

ECONOMY

IN THE TURKEY OF THE FUTURE

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This report is the summarized
version of the main report.

ECONOMY IN THE TURKEY OF THE FUTURE

ABSTRACT

Fundamental transformations await the world's economies in the upcoming 20 years. For Turkey to be able to achieve its desired level of prosperity, current structural problems must be solved and preemptive policies must be developed regarding global developments. For Turkey to attain prosperous and virtuous society of the future, Turkey needs a sustainable, long-term, fast-growing economy based on social justice. The Economy in the Turkey of the Future report provides a holistic vision for achieving the infrastructure of the prosperous and virtuous society of the future. The report meticulously analyzes Turkey's contemporary economy in the light of data and presents the necessary fields to focus on for the future and which kinds of policy ought to be handled with what kind of a perspective in accordance with the advantages and disadvantages. The report touches upon three global trends and their potential impact on national economies and Turkey. It then addresses social justice, sustainability, in the context of long-term economic growth, demographic dynamics and the workforce, Islamic finance, international trade, and sectors deemed strategic. The report focuses on the structural properties that determine the long-term economy rather than short-term economic fluctuations. Many of Turkey's short-term problems arise from the lack of long-term policies. To this end, the report's most important emphasis is on the need for long-term policies.

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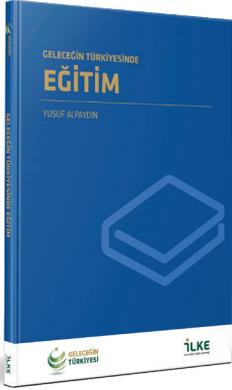
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ABOUT THE TURKEY OF THE FUTURE PROJECT

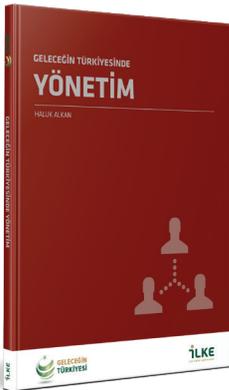


Having embraced the necessity of observing and understanding society, of producing analyses that acknowledge social needs, and of conducting studies oriented to social problems since the day of its inception, the İLKE Foundation for Science, Culture and Education believes in the importance of conducting studies relevant to humanity as a whole rather than any one particular group of people.

The current state of the deterioration in our intellectual productivity, inefficiency in realizing current potentials, and the expansion of problems building up in all spheres of life, riddled with many a vicious cycle, have reaffirmed the İLKE Foundation's conviction in studies oriented to field-research and problem-solving. To this end, we prepare reports by experts in their fields and provide them to the public in the fields of Education, Higher Education, Administration, Economics, Foreign Policy, Social Policy, Cultural Policy, and Civil Society.



As the İLKE Foundation, we aim to contribute to Turkey's vision for the future by adding the İLKE reports to our studies that promote principles and provide solutions, studies that check the world's pulse while simultaneously being informed by local dynamics. Within the purview of the Turkey of the Future project, we aim to provide guidance to policy-makers by developing coherent, functional, and sustainable strategy and policy recommendations based on data and knowledge in social, economic, cultural, and political spheres.



Foreword

As the İLKE Foundation for Science, Culture and Education, we believe that NGOs and the studies conducted therein are critical for policy-makers, practitioners, and the society. Accordingly, we endeavor to shape our studies so to function as a bridge between decision-makers and society. It is evident that society's level of prosperity will rise when the structures and functions of civilian organizations are better understood and constructed.

As the İLKE Foundation, we attach importance to being an active part of the construction of a strong society with institutions such as İLEM, YEKDER, and İGiAD that are part of our organization and are conducting compelling and leading studies in their fields. In this, we endeavor to keep our finger on the pulse of the civilian sphere while proceeding with the understanding that a deeper comprehension of national issues is necessary. We strive to construct all our studies in a perspective that addresses, first of all, our country and the entire world, for the wind of globalization has left no door unopened and has connected even the most disjointed of things. With this care and understanding, we prepare policy notes and research reports comprising proposals for practical solutions in a variety of fields and present them to the public. While we believe in the importance of the accumulated knowledge of the past, we also believe that the day's circumstances must be analyzed properly as to equip ourselves with a strong vision of the future.

The İLKE Foundation has espoused the mission of preparing our country for the future, under the Turkey of the Future Project, as it has done in other studies. With the Turkey of the Future Project, we study Turkey's fundamental issues on a real basis and by observing the integrity of time and space. Our main effort has consisted of consistently challenging the difficulties encountered when handling the issues comprising the project, treating the problems holistically, and suggesting solutions not only concerning our country but also worldwide. We believe that understanding and communicating problems is an important obligation, for solutions will become possible only when we meet problems head on and understand them holistically. Having said that, we also appreciate the importance of consulting our constructs, methods, and outputs with experts being aware that studies pertaining to the future are open to speculation.

We initiated the "Turkey of the Future Project" in 2018 with this objective. With this project, we want to draw attention to the increasing importance of speaking about the future in an era of constant change. In the purview of the project, we develop medium-term vision proposals for Turkey through research reports in the fields of primary and higher education, economy, governance, foreign policy, social policy, cultural policy, and civil society. In the other part of the project, we provide specific diagnoses and policy suggestions related to the aforementioned fields and their subfields through Policy Notes and Analysis Reports.

We hope that the studies conducted in the purview of the Turkey of the Future Project will illuminate our road ahead in the relevant fields and contribute to the creation of a more sustainable order.

Lütfi Sunar

Chairman of the İLKE Foundation
Coordinator of the Turkey of the Future Project

Introduction

The Turkey in which we will live in the future will be determined by what kind of a country we conceive today. If we have no common societal conception of the future, we will have no option but to live in a country designed by others according to their own ends. The primary motivation of this work is the question: "In what kind of an economy do we want to live in the Turkey of the future?" If one pays attention, this question will be seen to be radically different from asking, "What will happen to the Turkish economy in the future?" An answer to one of these questions corresponds to an active demand that requires effort, whereas another corresponds to a passive estimate of the future. The purpose of the work at hand is not to make economic estimates regarding the future.

The primary purpose of this work, while laying out an economic vision, is to draw attention to the issues that need focus pursuant to that economic vision and to provide

a basic framework. The vision laid out in this report has been shaped around the demand for a just, prosperous, and sustainable economy for a virtuous society. Accordingly, the vision of the "future economy" here has three fundamentals: social justice, prosperity, and sustainable production and consumption. Realizing an economy where each individual possesses enough material wealth to be able to access opportunities for procuring the life one desires in which social justice is practiced, and sustainability ensured is only possible through evidence-based and long-term policies in accordance with these aims.

The most significant message that we hope reaches all decision-makers in the economy through this work is the need for long-term perspectives. The effective way to adapt to quickly changing political and economic circumstances and to meet the contemporary challenges emanating from these is to have a long-term perspective. This requires prioritizing policies that aim for structural change rather than focusing on conjunctural policies.

One important distinguishing feature of this work is that it considers social justice, economic growth, and sustainability not as alternatives but as complementary to each other. In other words, we believe that while social justice and sustainability will nurture economic growth, economic growth will serve social justice and the prosperity of posterity when supported by just political and economic institutions. Building upon this, we recommend policies we believe to be necessary today for preparing the economy of tomorrow while evaluating the given advantages and disadvantages of Turkey's current economic structure.

Three Global Trends and Their Potential Impact on National Economies

Firstly, the global economy's center of gravity is moving from Europe and North America to Asia. The shift of concentrations of

manufacturing and trade to Asia has the potential to trigger regional and global political tensions. Foreign policy must be formed by taking this into consideration.

Secondly, manufacturing processes are undergoing a fundamental transformation with the current stature of robotics and artificial intelligence. The demand for labor will decrease as a result of the current wave known as Industry 4.0 or the era of automation; this means that comparative advantages based on cheap labor will be lost. This situation brings forth the risk of global income inequality further increasing in favor of countries capable of developing technologies.

Third, not being able to reduce greenhouse gas emission to required levels will have significant consequences for the global economy. Global GDPs on average are estimated to be 23% lower than expected throughout the 21st century if the average global tem-

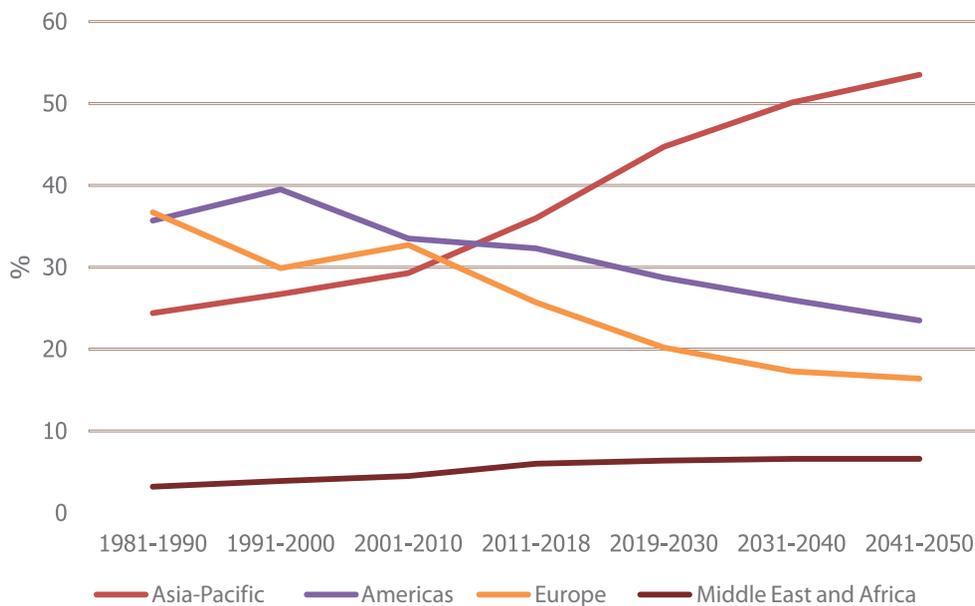


Figure 1. Percentages of regional GDP. Based on data from the Economic Intelligence Unit (2015).

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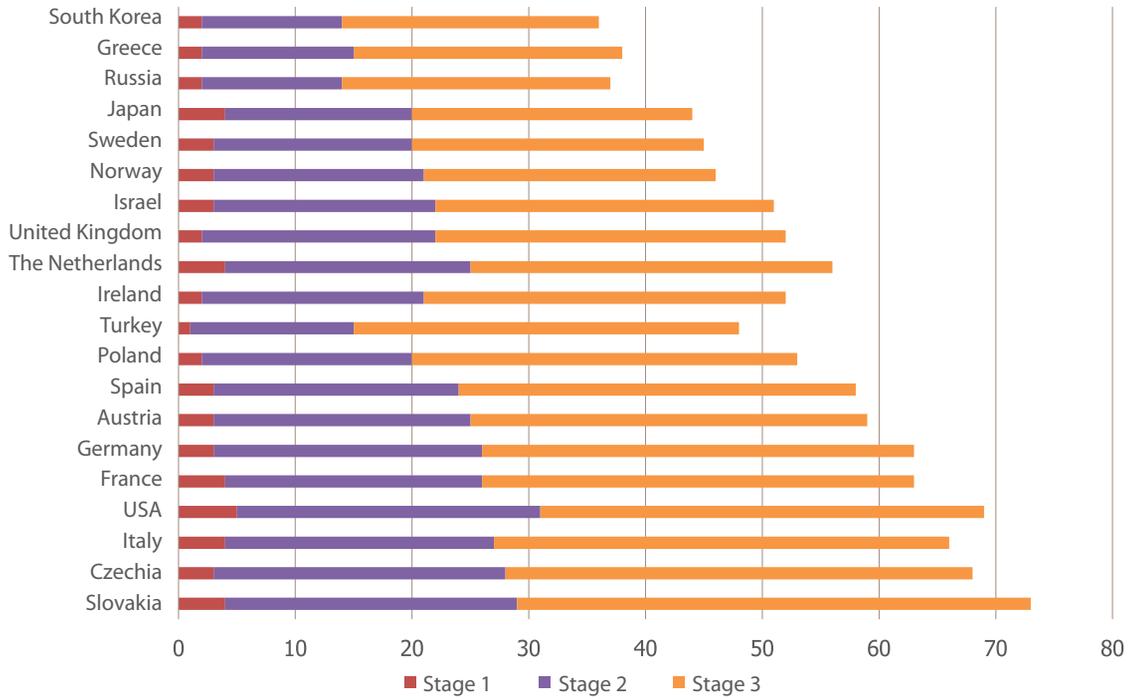


Figure 2. The percentage of jobs at high risk of automation. Adapted from PricewaterhouseCoopers (2018).

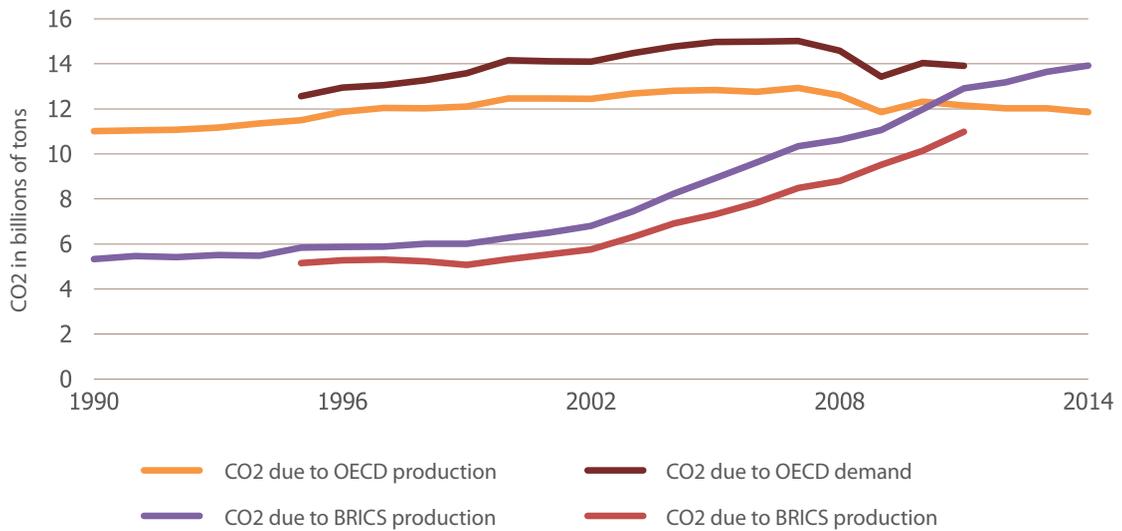


Figure 3. CO2 emissions according to energy usage. Adapted from OECD (2017)

perature rise more than 2°C. Should this be the case, it will have an important negative impact on the global economy. Unless further precautions are taken, global warming's annual impact on global GDPs on average could rise to 1-3% by 2060.

The Overlap of Social Justice, Sustainability, and Long-term Economic Growth

The growth of material wealth is only possible through long-term economic growth that increases productive capacity. Social justice, sustainability, and long-term economic growth are not alternatives to each other but rather complementary phenomena. Turkey's long-term growth performance over the years has not been high enough to come close to the national income levels of

developed countries. This is due to the low level of total factor productivity. Much needs to be overcome regarding inequality and, especially, inequality of opportunities. Just as it is detrimental to social justice, inequality of opportunities is also the principal obstacle to the accumulation of human capital and, therefore, long-term growth. Sustainable growth is economic growth that does not take away from the prosperity of posterity. The greatest threat to future generations is global climate change.

Demographic Dynamics and the Workforce

Turkey is losing its young population due to low birth rates. After 2040, the elderly population will exceed the population of those 15 years old and younger. Turkey has entered its era of "demographic window of opportunity" where the working age population is at

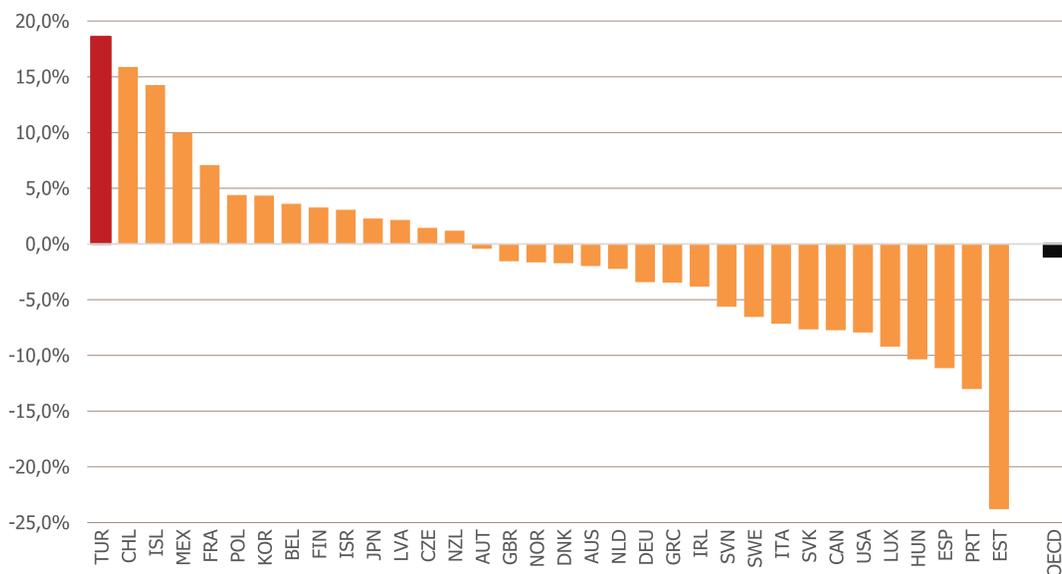


Figure 4. Difference in income increases between the highest and lowest segments of OECD countries (2010-2014). Based on data from OECD, Inequality Update (2016).

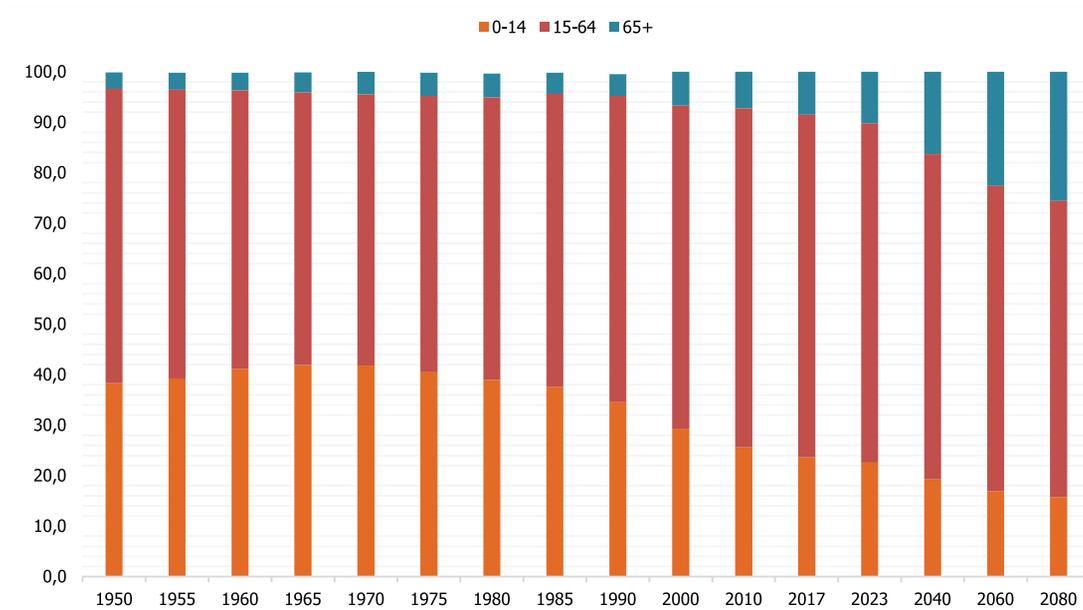


Figure 5. Projected distribution of the population by age group (1950-2080) Based on data from TURKSTAT (2018).

its highest. Along with this, the ratio of participation in the workforce is low. Only 47% of the working age population are employed, and one single employed person is responsible for taking care of 2.8 people. This is preventing us from benefiting from the demographic window of opportunity. The Turkish economy has undergone rapid economic growth in the last 15 years. The capacity of this growth to create employment is above the OECD average. However, unemployment has not decreased because the population that joins the workforce anew is too large. Long-term unemployment will lead to the normalization of unemployment and the formation of social problem areas that do not easily lend themselves to solutions. The increased use of computers, robotics, and artificial intelligence in manufacturing carries the risk of creating technological unemployment. 35% of the capabilities deemed valuable today will lose this status

in the upcoming years, whereas capabilities like analytical and critical thinking, innovation, creativity, technology use, and leadership will come into prominence.

Islamic Finance

Islamic finance is a model that supports social justice and sustainable development, and increasing its share in the Turkish economy is important. When examining the practice of Islamic finance in Turkey, it is seen that financial intermediation beyond banks is underdeveloped, that participation banking has not reached its desired extents, and that there are some problems in these banks' financial performances. When evaluating the social accomplishments of participation banks, it is seen that they are in a strong relationship with the traditional financial system, are focused on debt financing, and are functionally weak in terms of development finance.

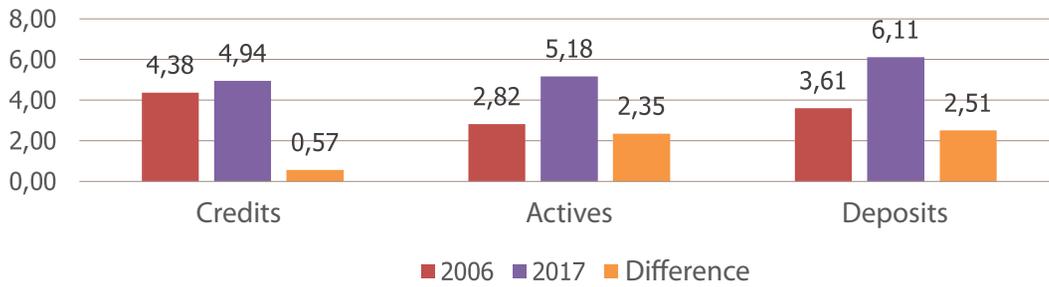


Figure 6. Market share of participation banking (%).

Areas of Fragility in Turkey's Economy: Foreign Trade Deficit and Export Diversification

An economic structure that continuously produces a foreign trade deficit is one of the foremost sources of fragility in Turkey's economy. Despite the rapid increases in the volume of trade since the start of the new millennium, the recoupment of exportation by importation has not differed over the years.

Furthermore, a significant amount of imported interim products and capital goods are used in Turkey's production of exported products. Fluctuations in input costs, primarily in commodities and energy, create uncertainty

and are an important risk for production and exportation. In addition to fluctuations in the costs of these products, high fluctuation levels in foreign exchange rates further augment the uncertainty. Increasing market diversification is important from the perspective of export stability and development. Market diversification is a field that requires improvement. Turkey has a higher level of export product diversification when compared to similar countries. The share of technology in Turkey's exports is small. This share should be increased. Increasing export product diversification provides an advantage in catching up with new technologies and being able to produce new products in the future.

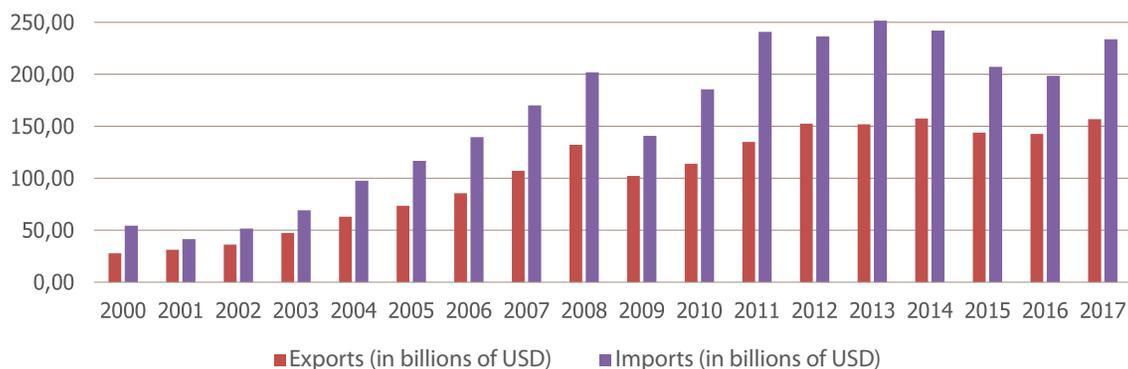


Figure 7. Exports and imports in Turkey since 2000. Based on data from TURKSTAT (2018).

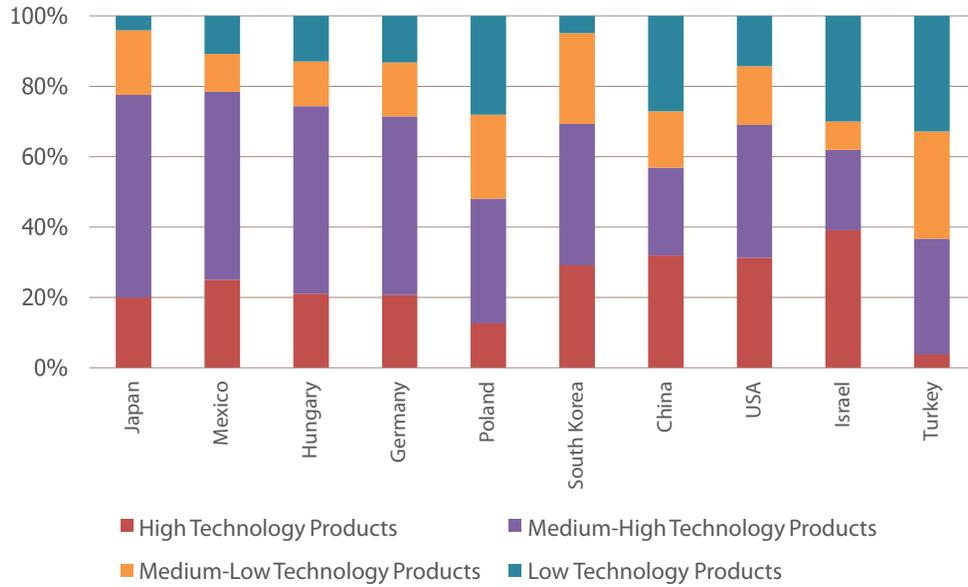


Figure 8. Technological intensity in the exports of selected countries (2015). Calculations based on data from OECD-STAN and TURKSTAT.

Turkey is located in the middle of the value-added spectrum; namely, in the segment of standard labor-intensive production. Turkey must move on to segments of the value-added chain with higher added value in order to increase foreign trade's contribution to growth.

The effort to create a holistic vision for the economy requires some components to be taken seriously. A vision for the future, specifically regarding the economy, needs to be based on quantitative data and scientific knowledge without disregarding today's limitations. Having a vision for the future independent of contemporary realities is unimaginable. Just as in sociology and politics, the phenomenon of *path dependency* has truth to it in economics as well. Cultural, political, and economic institutions are observed to show a significant degree of path dependency. In addition, it is not possible that prospective productive capacities, te-

chnological preferences, and accumulation of human capital be independent of current circumstances. An evaluation of the performance of Turkey's economy in the relevant dimensions from the past until today has been provided in every section of this work. These evaluations are based on proper quantitative data and evidence derived from empirical research in the literature.

The notions of long-term growth, social justice, and sustainability that are fundamental to our vision of *Economy in the Turkey of the Future* have been used in their terminological meanings as used in economics rather than their vernacular uses. We define these as follows:

Long-term growth: This is the increase in the productive capacity of the economy. Unlike short-term growth, it depends on structural factors such human capital, technology, and efficiency, rather than an increase in demand.

Social justice: This is the equality of rights and opportunities for individuals self-actualizing and conceiving their talents.

Sustainability: This means achieving economic growth without conceding the prosperity of posterity.

Conclusion

Some structural problems come to the fore when evaluating Turkey's past economic performance. Despite being well known and having been voiced by numerous researchers, these problems have persisted due to effective solutions not being implemented. Based on our data and the literature, the primary problem areas of Turkey's economy have been determined as the following:

- Past performance of long-term growth has been insufficient for achieving the prosperity enjoyed by developed nations.
- The most significant problem in the economy is about efficiency. Total factor productivity provides a very small portion of economic growth.
- Inclusive institutional structures have not been created.
- Social justice has not been provided.
- Economic growth is unsustainable.
- Economic participation and workforce skills are low.
- The desired level of exports has not been achieved.

Alongside these points, new problems will be awaiting the Turkey of the future. The economy's current structure is not capable of effectively dealing with these. The primary issues Turkey is expected to encounter in the future are as follows:

- The aging population.
- Transformations in manufacturing processes as a result of Industry 4.0.
- Global climate change.
- Manufacturing and trade's center of gravity shifting from Europe and North America to Asia, and the significant impact this will have on international trade.

ECONOMY

IN THE TURKEY OF THE FUTURE



TURKEY'S ECONOMY VISION

For Turkey's economy to prepare for the world of the future and develop a just and forward-looking system, Turkey must make headway in the following areas in the upcoming years:

1

Long-term development: Turkey must aim for long-term growth that corresponds to the increases in productive capacities based on structural factors such as human capital, technology, and efficiency.

2

Sustainability: Turkey must achieve economic growth without conceding the prosperity of posterity.

3

Investments: Turkey must direct investments to more efficient and strategic sectors instead of sectors such as real estate that contribute little to long-term growth.

4

Foreign trade: Turkey must increase the technological intensity and added value of exports by decreasing exports' dependence on imports.

5

A just tax system: Turkey must make the tax system just and implement governmental interventions aimed at income justice.

6

Workforce: Turkey must implement policies such as flexible work hours and tax refunds for wage income and aim for a workforce with strong adaptive capabilities.

7

Social justice: Turkey must ensure that individuals have equal rights and equal opportunities for self-actualizing and conceiving their talents.

8

Human capital: Turkey must have an education system that can raise individuals who possess strong adaptive capacities, master general skills, and have strong values in order to increase human capital.

9

Total factor productivity (TFP): Turkey must develop the innovation and entrepreneurship ecosystem and increase public transparency, participation, and accountability.

10

Sectors: Turkey must place particular importance on agriculture and husbandry and the energy, defense, and information sectors; these areas are strategic to the economy of the Turkey of the Future.

ECONOMY IN THE TURKEY OF THE FUTURE

The report provides a holistic vision for achieving the infrastructure of the prosperous and virtuous society of the future. The report meticulously analyzes Turkey's contemporary economy in the light of data and presents the necessary fields to focus on for the future and which kinds of policy ought to be handled with what kind of a perspective in accordance with the advantages and disadvantages. The report touches upon three global trends and their potential impact on national economies and Turkey. It then addresses social justice, sustainability, in the context of long-term economic growth, demographic dynamics and the workforce, Islamic finance, international trade, and sectors deemed strategic. The report focuses on the structural properties that determine the long-term economy rather than short-term economic fluctuations. Many of Turkey's short-term problems arise from the lack of long-term policies. To this end, the report's most important emphasis is on the need for long-term policies.