



Economic Policy Research Foundation of Turkey

**It takes two to tango:  
What is the “model” in the  
model partnership concept?**

Güven Sak  
24 January 2011

# Framework

- Why is Turkey important?
- Is there a risk for a middle-income trap for Turkey?
- Towards a new model partnership: how to cooperate in entrepreneurship & innovation?
- How does this new cooperation model map into Turkey's role in the region?

## Turkey is the largest Muslim economy

	Country	World rank	GDP est. 2011 (million USD)
1	<b>Turkey</b>	<b>17</b>	<b>789.601</b>
2	Indonesia	18	776.976
3	Saudi Arabia	23	475.987
4	Islamic Republic of Iran	29	342.255
5	United Arab Emirates	35	255.082
6	Malaysia	38	236.555
7	Egypt	40	239.241
8	Nigeria	41	206,664
9	Pakistan	47	190.204
10	Algeria	48	171.606

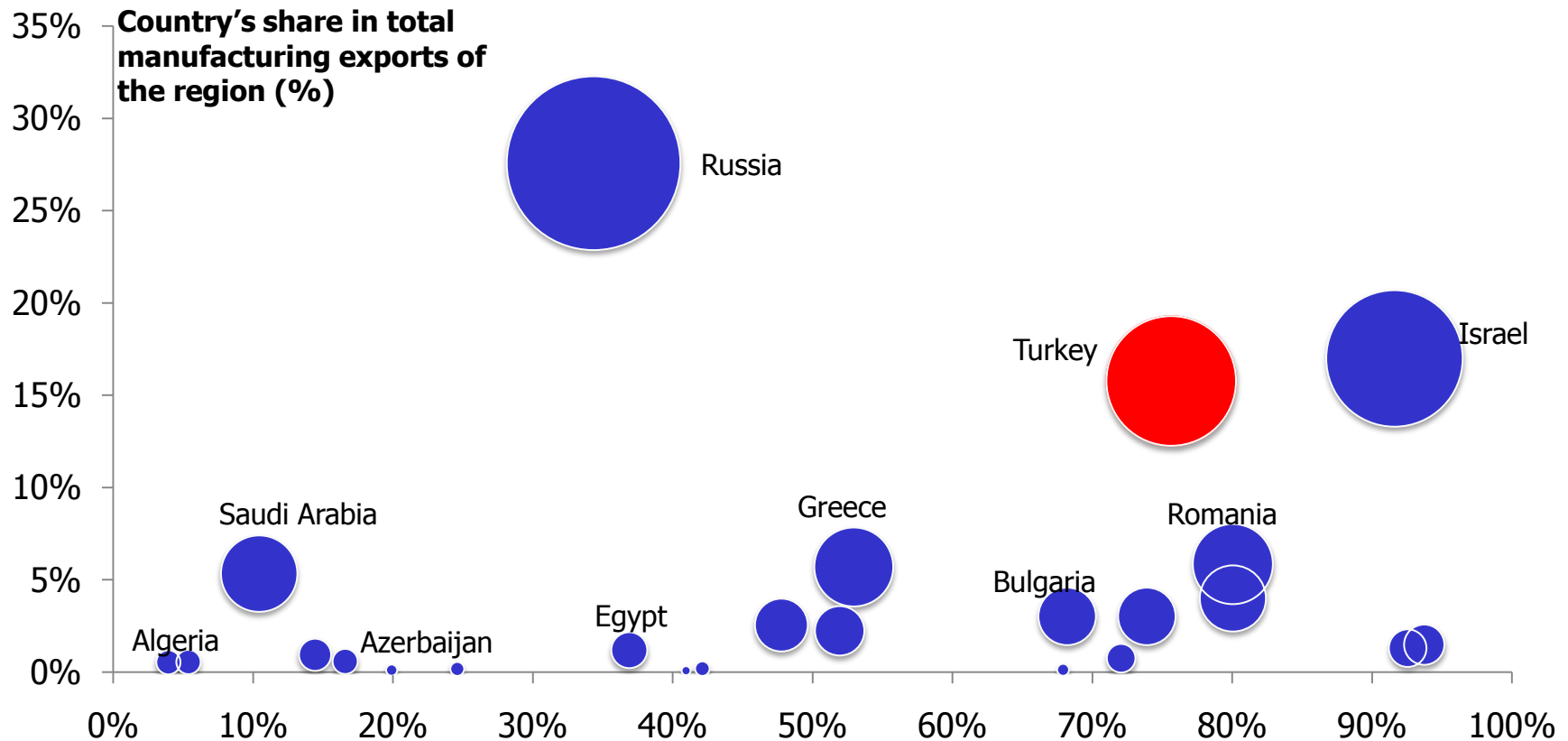


Major oil exporters

Source: IMF

# In mid-1990s, Turkey was an important industrial economy...

Export indicators of the countries in the region (1996)

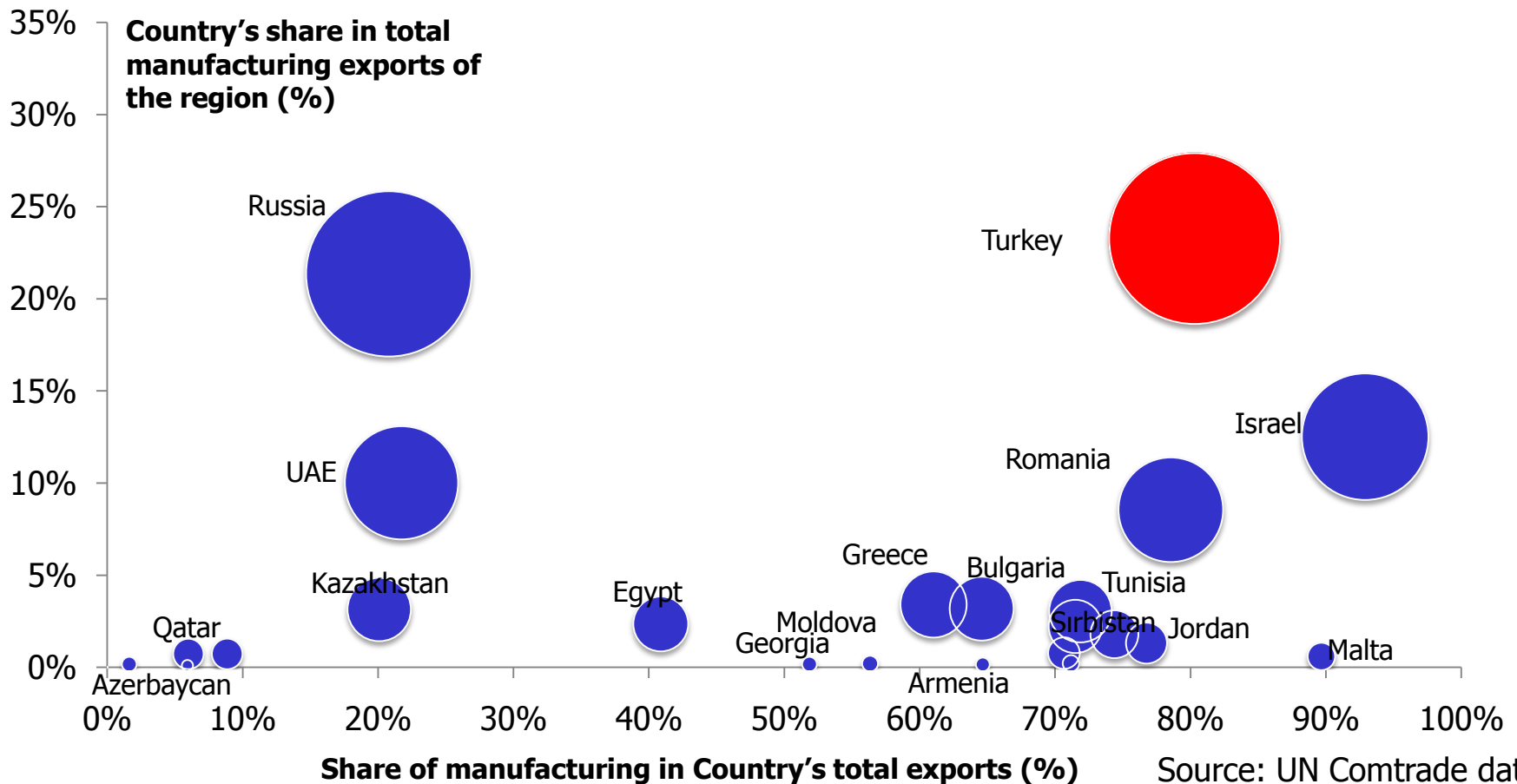


Share of manufacturing in Country's total exports (%)

Source: UN Comtrade data

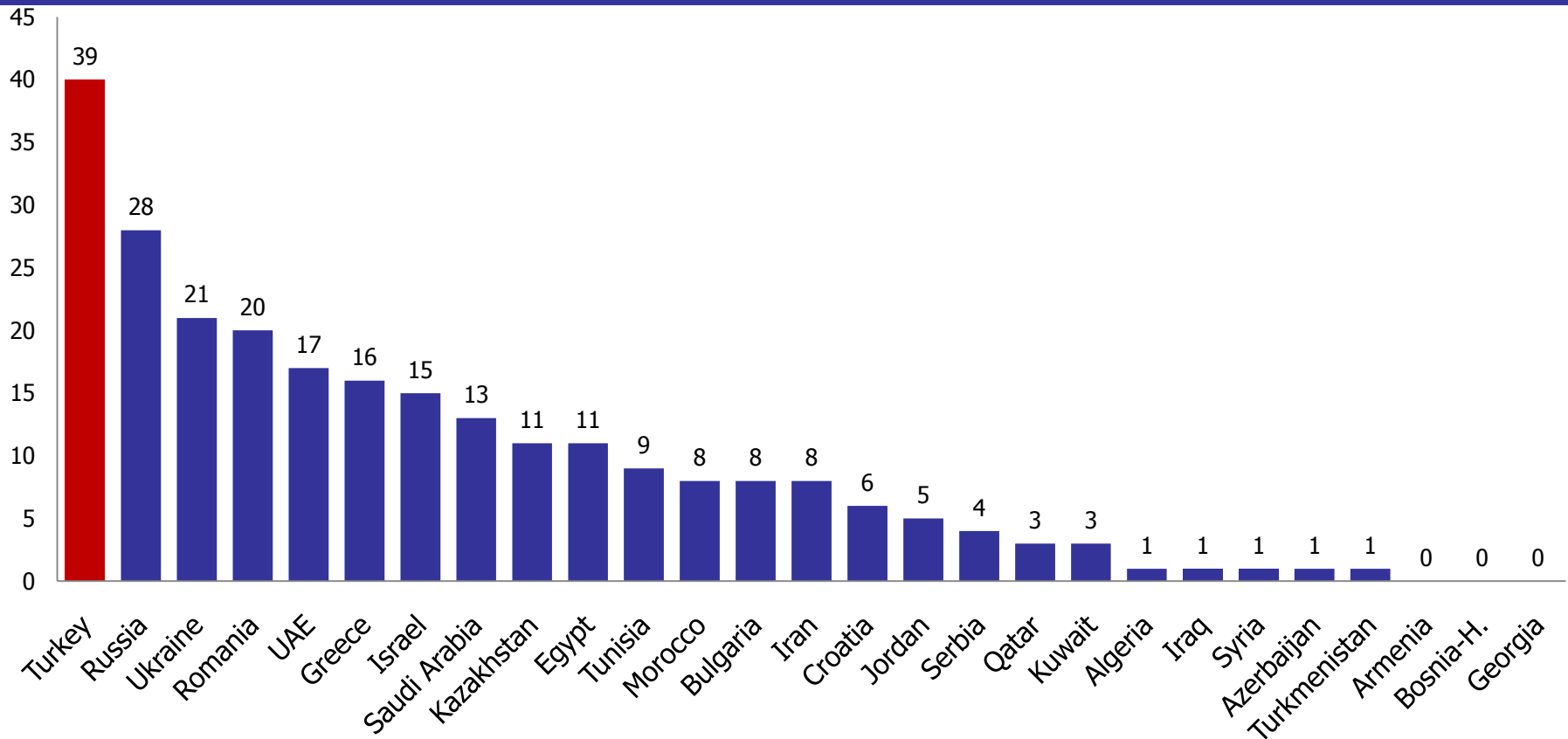
...today Turkey is the largest manufacturer in the surrounding region

Export indicators of the countries in the region (2008)



# Level of economic diversification is also striking

**Number of product groups with above \$ 500 million exports  
(HS4 classification, 2 digit, 2008)**



## Our fresh insights from Iraq...

- Turkish business community has strong ties and investments especially in the Iraqi Kurdistan
  - ➔ This supports stability in the region
  - ➔ Turkish business community also fosters social transformation (Malls, hospitals etc.)
- Turkey has a potential to transform Iraq, but there is need for concrete projects
- Possible activities for US-Turkey collaboration:
  - ➔ Special economic zones
  - ➔ Capacity building in public agencies
  - ➔ Labor skills improvement

## Turkey has a big potential, but there are risks

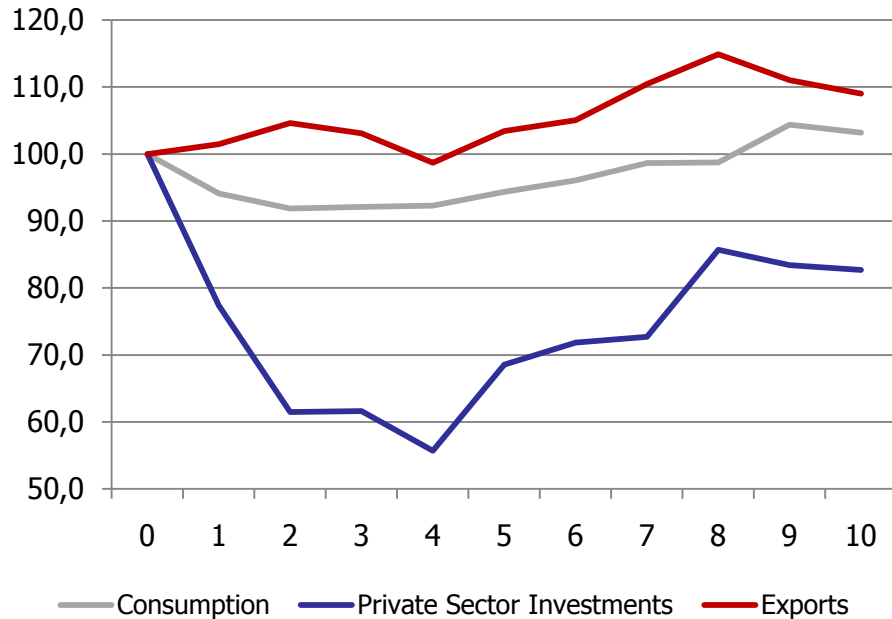
- Turkey has a critical role to play
  - ➔ The largest Muslim economy
  - ➔ The most diversified industrial economy in the region
- The need to continue the economic transformation of 2000s with a target of an innovation-driven economy
- The rapid recovery from crisis should not curtail the structural weaknesses
- Turkey has always grown with a current account deficit, in 2010 we hit 6%
  - ➔ Is the recent recovery pattern more dangerous?



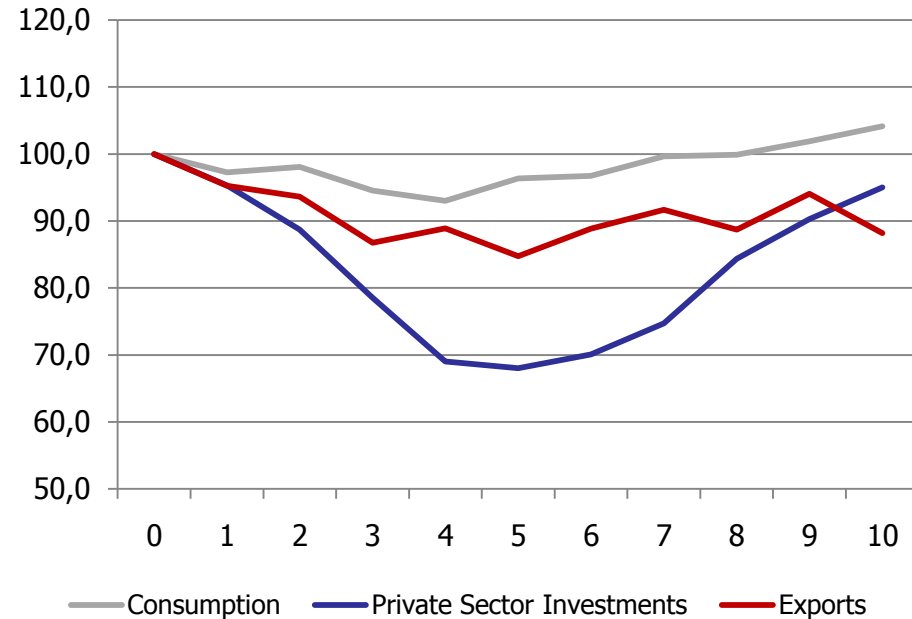
# A different kind of recovery this time

## 2001: export boom, 2009: domestic demand boom

Total Export and Consumption, 2000Q4=100 for 2001, 2008Q2=100 for 2009



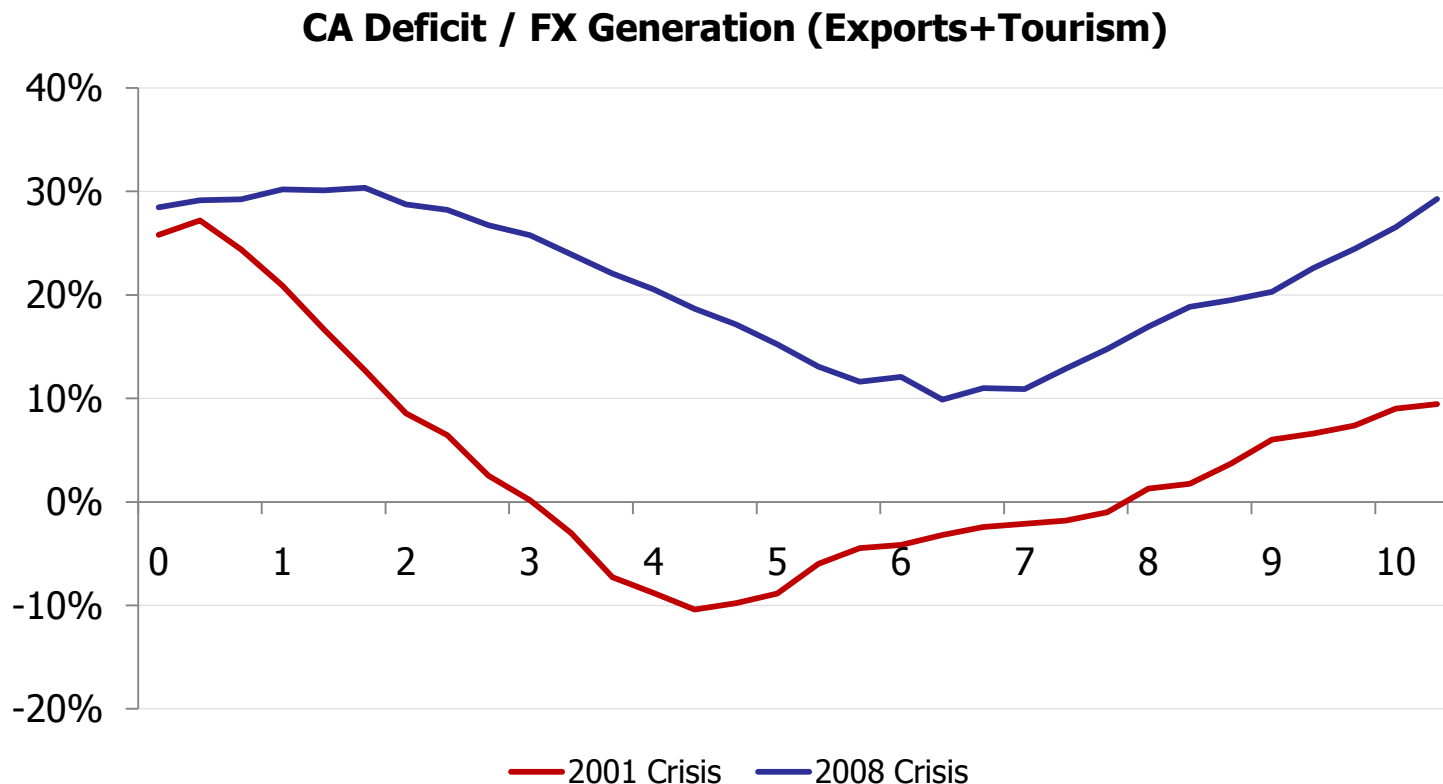
**2001 Crisis**  
(2000Q4-2003Q2)



**2008 Crisis**  
(2008Q1-2010Q3)

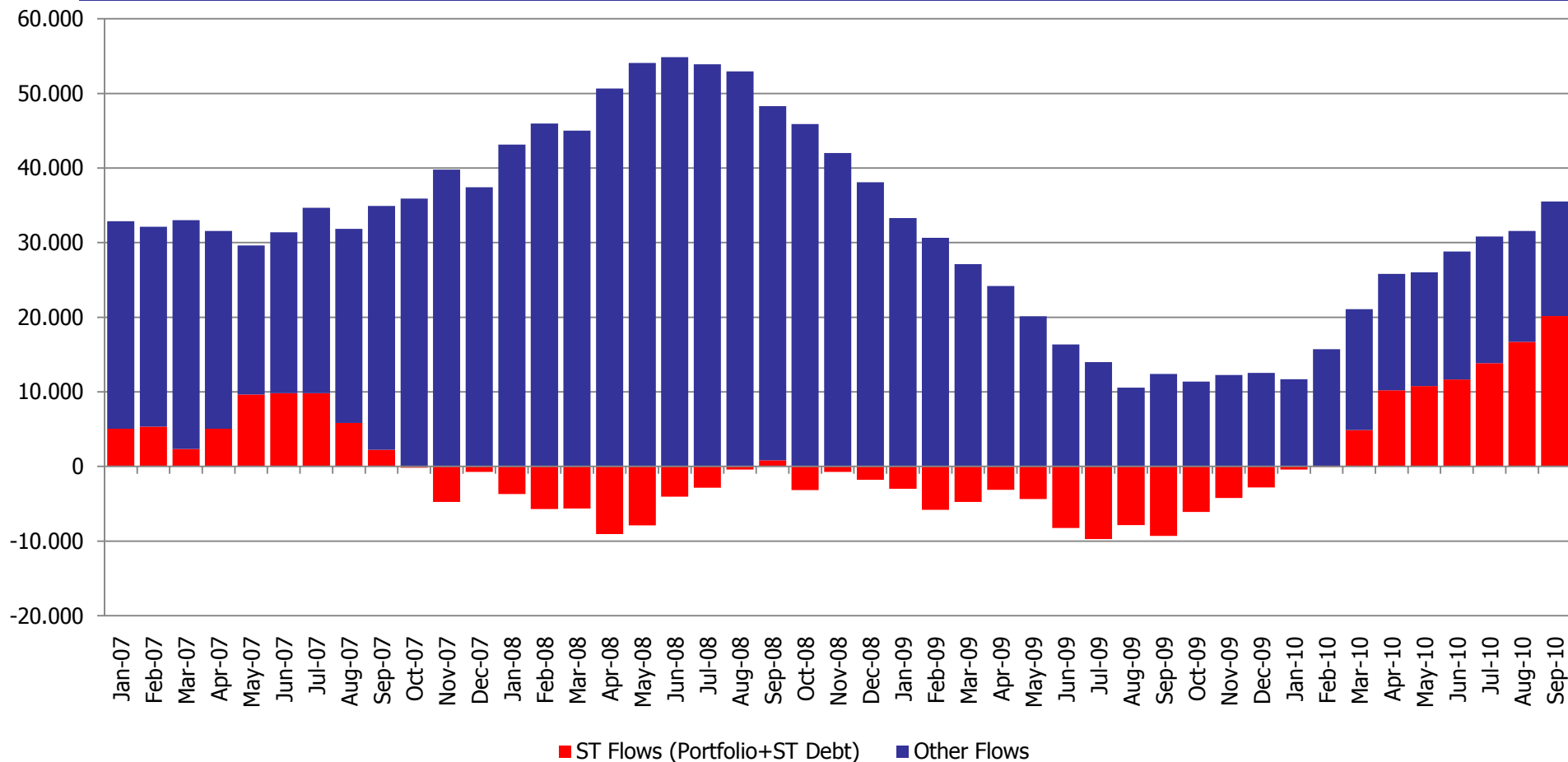
# Is this pattern more dangerous?

## Relatively lower FX earning capacity to sustain the current account deficit



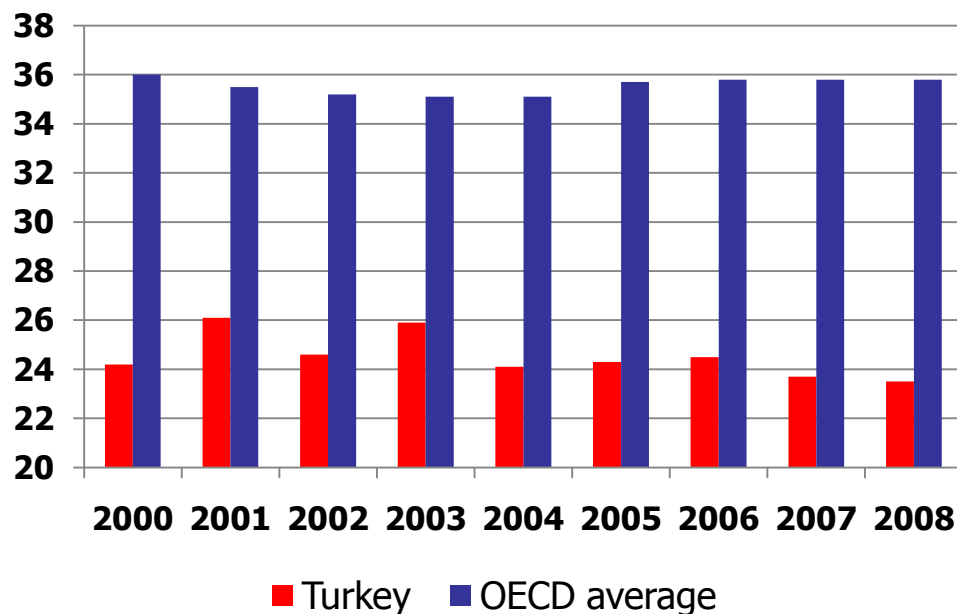
# Quality of finance sharply deteriorating

Short term capital inflow / total capital inflows, 2007-2010



# An archaic public financial management impedes convergence to OECD fiscal quality

## Total Tax Revenue (% of GDP), 2000-2008



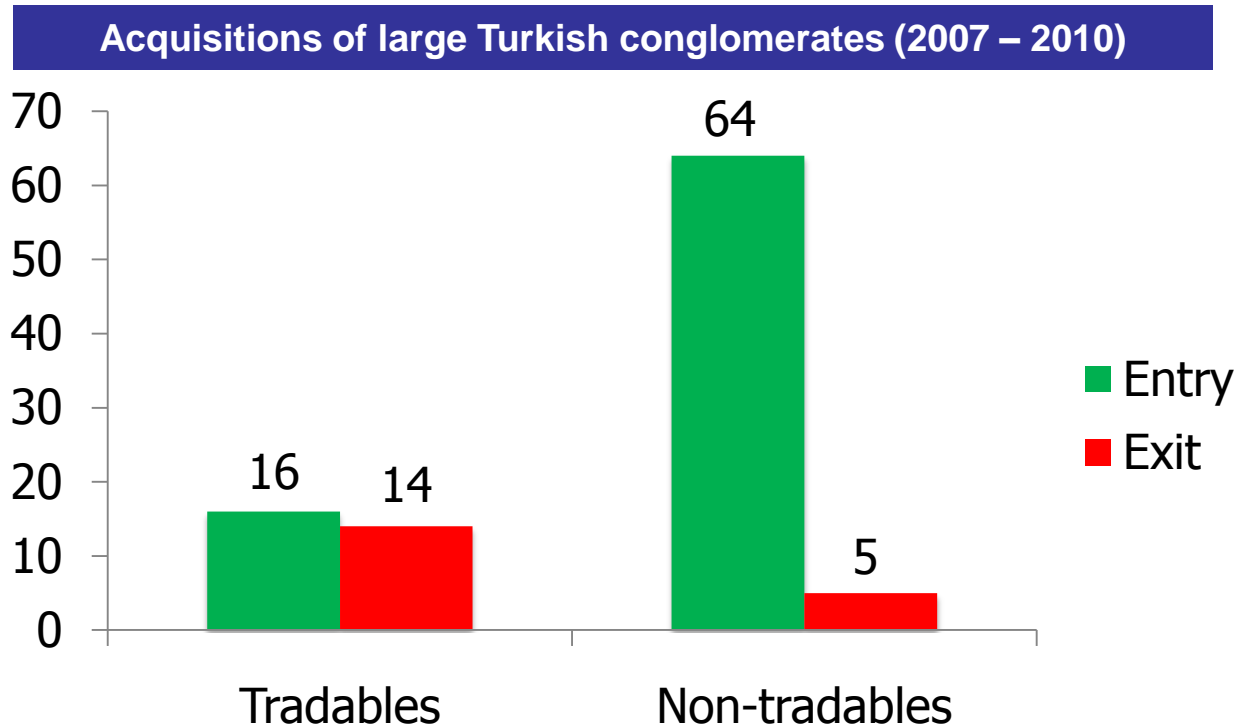
Source: OECD

## Interest expenditure (% budget rev)

Turkey	14.4
Greece	13.6
Iceland	13.4
Mexico	11.6
Argentina	11.4
Indonesia	10.7
Panama	9.6
Italy	9.4
Kenya	9.3
South Africa	8.8
Egypt	8.8
Hungary	8.5
Portugal	7.4
United States	5.6
Spain	3.7

Source: IMF

# A risk of de-industrialization: Serious problems in the incentive structure

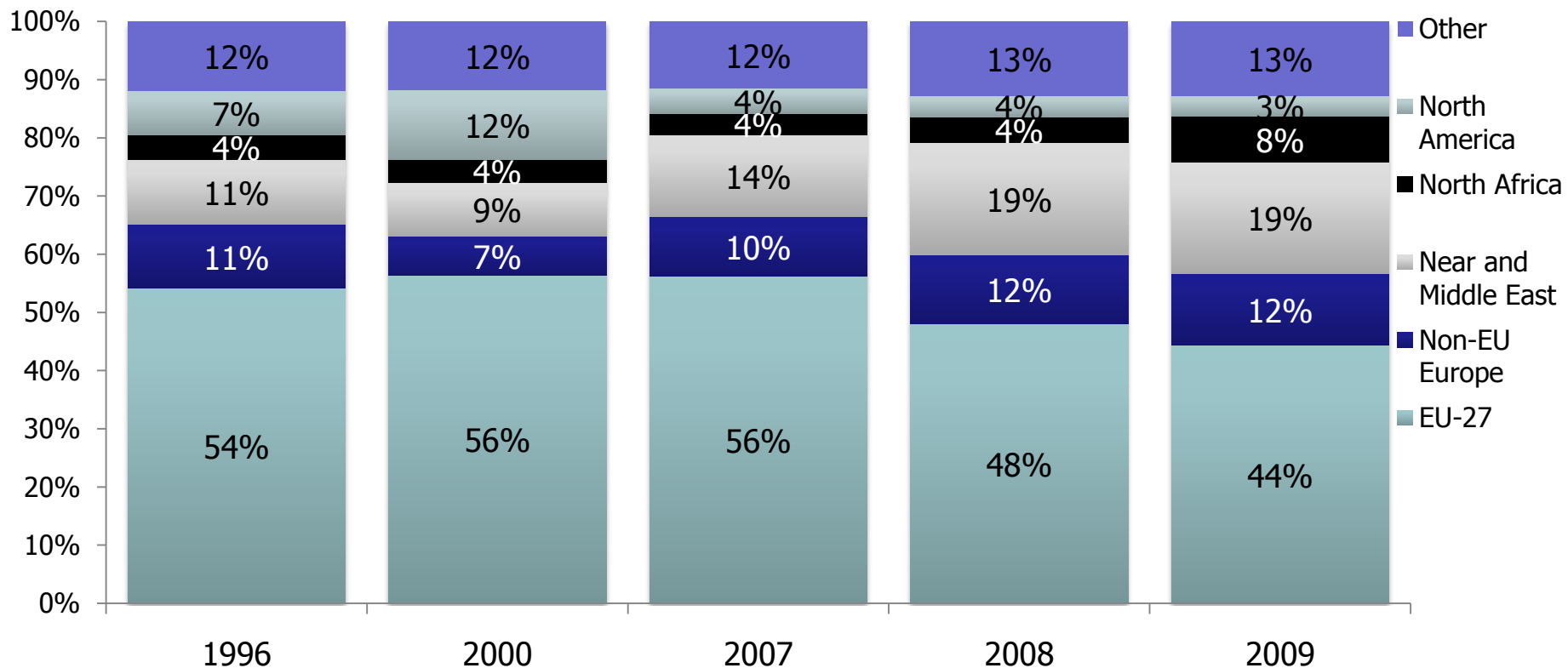


**Mergers and acquisitions of Koç, Sabancı, Eczacıbaşı, Doğuş, Zorlu and Yıldız groups**

\*Non-tradable sectors: Services, real estate and energy

Source: Web sites of the related groups

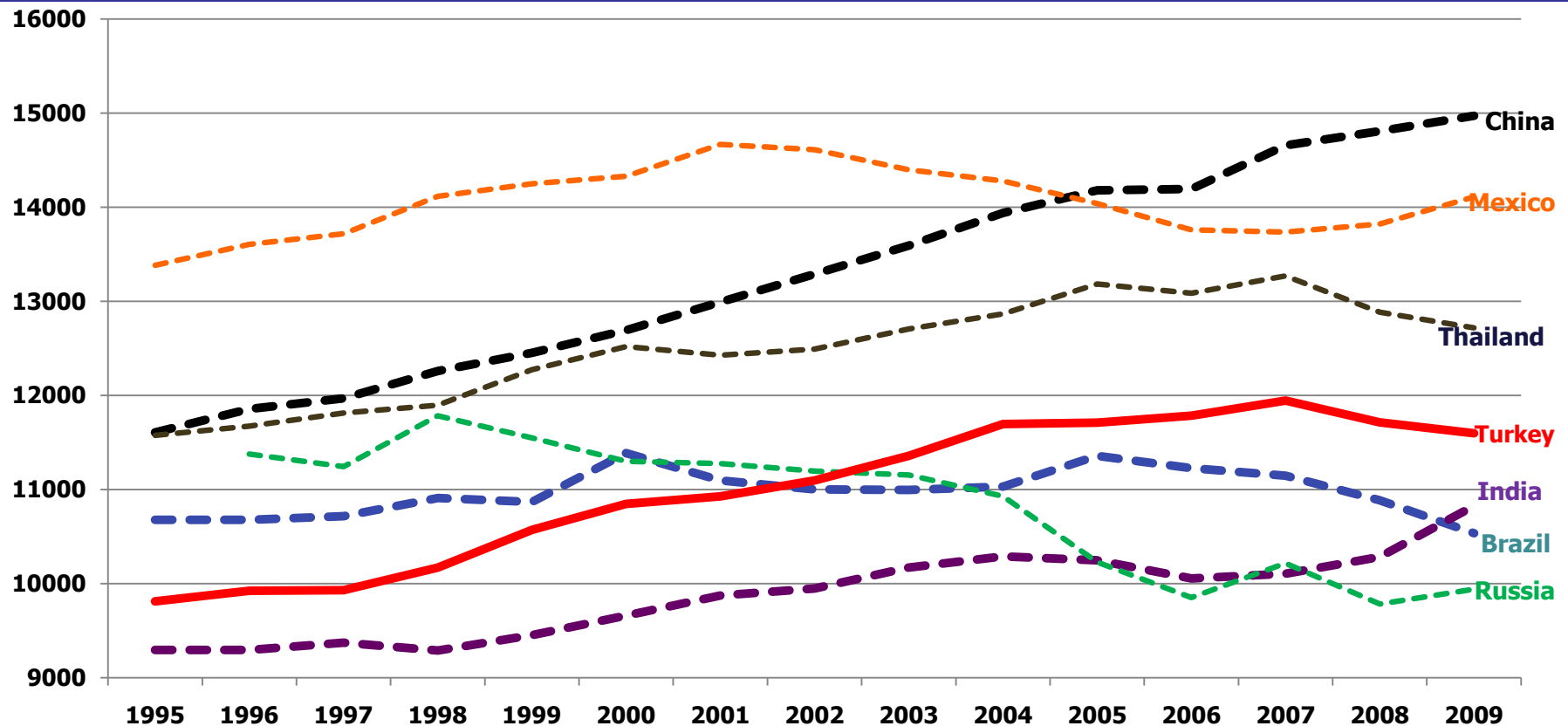
## Stagnation in the EU leads to diversification into new, yet less sophisticated markets



Source: UN Comtrade Database

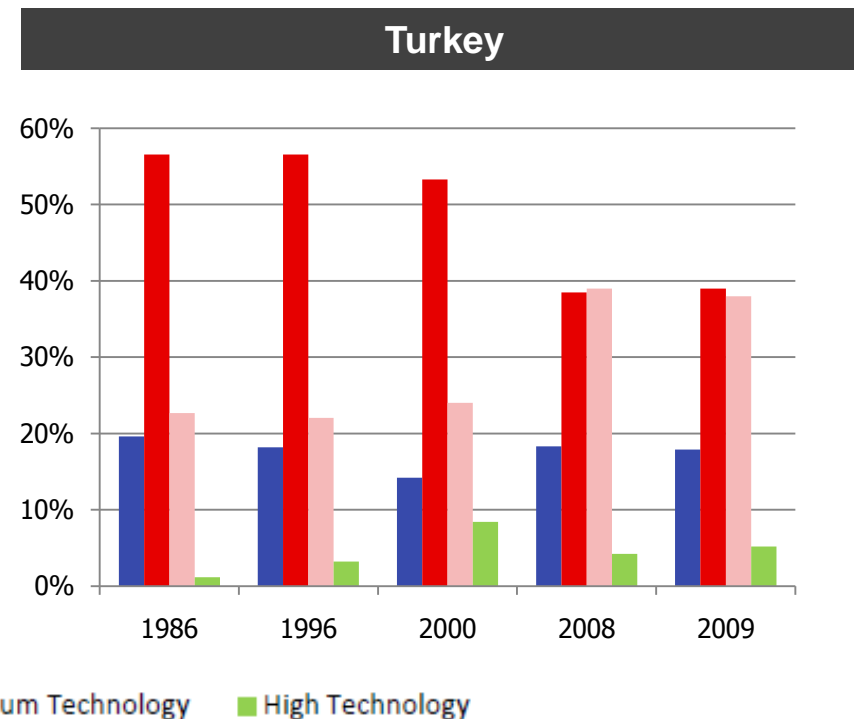
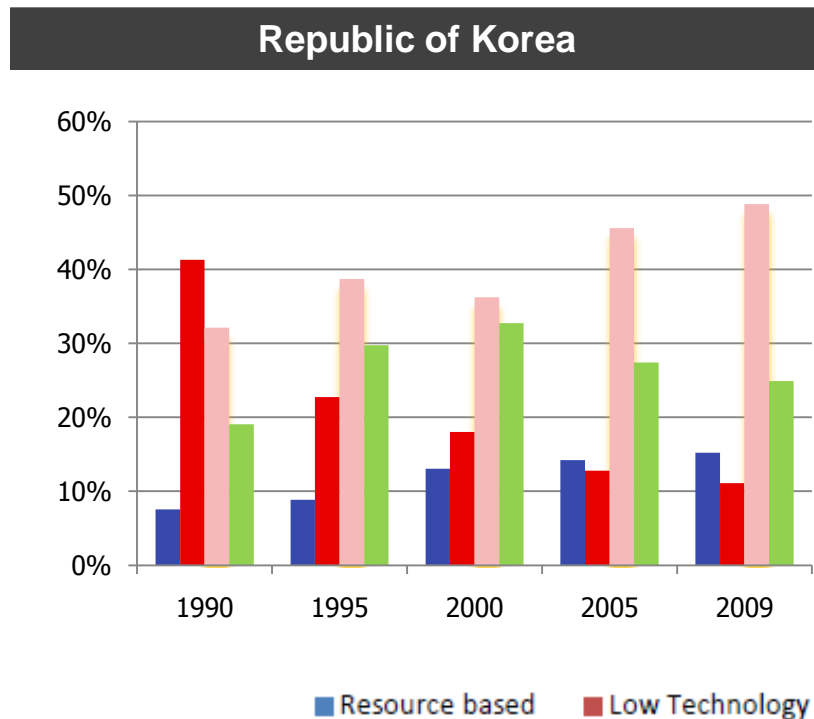
# Exports not only decline in level but also in terms of sophistication

Export Sophistication (EXPY) for Turkey and selected countries (1995-2009)



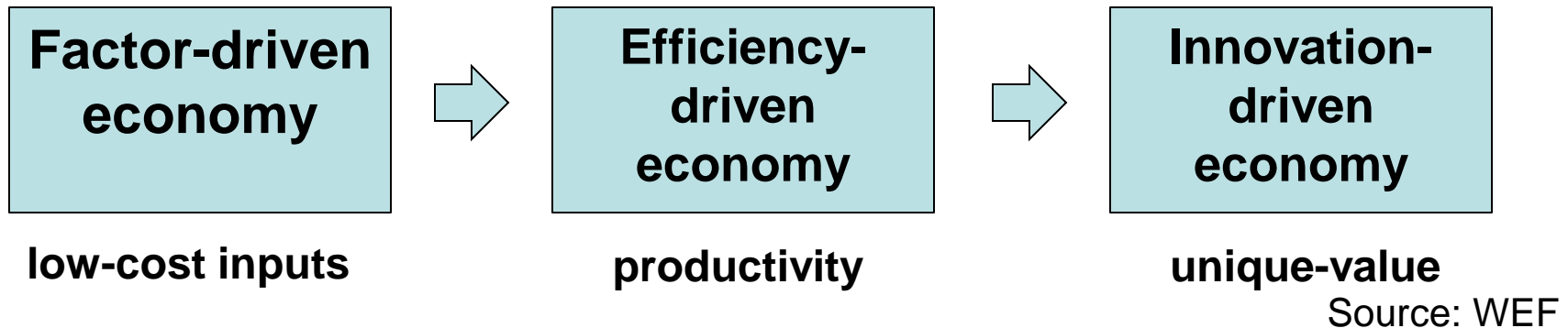
# When it comes to high-tech, Turkey has a long way to go

## Technological composition of exports of Korea and Turkey (1990-2009)





# Turkey might fall into a middle-income trap

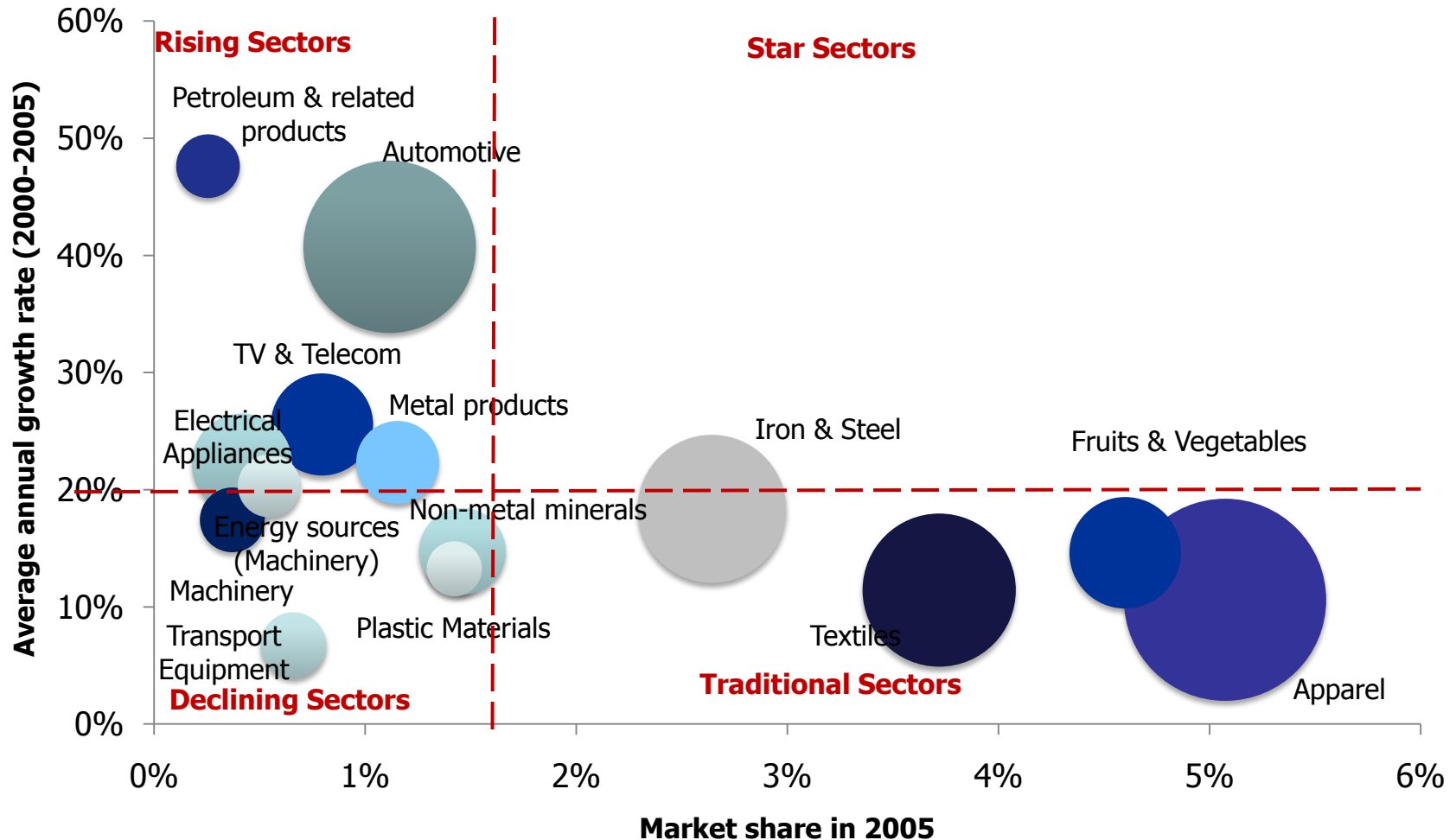


- Where does Turkey stand?
  - ➔ Turkey was a transition economy from efficiency-driven to innovation-driven in 2009.
  - ➔ In 2010, WEF downgraded Turkey to efficiency-driven.
- Upgrade to an innovation-driven economy? Delayed reforms
  - ➔ Need for a large set of reforms in a wide set of areas
- Risk: no-reform political climate
  - ➔ The period ahead will be even less conducive for reforms: elections in 2011, 2012, 2013, 2014, 2015 ....

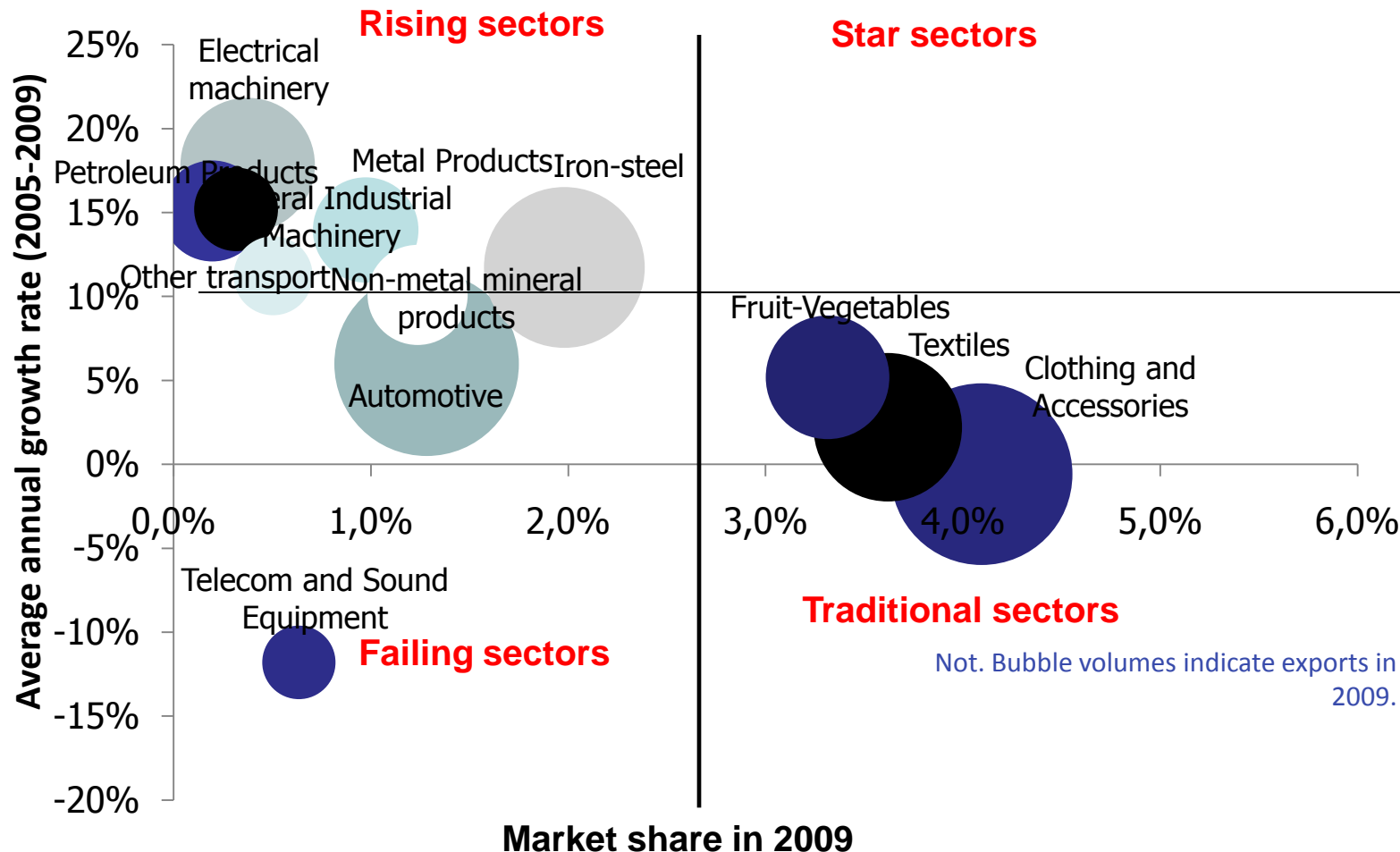
## Towards a new model partnership

- Purpose: Transforming Turkey to an innovation-driven economy
  - ➔ A more stable partner
  - ➔ Catalyst of transformation in the surrounding region.
- Focus: entrepreneurship and innovation
- Israeli experience might be inspiring:
  - ➔ BIRD Foundation (1985): matchmaking for joint R&D projects ➔ many joint products; Intel, Microsoft & IBM plants
  - ➔ YOZMA Fund of Funds for venture capital (1990): import of American equity financing, exits to NASDAQ
- Turkish – American bilateral mechanisms to foster:
  - ➔ Corporate restructuring (role for private equity investments)
  - ➔ Joint R&D for product development (matchmaking)
  - ➔ High-tech start-ups (role for venture capital networks)
- Joint product development and equity investments will also provide access for Turkish firms to American markets.

# Turkey has a problem in fostering star industries (2005)

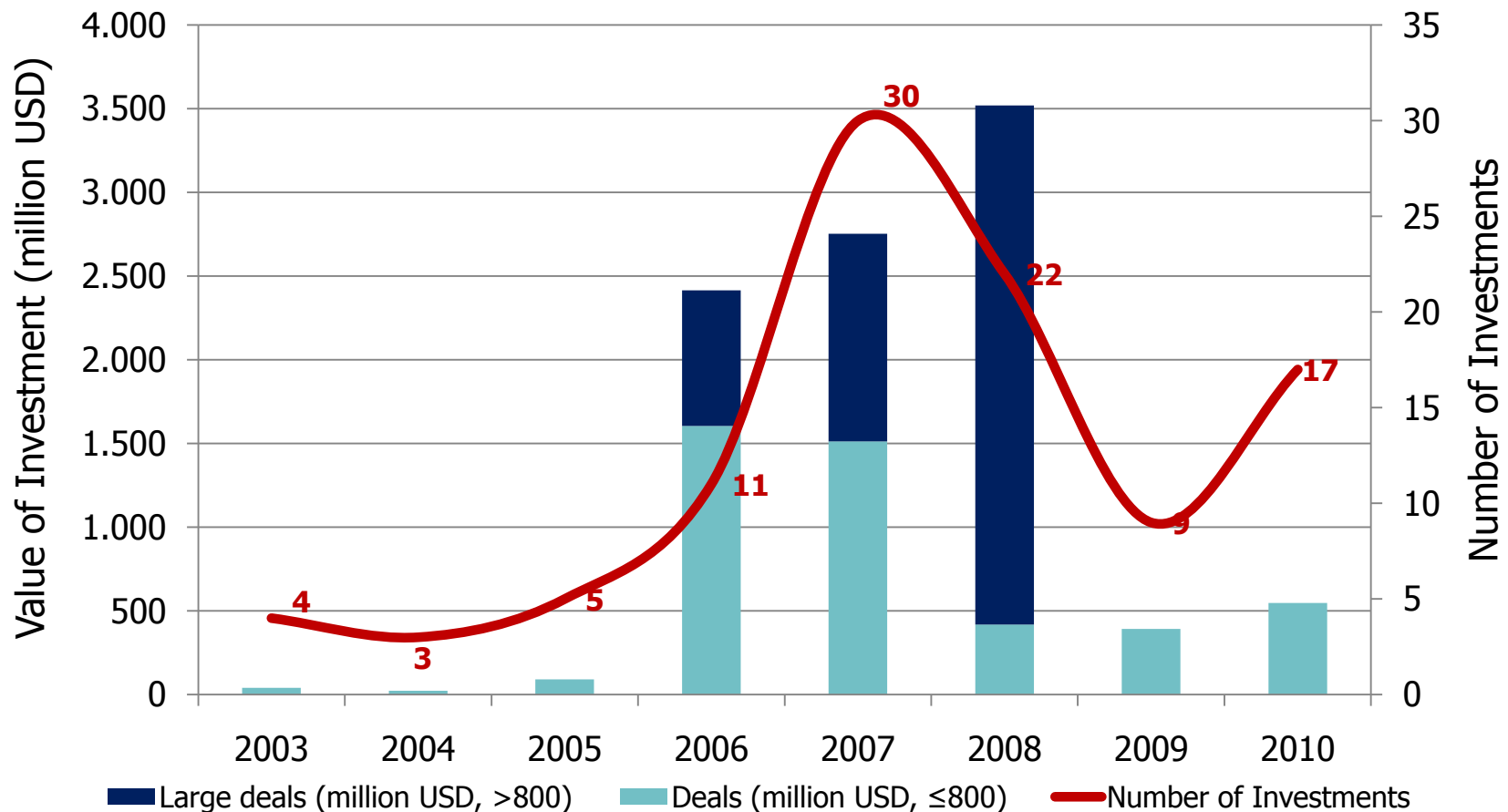


# No star industries in 2009, why don't we focus on star companies?

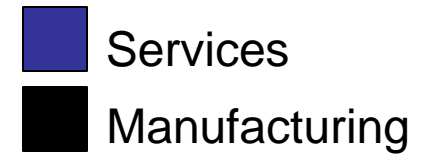


# PE is a good opportunity to identify and support star companies

## Development of Private Equity in Turkey: Change in Value and Number of Investments



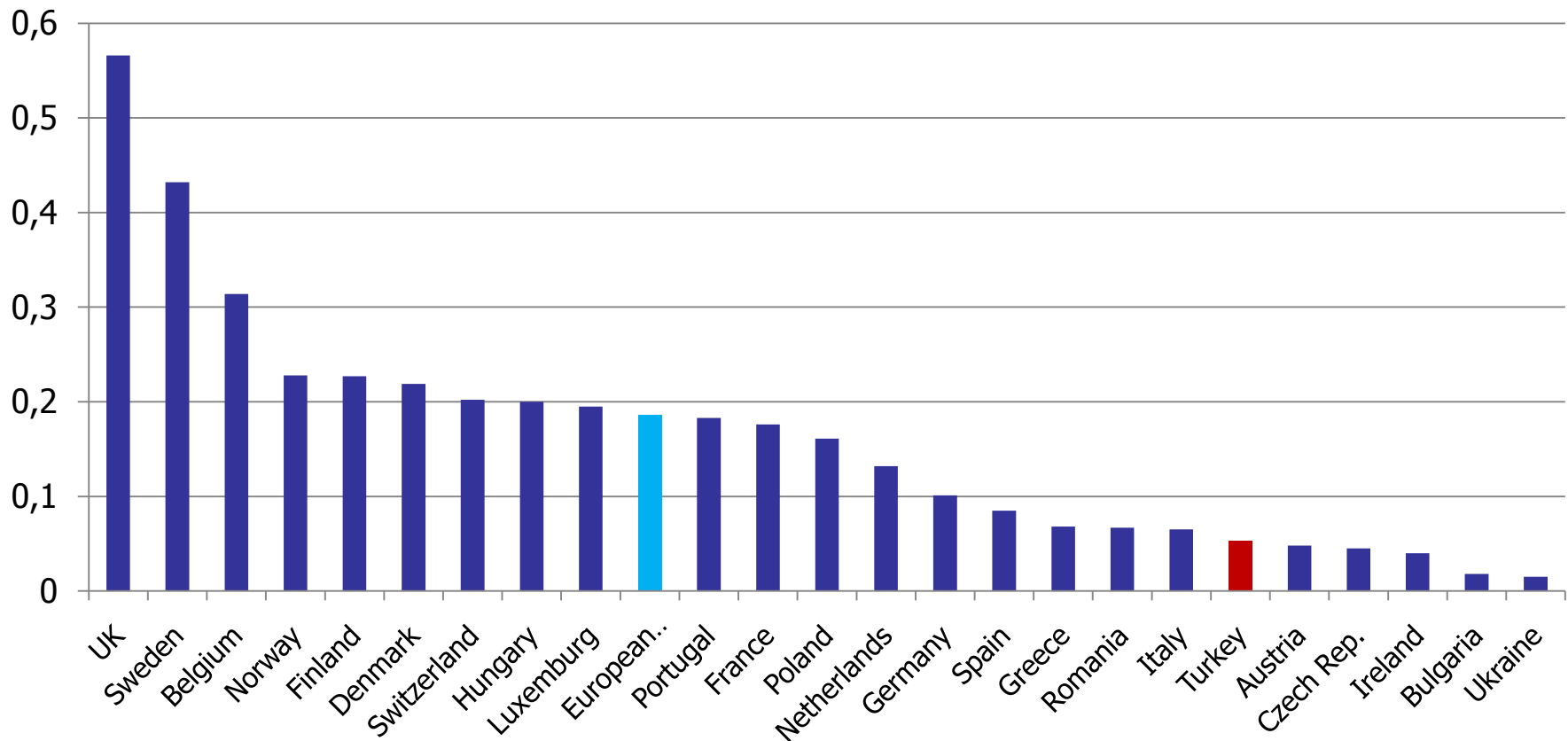
# ...in a wide range of sectors



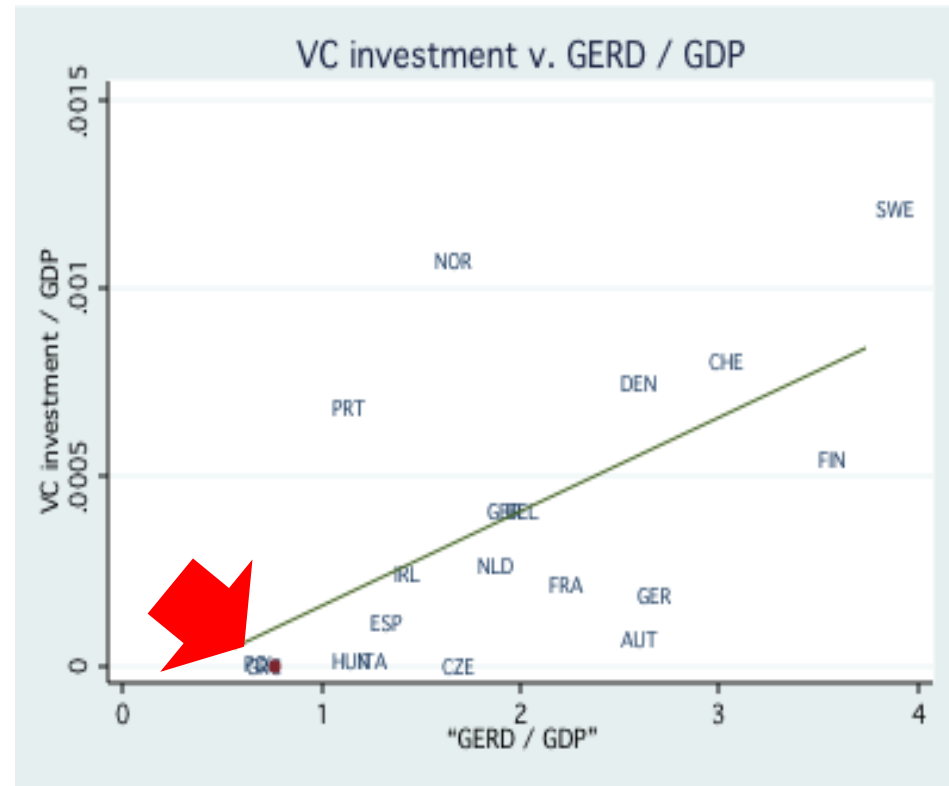
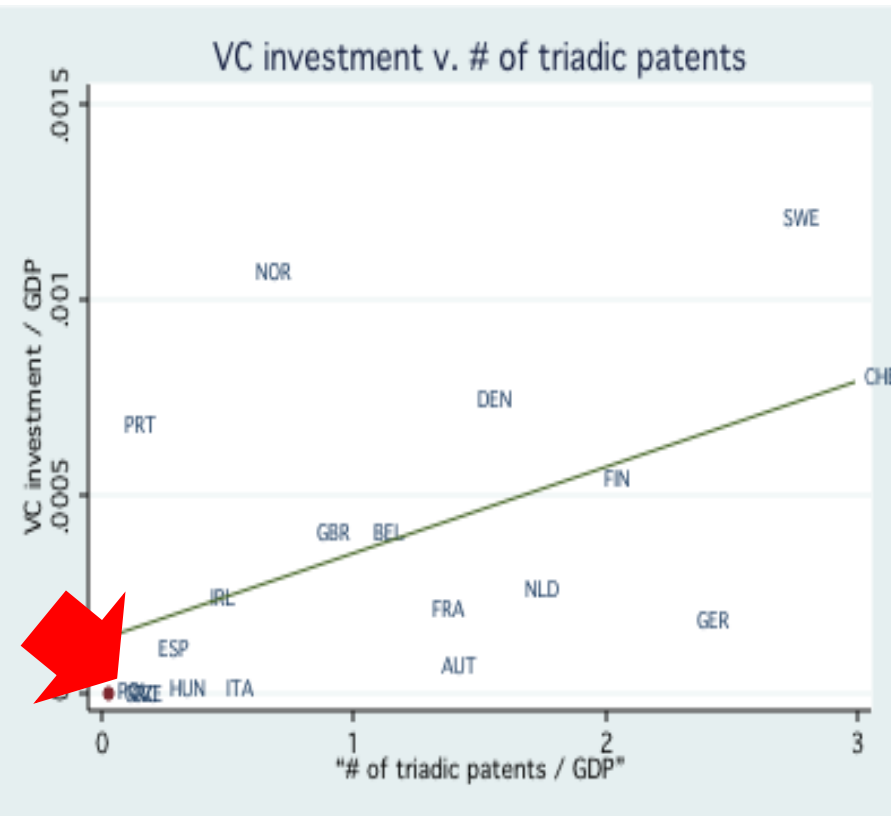
Airport Services	Entertainment	Mobile Marketing
Arts &Ent. & Recreation	Eyewear	Motion Picture
Automotive	Factoring Services	Multiplex Operator
Biotech	Fairs and Exhabitions	Paper & Packaging
Broadcasting	Fleet Rental	Payment Systems
Brokerage House	Food & Beverage	Pharmaceuticals
Cargo Carrier	Furniture & Carpets	Plastics
Ceramic Tiles	Health Care	Real Estate
Construction	Household Appliances	FMCG Retailing
Cosmetics Retail	Information and IT	Security Services
Dental Hospital	Leasing	Ship Building
Edible Oil Production	Logistics	System Integrator
Electrical Accessories	Media	Textile
Electronics Retail	Medical Equipment	Travel Accessories
Electronics	Mineral Products	Vehicle Inspection

# Still a large gap in PE: potential for a lot of star companies

European Countries Share of Private Equity Investments in GDP (2009)



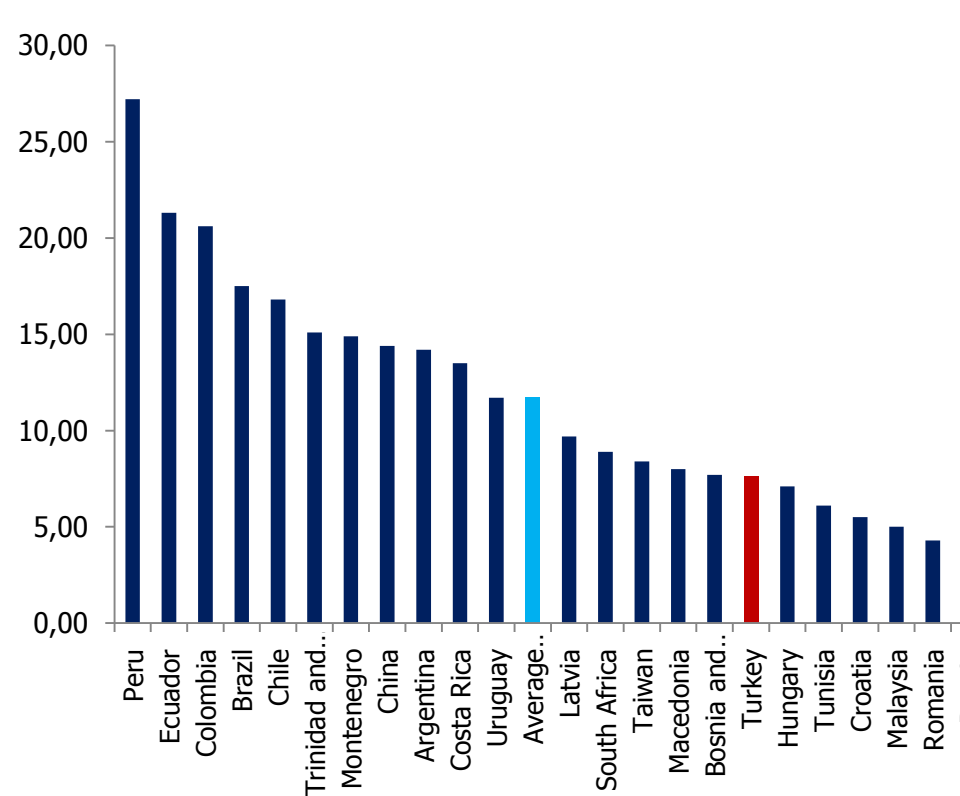
And a larger gap in the amount of VC investments: start-up financing is low even at our level of R&D



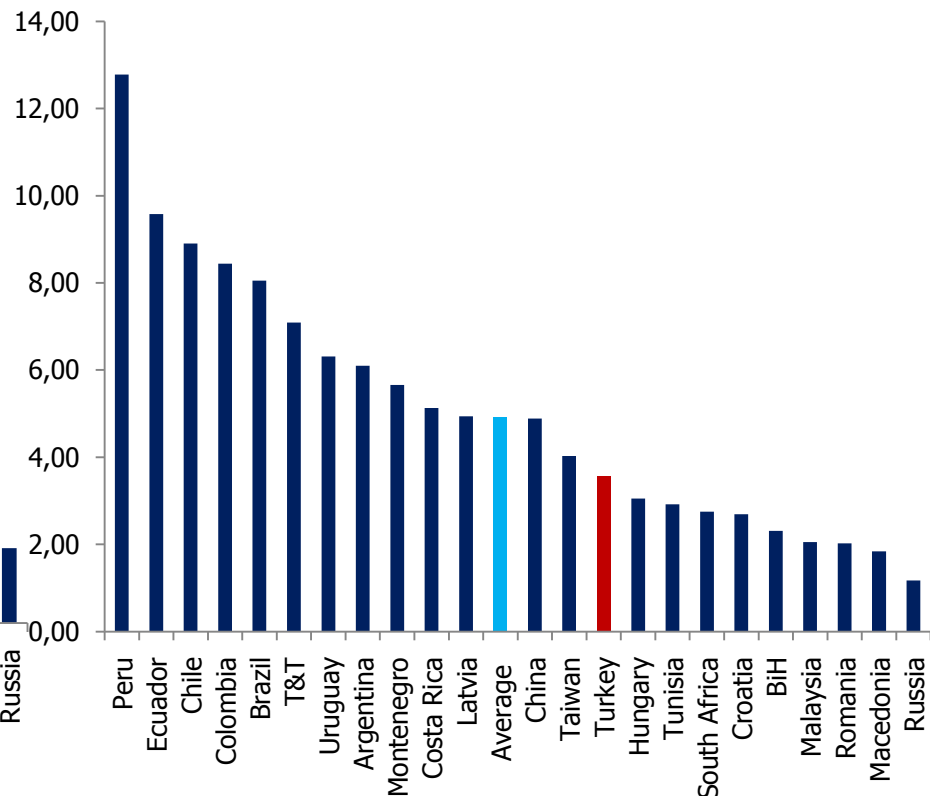


# Entrepreneurship is low in Turkey compared to other efficiency-driven economies

Total Entrepreneurial Activity (2010)



Total Improvement-Driven Entr. Activity (2010)



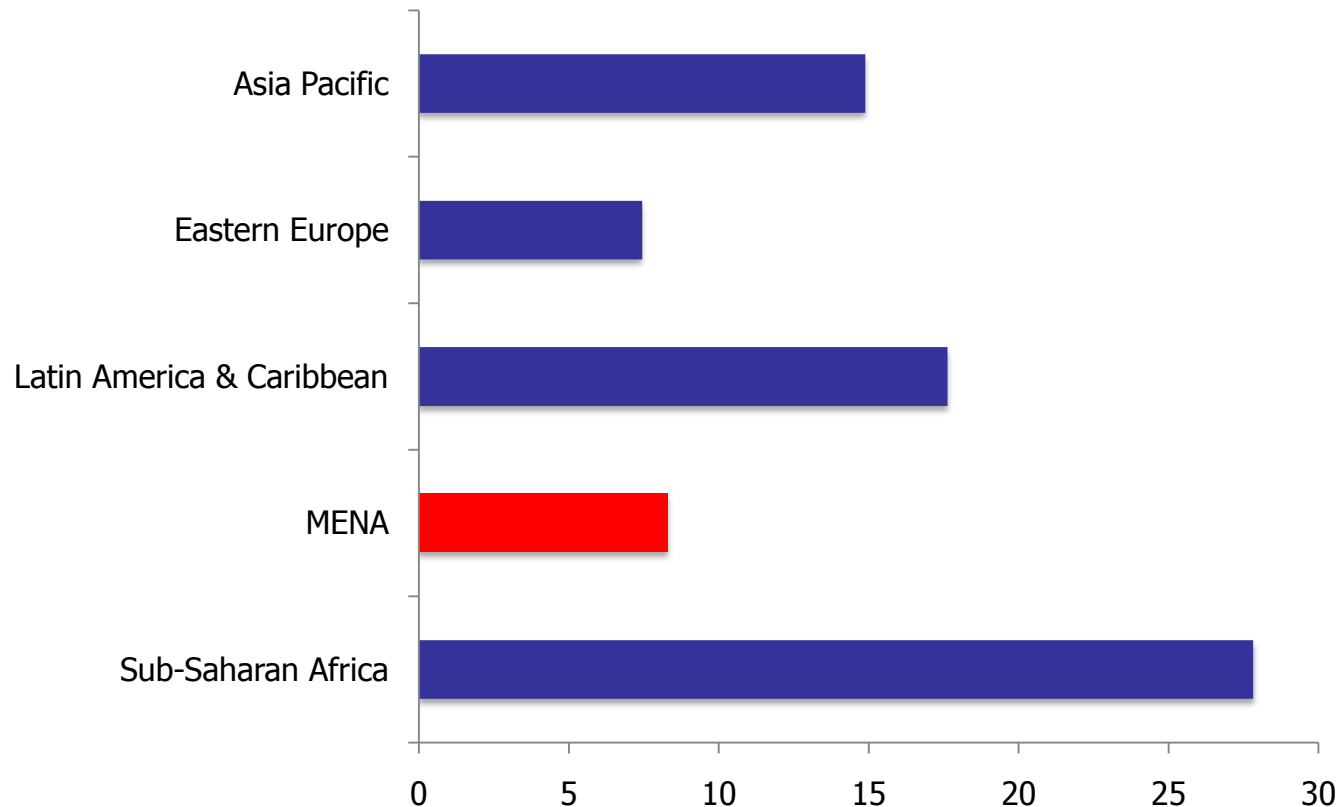
Source: GEM Global Entrepreneurship Report 2010

# Cooperation in innovation and entrepreneurship is a big opportunity

- Systematic mechanisms for corporate restructuring, technology cooperation and financing entrepreneurship
- Current mechanisms:
  - Partnership for New Beginnings
  - Global Entrepreneurship Program: Turkey should be the next chapter
  - Joint committee of ministers
- We have ad hoc mechanisms to kick-start initiatives, but it is time for more structured and institutionalized tools:
  - Turkish BIRD (for cooperation in joint R&D)
  - Turkish YOZMA (for PE and VC)
- Good news: The new commercial code removes many legal obstacles for acquisitions and equity investments

# Private sector development in Turkey will also have spillovers for the MENA region

Early-stage entrepreneurial activity (unweighted average, 2010)



# Special economic zones as tools for private sector development

- How to improve institutional and physical infrastructure for private sector development?
  - Designating certain areas for attracting private investments: Special Economic Zones
  - Superior infrastructure and better regulatory services, in a climate that is not conducive to entrepreneurial activity
- TOBB's SEZ activities in the region
  - Erez Industrial Estate (Gaza) 2005-2007; Jenin Industrial Estate (West Bank) since 2010
  - Hodeidah Industrial Zone in Yemen since 2011
  - Cooperation with Islamic Development Bank of promoting SEZs for private sector development and economic integration

# New value chains spanning the region

- Turkey's form of engagement with the region has to change inevitably
  - Focus on FX generating activities; simple trade relations that began in the 1980s
  - Today's challenge: how to utilize investment opportunities? (From construction to production)
- Value chain integration in the region?
  - Infrastructure is first pre-requisite (transit, water)
  - What sort of manufacturing activities can be good starters? (Textile? Construction materials? Automotive? Machinery?)
  - Turkish private equity industry can also act as a connector for equity investments in the regions with developed private sectors
- Critical importance of sustaining entrepreneurship in Turkey
- Potential for Turkey-US collaboration?

# Concluding remarks

- Turkey's regional transformative power can only be fully realized if her own transformation is successfully completed
  - ➔ Upgrading to an innovation-driven economy
- The new model for model partnership: Cooperate upgrading Turkey to an innovation-driven economy
  - ➔ Focus: entrepreneurship & innovation
- Spillovers in the region:
  - ➔ Only an innovation-driven economy can lead PSD in the region (positive-sum game; Japan-Vietnam relationship)
  - ➔ Developing entrepreneurship brings stability