, it will be paramount to ensure Occupational Safety and Health in particular regarding the risk of exposure to hazardous materials and the need for workers to be properly equiped and protected. This is also in the interests of Turkish businesses paying taxes and social security contributions, which want a level playing field for their business activities.

([3]) https://tusiad.org/en/reports/item/9642-women-matter-turkey-2016-report-turkey-s-potential-for-the-future-women-in-business.

Introducing greater flexibility in the labour market with more part-time work would help, as would replacing the current rigid severance pay system with upgraded unemployment benefits. In particular, this would help SMEs to create more formal jobs without outsourcing parts of the work to informal workers. The minimum wage should enable a decent standard of living without disincentivising the creation of formal labour. The net minimum wage is currently TRY 8 560 (EUR 428). According to the Turkish trades union confederation, TÜRK-İŞ, a single household needs currently TRY 10 612 (EUR 530) to be above the poverty line. The number of working poor has grown in Türkiye. In view of the high inflation, several adjustments to the minimum wage were essential in 2022 to prevent widespread impoverishment.

The government with its social partners should foster social dialogue at sectoral or branch level in the private sector, to enable the social partners to settle on an appropriate wage level for the individual sector or branch. Unfortunately, the rarity of collective bargaining and the under-developed social dialogue in the private sector constitute a missed opportunity for a sound approach to wage setting and tapping into the social partners' knowledge on vocational training, reskilling and upskilling.

The quality of school education has improved over the years in Türkiye, as demonstrated by the results of the OECD programme for international student assessment (PISA). Yet the results for 15-year-olds in reading, mathematics and science are still below the OECD and EU averages. There is notably no universal enrolment of 5-year-olds, of whom around 91% are currently enrolled at school. Early childhood education and care lays the basis for good performance later in school and should be prioritised, including before the age of 5. ERP reform measure 3 '*Access to preschool education will be provided based on equal opportunity principle*' aims among other things, at universal enrolment of 5-year-olds and granting an education to children in disadvantaged areas. This is a commendable initiative. Further efforts are required to increase the availability of child care below the age of 5 to improve learnng outcomes, increase the participation of women in the labour market thus strenghtening the economy and reducing poverty. In addition, Türkiye has introduced ERP reform measure 4 '*Specialised institutional guidance and inspection branches will be established depending on school and program types*', which aims to ensure quality in the delivery of education. Moreover, Türkiye is initiating ERP reform measure 14 '*Improving special education services, guidance and psychological counselling services.'* The latter targets students with special needs. The measures point in the right direction.

The quality of tertiary education must be upgraded, too. According to the OECD survey on adult education (under the programme for the international assessment of adult competencies – PIAAC), Türkiye has the biggest skills gap of any OECD country for workers with tertiary education. In addition, unemployment rates for graduates from tertiary education are higher than the rates for those with vocational training. Most unemployed graduates are women, whose studies are often not geared towards the needs of the labour market. Other factors that hamper the integration of educated women into the labour market – particularly in rural Türkiye – are traditional stereotypes linked to the role of women in the family and a lack of job opportunities. The Türkiye's national youth employment strategy (2021-2023) aims to provide a closer link between education and the labour market through career information and outreach activities. This is commendable but its impact remains to be seen.

Vocational education and training (VET) has the potential for getting people into jobs more quickly and for reducing the skills gap and the skills mismatch on the labour market as the economy develops, notably in the green and digital sectors. The labour market uptake is better for VET-trained students than for students with tertiary-level education in Türkiye. This is particularly relevant as the country has still a great deal of informal employment, high youth unemployment and a high NEET rate. The Turkish Ministry of National Education (MoNE) is in charge of VET education in Türkiye. The Vocational Education Board, composed of ministries, representatives from trades unions and employers' associations and public institutions, ensures that VET education is aligned with economic needs. MoNE has a strategic framework (2019-2023 strategic VET plan (in Turkish)) with seven objectives and 33 sub-objectives. They have become a part of the 2023 education vision. As regards the delivery of VET, upper secondary VET education is delivered through public and private vocational and technical Anatolian high schools. Türkiye has also introduced dual education for some VET students enrolled in vocational training centres. These students work in a company 4 days a week and go to school for 1 day. However, a large majority of students still attend classical VET schools. More work-based learning and focus on practical skills would help make VET education in Türkiye more practically relevant and would smooth school-to-work transitions. By progressively applying EU quality frameworks for traineeships[4] and apprenticeships[5] and Türkiye could improve the quality and relevance of work based learning opportunities and thus make VET more attractive to students. With a view to opening access to higher education, VET students have the right to sit exams for tertiary education if they cover the necessary preparatory courses.

In this context, Türkiye introduced ERP reform measure 13 'digital skills in VET curricula'. This is a very welcome reform step on the path towards digitalising the economy. Yet the outreach should go beyond the 5 updated programmes every year.

As regards adult education, Türkiye, just like EU countries, needs to embrace a culture of lifelong learning. The country endorses the Osnabrück Declaration objective of establishing a new lifelong learning culture. Lifelong learning is also referenced in the MoNE's strategic framework. For the 25-64 age group, participation in adult learning in Türkiye has increased but, at 5.8% (2020), it is still far below the EU average of 10.8% (2021). The need for more adult learning is also demonstrated by the OECD PIAAC survey on adult education, which reveals that Türkiye's performance is well below the OECD average for literacy, numeracy and problem-solving skills in technology-rich environments. Unsurprisingly, this leads to a skills gap. According to a MANPOWER survey, around 80% of Turkish employers have difficulties filling vacancies. The resultant labour shortages hamper growth prospects for the whole economy. Structural reform measure 1 '*Future professions'*, rolled over from last year's ERP, aims to upskill young people by on-the-job-training. However, the modest outreach of 1 000 training courses per year will not have a significant impact on Türkiye's economy. Bolder measures should follow.

To promote faster technological development, automatisation of industry, decarbonisation of the economy and continuous integration in global value chains, the Turkish economy needs comprehensive and ongoing skills upgrading of its workforce. According to World Bank, 13-18% of all Turkish workers may be at risk of dismissal. The Ministry of Labour and Social Security is starting to work on job transition strategies. Currently, Türkiye's labour force does not have the skills to enable the green and digital transition of Türkiye's economy. Particular attention needs to be paid to workers depending on fossil fuel industries, notably domestic coal and lignite, who are exposed to economic and social risks as the global and national economy speed up decarbonisation processes in line with the Paris Agreement objectives; an

(4) Council recommendation of 10 March 2014 on a European Quality Framework for Traineeships.

(5) Council recommendation of 15 March 2018 on a European Framework for Quality and Effective Apprenticeships.

ambitious just transition plan is urgently needed for these categories of workers.

Box: Monitoring performance on the European Pillar of Social Rights ([6])

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 people in the EU. The associated action plan, adopted on 4 March 2021, aims to rally all relevant parties to turn the principles into action. Since the 20 principles provide a compass for levelling up working and living conditions in the EU, they are also relevant for candidate countries and potential candidates.

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

Türkiye's labour market indicators have improved but structural problems persist, especially for young people and women. The employment rate has been improving – from 42.7% in 2020 to 45.2%, and improving further to 47.5% in2022. according to TurkStat. The unemployment rate decreased from 13.1% to 12% in 2021 and to 10.4% in 2022. It was still above the EU average of 6.1% in 2022. While long-term unemployment has slightly deteriorated in recent years to 3.3% in 2020, it is not significantly worse than the EU rates of 2.8% in 2021 and 2.4 in 2022. The youth NEET rate (aged 15-24) decreased to 22.6% in 2021. The gender employment gap is the highest in the region at 34.6 pps, compared with the EU average of 11 pps. A significant proportion of the female population never enters the formal labour market.

TÜRKIYE		
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., improving
	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., improving
	Unemployment rate (% of population aged 15-74)	Worse than EU avg., improving
	Long-term unemployment rate (% of population aged 15-74)	Worse than EU avg., improving
	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., stable
	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%. Primary education is not yet universal and 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 PISA results.

The impact of social transfers on poverty reduction remains very low. It accounts for only 8.94% (EU average 32.38%), although the figures are slowly improving. The rate of people at risk of poverty or social exclusion (AROPE) continues to increase. In Türkiye, 34.1% of the population and 43.4% of children are AROPE, compared to the EU averages of 21.7% and 24.4% respectively. Income distribution remains the most uneven in the region with the income quintile ratio at 9.20 compared to the EU average of 4.97.

Türkiye has a well-developed system for labour market and social statistics. The Turkish Statistical Institute (TurkStat) is the main producer and coordinator of Türkiye statistical system. TurkStat publishes the labour force survey monthly, quarterly and annually and the survey on income and living conditions annually.

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[6] The table in this box includes 16 of the Social Scoreboard's headline indicators , which are used to compare the performance of EU Member States (https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators), and also of the Western Balkan countries and Türkiye. The assessment includes the country's performance in relation to the EU-27 average (performing worse/better/around the EU-27 average; 2020 data are generally 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.

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

The institutional and regulatory framework remains fragile, particularly as regards predictability, transparency and efficiency, although some action has been taken to improve dispute settlement. The serious backsliding in recent years with regard to the judicial system continued to undermine business trust in its efficiency and independence. Effective measures to strengthen the rule of law, ensure adequate and timely contract enforcement and improve the availability and functioning of dispute settlement mechanisms are key factors for improving the business environment. Intellectual property rights enforcement remains very weak. Increased state interference in the economy and the lack of State aid checks hinder market-based consolidation of a level playing field for business.

Türkiye recognises the importance of a transparent, high quality and effective **judiciary** for economic activity. Measures under the 2019 judicial reform strategy have aimed to improve the functioning of businesses and have included facilitating the setting-up of specialised courts and providing online access to court decisions. These steps may have improved procedures technically but there is no evidence-based assessment of the results of strategy implementation. Most importantly, the measures do not address structural deficiencies in the judicial system, in particular with regard to its independence and professionalism, and thus do not lead to significant improvements in its overall functioning.

Effective measures to ensure appropriate and timely **contract enforcement and to improve the availability and functioning of dispute settlement mechanisms** remain crucial for improving the country’s business environment. Türkiye has introduced some important measures to improve the resolution of commercial disputes. In particular, it ratified the Singapore Convention for international commercial disputes in April 2022 and has further promoted mediation in a number of fields. However, commercial judicial processes remain slow, and a large backlog of commercial court cases persists. The reform of the bankruptcy system has yet to bring results while procedures are still costly and slow, with a low recovery rate. Since 2017, the average duration of bankruptcy and insolvency proceedings has been growing. With a view of streamlining bankruptcy case law, fast-track procedures could be introduced for SMEs, which represent the backbone of Turkish economy. Moreover, a distinction could be drawn in the law between regular and fraudulent proceedings.

The regulatory environment remains unstable and unpredictable and in some cases is an obstacle to fair competition. The independence of key regulatory authorities continued to be compromised by the increasing direct influence of the Presidency in their functioning. Preparations are underway for the 12th Development Plan for 2024-2028, with wide participation of stakeholders and social partners. In 2022, the Coordination Council for Improvement of the Investment Environment continued to hold meetings with private sector representatives. Despite these preparatory steps, the results of these meetings and related action plans are not reported. Besides this, no improvement can be reported in the use of consultation mechanisms to develop relevant legislation. There are still 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. Though a legal framework is already in place for regulatory impact assessments, such studies are still rarely carried out. As underlined in the OECD SME Policy Index 2022,[7] in practice, regulatory impact assessments are not

(7) OECD, *'SME Policy Index: Western Balkans and Turkey 2022'*, 8 July 2022.

being conducted for primary legislation – they are only conducted for subordinate legislation on an *ad hoc* basis, at the discretion of the Presidency.

Additionally, legislation on easing private investment has not been finalised despite the fact that comprehensive draft legislation had been drafted and was being revised in light of feedback from stakeholders.

Market interventions by the state hinder competition and the businesses' ability 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 State aid rules is long overdue in Türkiye, and its absence hinders enforcement and transparency. The current structure for monitoring State aid is not complete, independent or operational. Türkiye has not formally set up a comprehensive and transparent state inventory of all aid schemes. The Ministry of Industry and Technology, the Scientific and Technological Research Council (TÜBİTAK) and the Small and Medium Enterprises Development Organisation (KOSGEB) provide medium-high and high-technology sectors with support and incentives to increase value-added production; Türkiye is now implementing a special programme, the technology-focused industrial movement programme, to intensify the support and incentives.).

State intervention in price-setting mechanisms expanded in key sectors, which hampers the free functioning of product markets. More than a quarter of the consumer basket is composed of goods whose prices are set or heavily influenced by the public authorities. The authorities have continued to use a sliding scale system to curb the inflationary pressures coming from oil prices. Furthermore, from the beginning of 2022, Türkiye has implemented an electricity tariff system based on the level of consumption (block tariffs). The regulator has been also authorised to set up a tariff for vulnerable consumers before the gradual lifting of some subsidies.

The Türkiye Wealth Fund (TWF) and the Savings Deposits Insurance Fund (SDIF) are largely exempt from transparency requirements and competition. The TWF further expanded its presence in the economy. Created under a special law in 2016, the TWF is fully owned by the government. It holds shares in major companies in the financial, telecommunications, petrochemicals, real estate, mining, agriculture, and transport sectors. The TWF continues to enjoy a number of exemptions which are problematic from the competition point of view, such as exemptions from various taxes, charges and rules on (publicly held) corporations' transactions. In 2022 significant amendments were introduced to the TWF's legislative framework, further extending the exemptions and exceptions to cover companies, funds and their subsidiaries in which the TWF has become the controlling shareholder. TWF total assets increased to TRY 3.2 trillion at the end of 2021, up from TRY 2.2 trillion (44% of GDP) in 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 SDIF remains non-transparent and the number of companies managed under its trusteeship is still high at 683 companies with a total asset value of TRY 109.9 billion at the end of 2022. There is neither a schedule for releasing all companies from trusteeship, nor appropriate, effective, and timely means of legal redress.

Another factor disrupting the smooth functioning of the market is widespread distortion in the allocation of government contracts and assets. Türkiye 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 increasing use and wide scope of exemptions in procurement procedures have undermined the integrity of public procurement. The government continued to award several large public-private partnership contracts for big infrastructure projects to a small number of companies.

Finally, the legal framework regulating the **fight against money laundering** and terrorist financing needs to be improved in line with recommendations by the Financial Action Task Force and the Venice Commission.

The informal economy continues to distort the level playing field for businesses and thus undermines competitiveness. Despite a gradual decline, the informal sector still accounts for a significant share of economic activity, well above OECD average. Türkiye has finished implementation of the 2019-2021 strategy and action plan and for the fight against the informal economy but the results are difficult to measure since no concrete performance indicators had been identified. The 2023-2025 action plan was adopted at the end of 2022. It aims to reduce the informal economy and help to improve certain macroeconomic indicators such as income distribution, economic growth and employment.

Geopolitical uncertainties, the build-up of macroeconomic imbalances and an unpredictable business and regulatory environment, remain the main obstacles to attracting foreign investment. In 2021, foreign direct investment in Türkiye amounted to USD 6.8 billion, while in the first 11 months of 2022, net foreign direct investment inflows increased by USD 937 million compared to the same period in 2021 and totalled USD 7.1 billion. Türkiye's foreign direct investment strategy (2021-2023) continued to be implemented. Still, major obstacles discouraging potential investors have not yet been addressed. These include difficulties in getting approvals, weak enforcement of industrial and property rights and hidden market restrictions. The uncertainties and risks for investors increased further due to the strong depreciation of the lira, and the unpredictability of the overall direction of Turkish economic policy.

Limited financial resources hamper business development and the growth of companies. While economic growth was strong in 2022 (5.6%), driven by both domestic demand and exports, access to finance remains limited, especially for SMEs. SMEs receive a smaller share of business loans than medium-capitalisation and large firms – around 25% of total loans granted to Turkish firms. SMEs are financed mostly through short-term loans or equity. Other forms of financing are not available due to the inability of most SMEs to provide financial statements or robust collateral. It is, however, worth noting that the OECD found that alternative sources of finance are present in Türkiye, and that some efforts have been made to provide companies with start-up financing.[8] In particular, the OECD underlined that non-bank finance opportunities are present across Türkiye, offering alternative sources of finance, although at a smaller scale (e.g. by way of leasing and factoring). Progress has also been made in providing equity-finance opportunities for early-stage companies, and previous efforts to develop a local market for venture capital are beginning to reap their benefits. Finally, there is a number of financial support schemes in place to boost venture capital activity, also by establishing a platform for crowdfunding. A new crowdfunding legislation entered into force in late 2019 and was further strengthened in 2020 and 2021. This legislation enabled, and now regulates, both equity- and debt-based crowdfunding, in addition to the previously existing reward-based model.

(8) OECD, *'SME Policy Index: Western Balkans and Turkey 2022'*, 8 July 2022.

Measure 5a: 'Prioritizing technological product investments to increase the technology level and export capacity of SMEs and supporting the commercialization of R&D projects' and **Measure 5b: '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'** are both ambitious initiatives, but they do not appear to be part of a coherent policy. The government does not seem to be targeting either highly productive firms or firms with potential to grow (e.g. start-ups). The distribution seems to be rather arbitrary.

On digitalisation, **measure 7: 'Establishing Model Factories (SME Competency and Digital Transformation Centers) and Innovation Centers to increase the efficiency of SMEs and their digital transformation'** has been rolled over from the previous ERP. As the measure has been in place for some years now, some impact-related indicators could usefully be added. Currently all indicators are about the service provided, rather than the real objective of the measure.

Key structural challenge 3: Improving energy security, primarily through supporting the green transition of the economy and increased energy efficiency

Türkiye faces critical environmental and climate challenges, both in terms of mitigation and adaptation. Due to strong economic and demographic growth and the use of a high-emission energy mix, greenhouse gas emissions have increased by more than 185% (including land use, land-use change and forestry - LULUCF) since 1990, making Türkiye the fastest-growing emitter among G20 countries. Air quality, water pollution and pollution generally are a major concern, especially in large cities and industrialised regions. Global warming is depleting water resources in Türkiye's already semi-arid climate. More ambitious climate and environment policies are needed to make the Turkish economy effectively more sustainable and fir for future challenges.

Türkiye ratified the Paris Agreement on 6 October 2021 and adopted a first Nationally Determined Contribution including an objective of reducing greenhouse gas emissions by 21% below a business-as-usual scenario. Türkiye released a 'Green Deal action plan' on 16 July 2021. While this roadmap demonstrates the willingness of the Turkish government to engage with the green transition, **it does not set a time-bound and clear overall objective; most importantly, it fails to turn the Green Deal into an actual economic and social development strategy**. Moreover, while **Türkiye pledged to reach net zero emissions in 2053**, to date, it has not formally adopted its long-awaited climate law nor has it updated its Nationally Determined Contribution for 2030. Disappointingly, Türkiye announced at COP27 an updated Nationally Determined Contribution, setting 2038 as an emission peak year. This translates into increasing today's greenhouse gas emissions by more than 30% until 2030, a perspective that is hardly compatible with net-zero in 2053. In addition, a detailed long-term strategy is still necessary in order to substantiate the goal of reaching net-zero by 2053. The establishement of a national emission trading system (ETS) aligned with the EU ETS and with a sufficient level of ambition notably in the overall cap of allowances remains a necessary pre-condition for the Turkish economy's cost-effective decarbonisation; a pilot ETS is expected to start in 2024.

The long-term national energy strategy was released in December 2022 and Türkiye announced its **national energy plan for 2020-2035**. The government aims to reach a total installed electricity capacity of 189.7 GW (of which 7.2 GW nuclear, 52.9 GW solar and 29.6 GW wind) by 2035. The planned scenario also involves significant climate mitigation elements, such as reducing energy intensity by 35.3%, increasing the share of renewables in total electricity generation capacity to 64.7% and sharply cutting the share of fossil fuels in primary energy consumption by 2035, in line with the net zero emissions pathway toward

2053. To support these objectives, continued coordination between energy subsidies, taxation and overall green policies is vital, in particular a phase-out of fossil fuel subsidies and increased taxation weighing on fossil energy compared to renewables. In line with this, **measure 8: 'Technical assistance for the Green Deal action plan'** included in the ERP, once again, does not seem be sufficiently ambitious given the scale of the changes required in production and consumption patterns. Still missing are a clear roadmap and concrete policy steps and milestones to be undertaken to reach the objectives.

Additionally, a first draft of **national (climate) adaptation strategy** was shared with the Climate Change Presidency and internal consultations within the Ministry of Environment, Urbanisation and Climate Change are to be completed by mid-February 2023. The strategy will then be shared with other stakeholders, and unless major problems occur down the line, the strategy is set to be adopted by May 2023. The reconstruction process of areas devastated by the 6 February earthquakes must be based on the highest standards in terms of green and resilient buildings and infrastructure.

From an economic point of view, the ability to decarbonise, adapt to climate change and to move from linear to circular, sustainable, use of resources is key if businesses are to enjoy a competitive advantage in future. The Turkish 'Green Deal action plan', proposes an ETS system that is aligned with the EU system and that fosters the circular economy. Setting up such a system would help to decarbonise the economy and prepare for the implementation of the EU carbon border adjustment mechanism. Equally important is to foster the ability of agriculture, forestry and ecosystems to store more carbons and become more resilient to climate change. Eco-innovation is emerging in Türkiye, especially in the automobile and energy sectors. A first Climate Council was held in February 2022 to draw up 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 2022 ERP. While the target set for the number of replaced electric motors was 2000 in the last ERP, only 363 motors at 48 SMEs had been replaced as of November 2022. This is a commendable, modest contribution to addressing the challenges mentioned above and it can hardly be seen as a structural reform measure.

Türkiye has been steadily making progress on **diversifying energy supplies and increasing the share of energy generated from renewable sources**. Last year, renewables accounted for 53% of the country's installed capacity and 33% of electricity generation. However, the share of energy generated from renewable sources has not increased since the last ERP cycle and the overall share of renewables in total energy consumption has remained stable for the last 4 years. In addition, Türkiye's dependency on external energy supplies, in particular natural gas imports from Russia, is still significant. This dependency, combined with volatile international markets, has led to very high energy prices, which are among the key factors contributing to high inflation and putting pressure on the state budget. Türkiye's energy dependency on Russia is likely to increase with the completion of the nuclear power plant in Akkuyu, scheduled for 2023. Russia and Türkiye agreed in 2010 that the nuclear power plant would be built, owned and operated by a subsidiary of the Russian Rosatom. Türkiye still relies very much on coal-powered electricity generation and is still planning to open several coal-fired power plants – a move that is at odds with its commitment to the Paris Agreement and the latest recommendations from the International Energy Agency. Its gas sector is still dominated by the state-owned, vertically integrated gas company operating with subsidised tariffs, which does not promote competition in the sector. At the same time, Türkiye has high ambitions of becoming a regional energy hub, and is investing heavily in the exploration of new gas fields in the Mediterranean and the Black Sea, as well as in building new LNG terminals.

Achieving a balance between energy security, growing demand and decarbonisation is challenging. However, ensuring affordable, green and stable energy supplies is key for sustainable economic development. Increased use of renewable energy sources and greater energy efficiency are essential for transitioning to sustainable and secure energy and for dealing with the risks posed by the changing international energy market. Therefore, more ambitious climate and environment policies need to be established and implemented to create the necessary enabling environment for transition to a more modern and competitive economy. Further encouragement for the development of renewable energy installations (in full compliance with Türkiye's obligations under the customs union with the EU) can help to lower energy dependency and create new opportunities for businesses. A strong focus on reducing energy consumption through investment in energy efficiency, decarbonisation of transport, sustainable finance, support for research and development (R&D) activities and addressing the corresponding skills is key in moving towards a resource-efficient and zero-emission economy.

Developing sustainable finance – in particular by strengthening the legal framework (e.g. introducing green bonds) and working on a green taxonomy – is crucial, to encourage private investment 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 Türkiye have access to a broad range of financial support (grants, subsidised loans and similar) for their greening efforts, in particular support for improving energy efficiency and investing in eco-innovation.

Finally, the green transition requires 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 zero-emission economy

5. Overview of the implementation of the policy guidance adopted at the Economic and Financial Dialogue in 2022

Türkiye implemented the 2022 policy guidance to a limited degree. Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye has adopted targeted policy guidance 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 for the policy guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. Implementation of the policy guidance 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 2022 policy guidance jointly adopted by the EU and the Western Balkans and Türkiye at their Economic and Financial Dialogue at Ministerial level on 24 May 2022.

Overall: limited implementation (26.3%) ([9])	
2022 policy guidance (PG)	**Summary assessment**
PG 1: Rebalance the policy mix and use the available fiscal space in the 2022 budget to cushion the impact of adverse shocks through targeted support to vulnerable households and firms.	There was **limited implementation** of PG 1. 1) **Limited implementation.** The policy mix remained imbalanced as the central bank continued cutting its policy rate, despite the very high inflation. The fiscal stance tightened, as the government achieved a better-than-expected budget execution in 2022. It had to adopt a revised budget in July 2022 to allocate supplementary resources amid a surge in global energy prices and rampant inflation. Throughout the year, the government increased its support for households and firms via different channels (such as minimum wage hikes, support for energy bills, support for students, government-backed loan packages), although the massive increase in expenditure to cushion the negative impact of high energy prices was not well targeted. The budget funds allocated to current transfers for households and businesses in 2022 were increased but their share in the overall budget only increased marginally.
Increase the share of local currency in new borrowing and reduce the share of public banks holdings in domestic government debt.	2) **Limited implementation.** Despite an explicit commitment by the Ministry of Treasury and Finance to reduce the share of foreign currency-denominated debt in total debt stock, it has decreased only marginally from 66.0% in 2021 to 65.5% in December 2022. Meanwhile, the share of public banks' holdings in domestic government debt decreased from 38.6% in December 2021 to 36.7% in November 2022 and the share held by private and foreign banks increased from 26.9% to 32.9%. Both outcomes were achieved as a result of heavy-handed regulatory measures, forcing banks to hold lira-denominated government debt.

(9) 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. This is available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

Expand the tax base by developing a plan to gradually streamline tax exemptions and reductions.	3) **No implementation.** The government has enacted a series of temporary tax reductions, consecutive debt restructuring and amnesty practices over the last couple of years. Contrary to the commitments expressed in policy documents, tax restructuring and capital repatriation, which have adverse effects on the sustainable voluntary tax collection mechanism, have become established practice. The government recently proposed a new tax exemption bill to enter into force before the elections.
PG 2: Adopt the new framework legislation on Public Private Partnerships in order to improve their management and monitoring. Simplify public procurement procedures and reduce the number of exemptions. Phase out the FX value guarantees on lira time deposits as envisaged by the end of 2022 or earlier.	There was **no implementation** of PG 2. 1) **No implementation.** PPP framework legislation is still at the preparation stage and parliamentary approval is pending. In the last few annual presidential programmes, the government had also committed to producing guidelines for feasibility reports, expenditure-return analysis and contract drafting and management, and to delivering training on project preparation, monitoring and evaluation with the aim of standardising PPP contracts. However, the implementation stage of these plans has not been announced. 2) **No implementation.** The Law on public procurement contains a large and growing- number of exemptions (with consecutive amendments), affecting the transparency and accountability of public expenditure. Moreover, the government continues to make excessive use of negotiated procedure, which allows the contracting authorities to limit competition and transparency by referring to discretional criteria, which cannot be objectively measured. 3) **No implementation.** By the end of 2022, the volume of FX-protected deposits under the scheme amounted to TRY 1 415 billion. The implementation period for the FX value guarantees on lira time deposits and the incentives applied to the scheme have been extended. New incentives have been adopted to attract investors to the scheme (such as FX conversion support corresponding to 2% of the amount converted into TRY for companies).
PG 3: Use all available monetary policy instruments in line with the central bank's mandate of price stability to ensure a permanent fall in inflation towards the target. Enhance the institutional basis for sustainable price stability in line with operational central bank independence and bolster market confidence.	There was **limited implementation** of PG 3. 1) **No implementation.** Interest rates have been lowered further and the monetary policy stance has been too loose on account of various metrics. The current policy framework has also undermined the role of the policy rate as the primary instrument of monetary policy, blurring the policy signal and weakening transmission. To remedy the fallout from an overly loose monetary policy stance, a complex and distortive system of various macroprudential and regulatory measures is used. The absence of a clear nominal anchor and of a credible commitment to the inflation target exacerbates the risks of inflation becoming entrenched at very high levels. 2) **No implementation.** No improvements have been made to safeguard central bank independence after the dismissal of three central bank governors and several central bank policymakers since 2019. Monetary policy decisions have often been preceded by political guidance on interest rates. The complex system of measures adds

	unpredictability to the policy framework, further eroding policy credibility and market confidence, as evidenced, for example, by dis-anchored inflation expectations.
Further strengthen the integrity of financial sector regulatory framework in line with international and EU standards, withdraw the regulatory flexibilities provided to the financial sector during the pandemic, particularly with regard to loan restructuring and NPL recognition practices, encourage high quality credit risk management and enhance confidence by conducting more transparent asset quality reviews and publish its methodology and outcomes.	3) **Limited implementation.** The regulatory flexibilities provided to the financial sector during the pandemic were fully unwound and the banking system maintains high levels of provisioning. However, capitalisation and asset quality remain blurred by forbearance and the NPL regulatory framework lacks transparency and allows for unwarranted flexibility. Several measures introduced in 2022 have added further complexity to the regulatory framework while potentially creating financial vulnerabilities, by undermining banks' ability to price risk, distorting capital allocation and increasing operational, compliance and governance risks. The regulatory framework further departed from international and EU standards, with no progress in improving credit risk management and the transparency of asset quality.
PG 4:	There was **limited implementation** of PG 4.
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.	1) **Limited implementation.** Shortcomings in the independence of regulatory authorities have not been addressed. The 12th development plan (2024-2028) is being drafted with the wide participation of stakeholders and social partners under 80 thematic committees. Meetings with private sector representatives under the Coordination Council for Improvement of the Investment Environment continued in 2022, but the results of these meetings and related action plans are not reported. The related website of the Council is not updated. Besides this, there has been no improvement in the use of social dialogue mechanisms to develop relevant legislation.
Implement legislation and enhance transparency regarding state aid.	2) **No implementation.** Since Law No 6015 on monitoring and supervision of State aids came into force, the government has not implemented State aid monitoring and supervision. It has failed to set up a functioning organisational structure or to adopt the necessary secondary legislation. Instead, it has set up a new legislative structure responsible for the effective implementation, coordination, monitoring and evaluation of State aid. This new system is not geared towards alignment with EU *acquis*. It lacks independence in the enforcement of State aid legislation. The lack of transparency regarding the actual amount of State aid provided continues to be a source of concern.
Finalise the legislation on easing private investments and prepare its implementation.	3) **No implementation.** The legislation on easing private investments has not been finalised. Comprehensive draft legislation had been prepared and was being revised in light of feedback from stakeholders.
Prepare a new Action Plan for the fight against informal economy and set concrete performance indicators.	4) **Substantial implementation.** Türkiye has drafted a 2023-2025 action plan for the fight against informal economy. However, this new action plan fails to set specific performance indicators and the outcome of the previous action plan is not publicly available.
PG 5:	There was **partial implementation** of PG 5.
Take steps to set up a domestic carbon pricing.	1) **Limited implementation.** The work is ongoing on domestic carbon pricing with a number of studies and

	preliminary analysis being carried out. Türkiye published its 'national energy plan' in December 2022, which indicates that carbon prices in several sectors have been determined but does not provide details about prices. Discussions on carbon pricing and the ETS continued as part of the EU-Türkiye High-Level Climate Dialogue.
With a view to meeting the national decarbonisation objective, finalise the long term national energy strategy.	2) **Full implementation.** The long-term national energy strategy was released in December 2022 and Türkiye announced its national energy plan for 2020-2035. The government aims to reach a total installed electricity capacity of 189.7 GW (of which: 7.2 GW nuclear, 52.9 GW solar and 29.6 GW wind) by 2035. The planned scenario also involves significant climate mitigation elements, such as reducing the energy intensity by 35.3%, increasing the share of renewables in total electricity generation capacity to 64.7% and sharply cutting the share of fossil fuels in primary energy consumption by 2035 in line with the net zero emissions pathway toward 2053. Concrete steps to swiftly decarbonise the energy sector, notably its reliance on domestic coal and lignite in a just way, need to be undertaken.
In order to adapt to climate change, finalise the update of the national adaptation strategy.	3) **Limited implementation.** A first draft of national (climate) adaptation strategy, which was shared with the Climate Change Presidency and internal consultations within the Ministry of Environment, Urbanisation and Climate Change, was due to be completed by mid-February 2023, although it has not – to date – been published. The strategy will then be shared with other stakeholders and, unless major problems occur down the line, adopted by May 2023.
PG 6: Improve the transition of young people into the labour market through active labour market measures, better access to education and improvements in the vocational education and training system.	There was a **partial implementation** of PG 6. 1) **Partial implementation.** The transition of young people into the labour market remains a challenge. The youth unemployment and NEET rates, particularly for women, remained high despite some improvements in youth employment in the third quarter of 2022. Implementation of the national youth employment strategy and action plan (2021-2023) continued, with active labour market activities on career guidance and vocational training.
Incentivise female labour market participation through legislative and fiscal measures and provision of appropriate and affordable childcare infrastructure beyond the big urban centres of Turkey.	2) **Partial implementation.** Gender gaps in the labour market remain high. The government continues to provide employment subsidies, but their impact on female labour market participation needs to be followed up. Women continued to benefit from vocational and on-the-job training, but no new tailor-made programme has been initiated to promote women employment. The provision of pre-primary education services was expanded with investment in public schools across the country (3 000 pre-primary schools included under the investment programme). The minimum number of children needed for the opening of pre-primary classrooms in rural areas was reduced from 10 to 5. However, municipalities still face legal barriers to set up childcare centres. Overall, progress has been achieved in terms of appropriate

	and affordable pre-primary education for 5-year olds. However, for younger ages, childcare infrastructure did not improve significantly.
Increase offers and participation in lifelong learning measures and step up re- and upskilling possibilities for the labour force.	3) **Substantial implementation.** The recent reforms and flexible structure of vocational education made vocational training centres quite attractive, especially for poor families. Consequently, the number of students increased from 159 506 in December 2021 to 1 033 000 at the end of November 2022, exceeding the 1 000 000 target for the end of 2022. Vocational training centres provide on-the-job training, as well as reskilling and upskilling, through tailor-made training. However, the quality of the former needs to be ensured with qualification certificates in line with the Turkish Qualifications Framework.

ANNEX A: ASSESSMENT OF OTHER AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE 2023-2025 ERP

Education and skills

This area and reform measures 1, 2, 3, 4, 13 and 14 are analysed above in Section 4 under **key structural challenge 1**.

Research, development and innovation

Türkiye's industry and technology strategy has set ambitious targets to be reached by 2023. Although there has been some progress since 2018, the gap between actual figures and the 2023 targets remains significant. For example, in 2021, Türkiye's R&D spending amounted to 1.13% of GDP, still short of the targeted 1.8%.

Türkiye remains an 'emerging innovator' according to the European Innovation Scoreboard for 2022, performing at 47.7% of the EU average. Despite small performance improvements last year, the gap between Türkiye's performance and the EU average has grown larger since 2015. Türkiye's top three strengths are in medium and high-tech goods exports, government support for business R&D and job-to-job mobility of human resources in science and technology.

Measure 5: 'Enhancing the R&D and innovation activities of SMEs' (2022-2024 ERP measure 7)

Measure 5a: 'Prioritising technological product investments to increase the technology level and export capacity of SMEs and supporting the commercialisation of R&D projects' (2022-2024 ERP measure 7a)

This measure is a continuation of measure 7a in the previous ERP (2022-2024). As in previous years, the measure describes only output-based indicators, i.e. the number of SMEs supported. The measure could benefit from moving focus towards impact-related indicators, such as increase in value added, increase in the share of high-technology products in SMEs' exports, increase in patent applications and patents etc.

Moreover, green technologies and clean energy solutions could be prioritised to increase the positive impact in terms of the green and digital transformations.

Measure 5b: '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' (2022-2024 ERP measure 7b)

The measure has been rolled over from the previous ERP (2022-2024). It is based, in particular, on TÜBİTAK's calls/programmes for enhancing SMEs' research, development and innovation activities. These programmes are comprehensive and reach out to almost all stakeholders in the research and innovation ecosystem. They should be viewed as positive for the way they support SMEs' innovation activities through access to finance, know-how and networks.

The allocated budget is ambitious and, if implemented, it will have a significant impact by increasing Türkiye's R&D spending as a percentage of GDP.

Moreover, it is declared that, in some of these calls, projects contributing to EU Green Deal goals will be prioritised. The alignment of at least some calls with EU Green Deal goals should be viewed as positive.

The Commission also agrees with the suggestions provided in the 'Impact Assessment of TÜBİTAK and KOSGEB Supports' prepared by the General Directorate of Strategic Research and Productivity within the Ministry of Industry and Technology[10]. The study recommends supporting:

- integration of high-technology companies in international value chains; and
- access to venture capital and risk equity networks.

Nonetheless, the expected impact of the measure on environment and climate change should be clarified.

Measure 6: 'Performance-based support of the research infrastructures supported under Law 6550 within the new legal framework' (2022-2024 ERP measure 8)

This measure is a continuation of measure 8 in the previous ERP (2022-2024). It is in line with the 11th development plan.

While the Commission's view on the measure remains positive, there has been relatively little progress on implementation since 2020. There are still only seven research institutions within the scope of Law No 6550 on supporting research infrastructure. As a result, the plan to support nine new centres over the course of the next 3 years might prove challenging.

While the supported research areas cover fields such as nanotechnology, biomedicine and genome research, and solar energy technologies and should, in theory, support green transition and access to healthcare, the expected impacts of the measure on climate change and social outcomes are not clearly defined.

Measure 7: 'Establishing Model Factories (SME Competency and Digital Transformation Centres) and Innovation Centres to increase the efficiency of SMEs and their digital transformation' (2022-2024 ERP measure 9)

This measure is a continuation of measure 9 in the previous ERP (2022-2024). However, as in previous years, the expected impact of this measure is unclear, as all indicators used focus on the provided service itself, not on the goal. Some impact-related indicators with measurable and objective targets could include: (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.

Green transition

This area and reform measure 8 are analysed above in Section 4 under **key structural challenge 3**.

Digital transformation

Over the last few years, Türkiye has been steadily developing its information and communication technology infrastructure. Türkiye's internet penetration rate has been on the rise, although it remains below the EU average.

The Digital Transformation Office has been set up and charged with the digitalisation of public services in Türkiye. The 2022 eGovernment benchmark estimates the country's eGovernment maturity at 72%, slightly above EU average of 68%.

(10) https://www.sanayi.gov.tr/assets/pdf/birimler/SAVGMAr-GeDestekleriDegerlendirmesi2.pdf

Measure 9: 'Increasing the secure sharing and accessibility of public sector data with new data strategy' (2022-2024 ERP measure 12)

This measure is a continuation of measure 12 in the previous ERP (2022-2024). It is a good measure addressing a well-defined obstacle and providing concrete indicators to assess its impact.

Energy market reforms

This area and reform measure 10 are analysed above in Section 4 under **key structural challenge 3**.

Agriculture, industry and services

Agriculture remains a major contributor to Türkiye's economy. In 2021, this sector accounted for 6.2% of Turkish gross value added and 17.2% of total employment, way above EU averages of 1.8% and 3.8%, respectively. Hence, it still plays a significant role in providing employment opportunities and generating income.

Despite the country's favourable conditions for agriculture, the sector faces various challenges, fuelled in particular by climate change, such as water scarcity, soil degradation and outdated farming practices. Increased temperatures, changes in rainfall patterns, and more frequent extreme weather events are already negatively affecting crop production and livestock farming. That is why it is vital for Türkiye to invest in the long-term sustainability of agriculture and support solutions to increase the resilience of the sector, reduce its contribution to climate change and improve the ability of agricultural land to store carbon.

Following the impressive increase in the share of total gross value added in the second half of the last decade by around 10%, Türkiye's industry has continued its strong and stable growth. In 2022, this sector accounted for almost 30% of Turkish value added, significantly above the EU average. Industry's contribution to employment has remained more or less constant at levels around 20%.

At the same time, key structural weaknesses persist. The high dependency on foreign energy sources and raw materials has hardly diminished. The productivity gap between large companies and SMEs has grown, except for start-ups. The commercialisation of R&D is still hindered by the low capacity of Turkish SMEs to adopt process innovations. To maintain its competitiveness, Türkiye's needs to accelerate its green and digital transformations as well as improve business and investment environment.

Services are a critical component of Türkiye's economy, accounting for almost two-thirds of gross value added and over half of total employment. This sector includes a wide range of activities, such as tourism, finance, transportation, and telecommunications, as well as various professional services like consulting, legal, and healthcare.

Tourism is a particularly important sub-sector of the services industry. The further expansion and diversification of tourism in Türkiye was one of the priorities in Türkiye's economic programme for 2020-2022 with a view of restoring sustainable growth and increasing employment. In spite of the tourism sector' already strong performance, average expenditure per person remains very low, and there is still a largely untapped potential in the tourism sector.

Measure 11: 'Increasing tourism market share and brand value' (2022-2024 ERP measure 15)

This measure is a continuation of measure 15 in the previous ERP (2022-2024). Compared with previous years, the measure is more clearly defined. Nonetheless, there is still no clear budget allocation for the planned activities.

Since Türkiye has been becoming one of the leading health tourism destinations, the measure could benefit from activities supporting Türkiye's potential in this area. Additional actions could involve improving existing regulations, increasing the quality of healthcare and healthcare-related services, implementing more rigorous licensing, etc.

Social protection and inclusion

The rate of people at risk of poverty or social exclusion (AROPE) was already very high prior to COVID-19 and continued to deteriorate as a result of the 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.

Measure 12: 'Raising awareness of hygiene, healthy eating, nature protection, food waste prevention in schools and institutions' (2022-2024 ERP measure 17)

This measure is a continuation of measure 18 in the previous ERP (2022-2024). Overall, the implementation of the measure has been progressing in line with expectations. As of 2022, 90% of schools affiliated with the Ministry of National Education have been prepared in accordance with the guidelines, and inspection and certification activities are ongoing.

Measure 15: 'Dissemination of family-oriented social services models' (2022-2024 ERP measure 18)

This measure is a continuation of measure 18 in the previous ERP (2022-2024) 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 Social and Economic Support Service (SED) needs to be modelled and enhanced further to prevent child labour, i.e. providing the most vulnerable families with sufficient support, conditional on children attending school. At the same time, the foster care system needs to be strengthened to provide emergency foster care services. Moreover, children with disabilities and refugee children should receive tailored treatment.

Healthcare

Türkiye has a comprehensive health insurance system aiming for universal coverage. Despite generally affordable premiums, about 10% of the population is still not covered.

One of the challenges for the Turkish healthcare system is 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 11th national development plan (2019-2023) aimed to improve the quality and efficiency of primary care. However, its effectiveness in addressing this challenge has not yet been determined.

The COVID-19 pandemic put extreme stress on Türkiye's healthcare system, hindering its capacity to deliver essential services. However, in 2022, its effects were no longer felt.

Measure 16: 'Increasing the access of Syrian nationals under temporary protection to health services' (2022-2024 ERP measure 21)

This measure is a continuation of measure 21 in the previous ERP (2022-2024) aiming to increase access to healthcare services for Syrian nationals under temporary protection. The migrant health centre model is sufficient to provide appropriate quality healthcare services for migrants. Structural reforms are needed to further integrate migrant health services into the Turkish health system, to ensure a sustainable continuation of services.

The measure is expected to have a significant impact on public health, if implemented successfully. However, it is largely financed by the EU and will not have a clear impact on growth or competitiveness.

No measures presented in the following areas:

- ***Public finance management***

No measure was presented in this area in this ERP (2023-2025), and the section on public finance management focuses exclusively on transition to the performance-based programme budget system. It fails to present the main challenges, such as the need to revise public procurement legislation, adopt new framework legislation on public-private partnerships or strengthen budget transparency and accountability (for instance, improving *ex post* monitoring and reporting).

- ***Business environment***

No measure was presented in this area in this ERP (2023-2025). This area is analysed in detail above in Section 4 under **key structural challenge 2**.

- ***Economic integration reforms***

No measure was presented in this area in this ERP (2023-2025). The section on economic integration reforms stresses the significance of the free trade agreements and preferential trade agreements Türkiye's has negotiated and concluded with non-EU countries. However, it does not include any diagnostic analysis or provide suggestions for any reform measures. To improve its competitiveness and ensure better integration in global value chains, Türkiye should focus on identifying and removing existing impediments. Ad hoc protective measures and extensive use of restrictive practices disrupt the functioning of supply chains and undermine the predictability of the business environment, negatively impacting investment.

- ***Transport market reforms***

No measure was presented in this area in this ERP (2023-2025). The section lacks an in-depth analysis of the main obstacles. Instead, it presents decontextualised data, among others, on the railway network and passenger traffic.

The section fails to acknowledge Türkiye's transport market's dependency on fossil fuels. Following the Russian war of aggression against Ukraine, high natural gas and petroleum prices have negatively impacted the Turkish economy. As already described in Section 4 under key structural challenge 3, dependency on energy imports remains a major structural challenge for Türkiye. Since 90% of transport depends on fossil fuels, measures aimed at decarbonisation of this sector could play a critical role in addressing these challenges. Moreover, decarbonisation of transport will be essential to decrease Türkiye's carbon footprint in line with the country's net climate neutrality ambitions and international commitments under the Paris Agreement.

Türkiye is one of the key players in the European aviation market and has a key role to play in accelerating the provision and uptake of low-carbon or zero-carbon alternative fuels (biofuels, hydrogen). The development of alternative fuel infrastructure at airports should be considered one of the priorities for the development of more sustainable aviation. The ERP would benefit from discussing challenges and efforts made to support the decarbonisation of this mode of transport.

The ERP could also focus more concretely on Türkiye's maritime decarbonisation ambitions. As part of the Instruments for Pre-accession Assistance, the EU supported a project to encourage the use of innovative and environmentally friendly technologies in ports and ships in Türkiye. The project supports the green transition to low-carbon energy and a fuel-efficient maritime fleet, the development of infrastructure for alternative fuels such as hydrogen, and the establishment of port electricity infrastructures in port facilities. More details would be welcome on Türkiye's plan with regard to maritime decarbonisation.

Türkiye might also consider including maritime and aviation sectors in its emission trading scheme.

In the context of the war in Ukraine, Türkiye's strategic role as a transit country to the Middle East, Central Asia, and China has only increased. The commercial feasibility of new trade corridors linking Turkish ports with other Black Sea ports, especially Varna and Constanza, will be tested. Nonetheless, Türkiye's full potential can only be realised on the shoulders of an efficient and effective railways network. In this respect, inter-modal integration with key airports, roads and ports is emerging as a necessary condition.

Despite significant investment in the last decade, rail has not increased its share of the transport market. Turkish railway legislation is still not fully aligned with the market pillar of the EU rail *acquis*, in particular as regards the independence of the infrastructure manager in the holding structure of the national railway undertaking; there must be a clear functional separation of the activities, and a strict separation of financial and accounting systems. For railways to become an attractive alternative to medium and long-range hauls, Türkiye should increase efforts to address these challenges. An efficient market-based railway sector in Türkiye – given its strategic geographical location – is key in the international context of Euro-Asia transport connectivity and the extension of rail services eastwards beyond the EU. Further investments in the modernisation of the railway infrastructure are needed. Completion of the flagship the Halkali-Kapikule Railway Line project should be considered a priority.

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

Area/Sector	2016	2017	2018	2019	2020	2021	EU-27 Average (2021 or most recent year)
Energy							
Energy imports dependency (%)	75.5%	77.2%	73.8%	70%	70.6%	n/a	55.6%
Energy intensity: kilograms of oil equivalent (KGOE) per thousand euro	175.03	175.30	167.69	168.42	162.79	n/a	110.35
Share of renewable energy sources in final energy consumption (%)	13.7% w	12.8% w	13.7% w	n/a	n/a	n/a	21.7%
Transport							
Railway network density (metres of line per km^2 of land area)	12.92 w	13.08 w	13.22 w	13.31 w	13.30	13.50 w	n/a
Motorisation rate (passenger cars per thousand inhabitants)	142	149	151	150	157.5	n/a	n/a
Agriculture							
Share of gross value added	7.0%	6.8%	6.4%	7.1%	7.5%	6.2%	1.8%
Contribution to employment (% of total employment)	19.5%	19.4%	18.4%	18.1%	17.6%	17.2% w	4.3% (2020)
Utilised agricultural area (% of total land area)	4.91%	4.89%	4.90%	4.84%	4.84%	n/a	40.6% (2020)
Industry							
Share of gross value added (except construction)	22.2%	23.3%	24.9%	24.2%	25.6%	29.1%	19.9%
Contribution to employment (% of total employment)	19.5%	19.1%	19.7%	19.8%	20.5%	21.3% w	16.1%
Services							
Share of gross value added	61.2%	60.3%	60.8%	62.7%	61.0%	59.1%	79.2%
Contribution to employment (% of total employment)	53.7%	54.1%	54.9%	56.6%	56.2%	55.3% w	70.9%

Area/Sector	2016	2017	2018	2019	2020	EU-27 Average (2020 or most recent year)
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%	2.26%
R&D expenditure – EUR per inhabitant	93.6	90.8	83.5	88.1	82.1	EUR 734,5
Digital economy						
Percentage of households with internet access at home	76%	81%	84%	88%	91%	92.5%(2022)%
Share of total population using internet in the 3 months prior to the survey (% of population aged 16-74)	58.3% w	64.7% w	71% w	73.98% w	78%	90%(2022)
Trade						
Export of goods and services (as % of GDP)	23.1%	26.0%	31.2%	32.7%	28.7%	50.4%
Import of goods and services (as % of GDP)	25.2%	29.7%	31.4%	30.2%	32.2%	46.7%
Trade balance (as % of GDP)	-6.5%	-8.9%	-7.0%	-4.1%	-6.7%	n/a

Area/Sector	2016	2017	2018	2019	2020	EU-27 Average (2020 or most recent year)
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 not in employment, education or 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 childcare (% of children aged under 3)	n/a	n/a	n/a	n/a	n/a	35.3% (2019)
Individuals who have basic or above basic overall digital skills (% of population aged 16-74)	28%	34%	n/a	36%	n/a[11]	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

(11) The value data for 2021 is 30.12%.

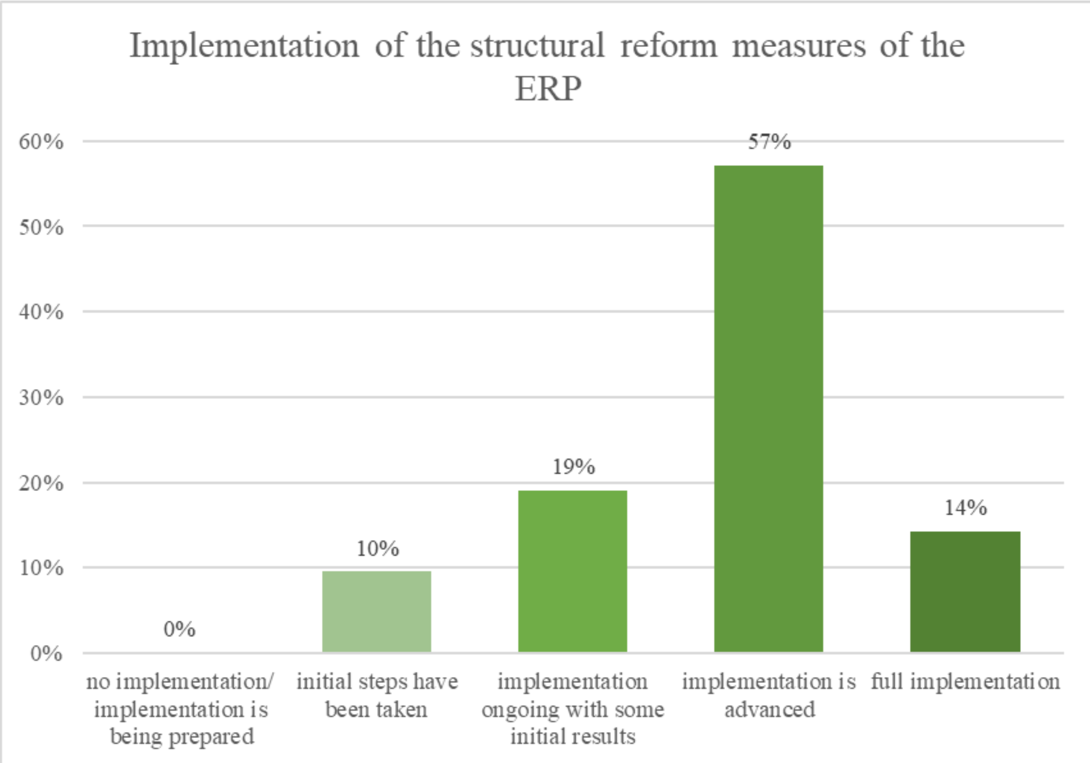
Area/Sector	2016	2017	2018	2019	2020	EU-27 Average (2020 or most recent year)
Social protection system						
At-risk-of-poverty or social exclusion rate (AROPE) (% of population)	26.6%	32.3%	32.4%	33.2%	34.1%	21.9%
At-risk-of-poverty or social exclusion rate of children (% of population aged 0-17)	35.6%	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 aged 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 to 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 2022-2024 ERP

There was a steady progress in implementing the measures in 2022. The average score for implementing the measures in 2022 is 3.76 out of 5, which is slightly worse than the previous year (3.8).



Measure 1: 'Job clubs'

Although some activities planned for 2022 were carried out, they fell short of the targets set for the year. Out of the 10 new job clubs planned, only four started up in 2022. A score of '4 - implementation is advanced' would be more appropriate.

Türkiye decided to exclude this measure from the 2023-2025 ERP. In the future, a new measure on the quality of services provided by job clubs could be considered.

Measure 2: 'Professions of future'

The Commission agrees with the reporting and scoring. While the planned activities were carried out, the targets set for the year have not been fully met. The impact of training should also be followed up.

Measure 3: 'Youth employment will be increased by strengthening vocational training centres'

The Commission agrees with the reporting and scoring. The activities were implemented, but the targets have not been fully met. The impact of this training should also be followed up.

Measure 3: 'Youth employment will be increased by strengthening vocational training centres'

The Commission agrees with the reporting and scoring.

Measure 4: 'Reducing unregistered employment by focusing on increasing audit capacity in non-agricultural sectors'

The Commission agrees with the reporting and scoring.

Türkiye decided to exclude this measure from the 2023-2025 ERP because there are no plans to recruit more social security controllers.

Measure 5: 'Access to preschool education will be provided based on equal opportunity principle'

The Commission agrees with the reporting and scoring.

Measure 6: 'Specialized institutional guidance and inspection branches will be established depending on school and program types'

The Commission agrees with the reporting and scoring.

Measure 6: 'Specialized Institutional Guidance and Inspection branches will be established depending on school and program types'

The Commission agrees with the reporting and scoring. The overall score assigned for this measure is 4.

Measure 7a: '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 implementation is insufficient. There is no information on indicators. The score is most likely overestimated and 4 would be more appropriate.

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'

The information provided on implementation is insufficient. There is no information on indicators. The score is most likely overestimated and '4 - implementation is advanced' would be more appropriate.

Measure 8: 'Performance-based support of the research infrastructures supported under Law 6550 within the new legal framework'

This measure was given a score 5, which means full implementation. Nonetheless, there has been relatively little progress on implementation of this measure since 2020. There are still only seven research institutions within the scope of Law No 6550 on supporting research infrastructure. Hence, we suggest lowering the score to 4.

Measure 9: ‘Establishing model factories (SME competency and digital transformation centres) and innovation Centers to increase the efficiency of SMEs and their digital transformation’

The Commission agrees with the scoring. However, the information provided on implementation is insufficient and there is no information on indicators.

Measure 10: ‘Support mechanism will be established for the replacement of inefficient electric motors used in industry with more efficient ones’

Out of the planned 2 000 motors, only 363 inefficient electric motors used in industry were replaced with more efficient ones. Therefore, the score should be lowered to ‘3 - implementation ongoing with some initial results.’

Measure 11: ‘Technical assistance for the Green Deal action plan’

The Commission agrees with the reporting and scoring.

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

The Commission agrees with the reporting and scoring. The overall score assigned for this measure is 4.

Measure 13: ‘Update of Türkiye-EU customs union’

This is not considered a reform measure.

Measure 14: ‘Improvement of data collection processes and increasing the capacity of evaluation in agriculture statistics’

The information provided on implementation is insufficient. The original measure envisaged three results indicators – a project output report (1), a number of training courses (10), and a number of trained personnel (1 000). Out of the 10 planned training courses, only eight were conducted in 2022. No details have been provided as regards the scope of these training activities. Moreover, no information has been given on other results indicators. The score is most likely overestimated and should be lowered to 3.

Measure 15: ‘Increasing tourism market share and brand value’

The Commission agrees with the reporting and scoring.

Measure 16: ‘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-authorization programs organized for individuals within the scope of lifelong learning’

The Commission agrees with the reporting and scoring.

Measure 17: ‘Raising awareness of hygiene, healthy eating, nature protection, food waste prevention in schools and institutions’

The Commission agrees with the reporting and scoring.

Measure 18: 'Dissemination of family-oriented social services models'

The Commission agrees with the reporting and scoring.

Measure 19: 'Supporting clinical trials on vaccines and drugs'

Given the problems with implementation, such as clinical test delays, and the failure to meet the targets set for 2022, the scoring seems too high and should be lowered to 3.

Measure 20: 'Strengthening of the Ministry of Health's Covid-19 response capacity'

The project was scheduled for completion by January 2023. Given the unspent funds due to COVID-19 containment measures, the project duration has been granted a no-cost extension (of 15 months) until the end of April 2024.

Türkiye has been successful in implementing the project. The physical and human resources infrastructure of the national virology laboratory has been enhanced, and a molecular surveillance component has been included in the national surveillance system for communicable diseases, attaining a 500-fold increase in the laboratory's sequencing capacity in 2 years.

To fully utilise the capacity developed through the project, a national strategy on genomic surveillance will be developed during the extended implementation period. However, for a longer-term reinforcement of Türkiye's emergency preparedness and response capacities, the Ministry of Health has to:

- ensure continuity in the workforce empowered with relevant technical and practical skills;
- earmark national funds for the kits that sequencing requires;
- upgrade the surveillance programmes to incorporate microbial genomic sequencing methods and,
- ensuring laboratory information is digitally plugged into public health monitoring systems at national and international levels.

Although implementation is advanced, the scoring seems too high given that no steps have yet been taken to ensure the sustainability of the measure. Therefore, the score should be lowered to 4.

Measure 21: 'Increasing the access of Syrian nationals under temporary protection to health services'

The Commission does not agree with the reporting. The tender process for the procurement of medical equipment and supplies is characterised by unpredictability, with plans undergoing constant changes. As a result, the figures provided in this section might prove to be no longer valid. Moreover, counter to the information provided, no migrant health centre has been constructed or became operational to date.

ANNEX D: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The 2023-2025 ERP was submitted to the Commission on 31 January 2023. Overall, it has followed the Commission's guidance note.

Inter-ministerial coordination

The Presidency of Strategy and Budget has been responsible for central coordination of the ERP since 2019. The Presidency works closely with the Ministry of Treasury and Finance for the macroeconomic outlook and public finance and all other line ministries and institutions for the structural reforms.

Each line ministry has designated a coordinator for the ERP, which has helped significantly to ensure a smooth inter-ministerial ERP coordination process. The proposed measures for the new ERP were discussed in a workshop held in November 2022 by the Presidency of Strategy and Budget with the ERP coordinators, experts responsible for the measures and Instrument for Pre-Accession Assistance (IPA) coordinators. Afterwards, the ERP coordinator remained in contact with the different line ministries and relevant institutions in the preparation of the document.

Stakeholder consultation

The line ministries and related institutions were involved in the preparation of the ERP document. It is mostly based on the 11th national development plan (2019-2023), the medium-term programme (2023-2025) and the 2023 Presidential annual programme. The 11th national development plan and the other policy documents were developed in a broad consultation process with stakeholders and experts (including private-sector representatives, NGOs, and academia).

As part of the preparatory work for the structural reform measures, two training programmes were organised in cooperation with the Connecting Europe Facility in October and in November 2022. These provided a major opportunity for the line ministries to discuss their proposed structural reform measures and to work out the scope of the measures. The line ministries thus had sufficient time to work out the details of these measures over a couple of months in light of the exchanges made during the training and separately with the Presidency of Strategy and Budget.

However, no specific consultations took place with external stakeholders on the draft ERP and no draft was made available to the public before its adoption. The ERP document does not provide sufficient information on the feedback and how it has been worked in. Written comments were not annexed to the ERP.

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 major exception – it does not present an alternative scenario. This is a repeat omission and is a major drawback, especially in view of the high levels of domestic and global uncertainty. The analysis would have benefited from better linkage between the macroeconomic and fiscal framework sections and with the macro-relevant structural reforms. The presentation and analysis of risks is rather schematic and could 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 information on the 2023 budget, although a more systematic presentation of the main discretionary fiscal measures (equal to or above 0.1% of GDP) would have been welcome. The chapter lacks detail on the medium-term plans and the underlying measures. The section on contingent liabilities could be expanded to systematically cover all sources of liability. 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

Reporting on the implementation of the policy guidance is, at times, not well developed. It fails to provide a good overview of all the measures implemented for the different policy recommendations. Furthermore, for some policy recommendations, no indications are provided on the implementation process. Similar shortcomings are noticeable in the reporting on the implementation of the structural reform measures from the 2022-2024 ERP, with visible inconsistencies in the reporting and scoring in Table 10. In many cases, the information provided on implementation is not well developed. The maximum number of reforms (20) is respected; the current ERP (2023-2025) presents a total of 16 measures. However, the page limit (50) is not respected, as the section on the structural reform stretches to 81 pages. The ERP document includes the two Tables 9, presented as 8a *'Social Scoreboard Indicators'* and 8b *'Other Selected Indicators'*, which provide some information requested under Table 9. The ERP document presents *'Table 10a: Costing of structural reform measure'* as *'Table 9a'*. The table contains information for each measure. The ERP document presents *'Table 10b: Financing of structural reform measure'* as *'Table 9b'*, but there seem to be some inconsistences as it includes a measure on *'profession of future'* but was not presented among the measures of this ERP cycle. The ERP document also includes *'Table 11: Reporting on the implementation of the structural reform measures of the ERP 2020-2022'*, which is presented as *'Table 10'*.

The Annex 2 table, *'linking reform areas and relevant policy document'* does not cover all the reform measures presented in the ERP document. Furthermore, the links between the reform areas and the relevant policy documents need further elaboration (especially as regards the Enlargement Package). There is significant room for improvement.