Dear Dr. Kim,

1. Our Government’s strong commitment on sound economic policies and structural reforms ensured macroeconomic stability, provided economy with a flexible and productive structure and therefore improved quality of life of our people.

2. Our economic and social policies together with structural reforms implemented during the last decade converted Turkey into an upper-middle income country.

3. These reforms have also helped us to cope with the adverse impact of the 2008-2009 global crisis. In addition to the strong fiscal position, Turkish banking sector, which is ranked among the best performers in Europe, has a prominent impact on the economic performance of Turkey since 2002. Strong capitalization, minimal FX exposure, primarily deposit-based funding, and adequate liquidity allowed banks to weather the financial and output shocks.

4. Throughout the global crisis period, we implemented timely, targeted and efficient macroeconomic policy combinations and confidence was restored quickly. Thus, Turkish economy was recorded among the fastest growing economies around the world with the 9.2 per cent and 8.8 per cent GDP growth rates in 2010 and 2011, respectively. Along with our commitment to fiscal discipline, we have implemented macroeconomic and prudential policies in order to address the consequences of the fast recovery in domestic demand and the surge in capital inflows on external accounts.

5. As a result of these policies, along with global weaknesses, Turkey successfully engineered a soft landing and rebalancing in the economy in 2012. GDP growth slowed down to 2.2 percent and current account deficit shrank by almost 4 percentage points as a result of solid export performance and slowdown in domestic demand. This achievement
was globally recognized and along with the strong fiscal and banking sectors helped Turkey’s credit rating to reach investment grade in late 2012.

6. We recognize that reaching above potential growth rates with a sustainable external balance requires measures that address the structural portion of the current account deficit. In this respect, in our Medium Term Program for 2013-2015, we are now focusing on structural reforms to enhance competitiveness, to improve business climate, to reduce import dependency on energy, to raise domestic savings. Through these reforms we will also ensure shared prosperity and generate more and better jobs.

I. Competitiveness

7. Competitiveness is one of the key pillars of the 9th Development Plan (2007-2013) and will continue to be on top of our Government’s policy agenda through new Development Plan.

8. The new Commercial Code which is a critical step towards modernizing the regulatory framework to improve business climate and competitiveness is under implementation since July 1, 2012. The amendments that we introduced to the Commercial Code in June 2012 and all the secondary legislations that have been issued since August 2012 provided a base for smooth implementation of the Code. We have issued critical secondary legislation regarding trade registry system, scope of independent audits, minimum requirements for annual activity reports, and rules and procedures for undertaking general assembly meetings and the electronic general assembly system. The Commercial Code brings a more transparent financial reporting through Turkish Financial Reporting Standards which are fully aligned with the IFRS. This is particularly important for private sector’s access to finance and equity capital. Widened scope of independent auditing, strengthened shareholders rights, and enhanced accountability and corporate governance practices are expected to improve doing business and investment climate environment of Turkey.

9. We have widened the scope of companies that are subject to external audit through the Council of Ministers Decree published in Official Gazette on January 23, 2013. We envisage that the number of companies subject to independent audit will reach around 2,500 by 2015 from around 700 currently. Regarding the independent audit of SMEs and their compliance with international accounting standards, our Public Oversight, Audit and Accounting Standards Board is pursuing a timeframe in parallel with the practices in the European Union. In our Medium Term Program 2013-2015, we aim at strengthening corporate governance, extending strategic management in state owned enterprises, and improving their compliance with the new Commercial Code.
10. In parallel to the Commercial Code, full implementation of Civil Procedures Law has also been a milestone towards improving investment climate through reducing court workloads and the related burden on business. In order to speed up the court process, we introduced preliminary investigation mechanism before court hearings. In addition, the out of court settlement mechanism was introduced for improved contract enforcement through the secondary legislation dated April 2012.

11. Simplification of business registration system is one of the priorities for our Government. We issued a Circular to simplify the registration of businesses by reducing the number of procedures to start a business. The Central Business Registration System (MERSIS) Project that aims to complete all the trade registry transactions in an electronic format and creates a central database for companies is expected to be fully operational in 2013. The MERSIS will contribute to the investment climate and doing business practices in Turkey by facilitating the fulfillment of the companies’ disclosure requirement. Online access to detailed information about companies by third parties and integration among other public registries will increase the integrity and reliability in the market. As part of our doing business reform agenda, the Coordination Council for the Improvement of the Investment Environment (YOIKK), the platform to improve investment climate through public private dialogue, will continue to determine actions to improve Turkey’s ranking within each World Bank Doing Business indicator and overall ranking.

12. We are closely monitoring the progress in the Fight Against Informality Strategy Action Plan 2011-2013 in order to support level playing field and to improve productivity. A new Ministerial Supervisory Committee and a dedicated page in the Revenue Administration website are some of the mechanisms for monitoring the Action Plan. Increasing voluntary compliance, strengthening audit capacity, enhancing discouragements of sanctions, sharing database among relevant agencies, and raising awareness are the main objectives of the Action Plan.

13. In this regard, as part of our wide-ranging efforts to reduce informality in all stages of the value chain, we are aiming to strengthen the audit capacity of our institutions and expand the scope of targeted audits. In particular, Social Security Institution (SSI) has strengthened its auditing capacity by increasing the number of auditors to 1367 by the end of 2012 from 700 in 2010 and 1100 in 2011. Moreover, a risk analysis unit was established in SSI in May 2012, with a view to identify the high risk groups and launch targeted audits towards these groups. These efforts will complement our earlier efforts like five percentage points cut in the social security premium (non-wage labor cost) which incentivized formalization by making it less costly.
II. Saving and Financial Deepening

14. Reducing external vulnerabilities in the medium term is one of the top priorities for our Government. Our Government has introduced new policy measures to increase domestic savings, lengthen maturity of saving instruments and deepen the financial markets.

15. Turkey’s saving rate is low by international standards and has been falling over the past decade, primarily due to a decline in private savings. In the context of our reform efforts to encourage savings, we have amended the Private Pension Law in June 2012 to restructure voluntary private pension schemes. The secondary legislation were issued by the end of 2012.

16. The 2012 amendment on the Private Pension Law replaces tax incentives, which favored potentially higher income groups, with a direct government matching mechanism of 25 percent of contributions (capped at the annual gross minimum wage). The matching mechanism aims to lengthen the maturity of the savings in the system: beneficiaries cannot access the matching contributions during the first three years and have only partial access until retirement age.

17. Continued high level of fees in the private pension system which reduces the net returns to the participants has been an obstacle for the system. In order to address this issue, we have reduced caps for administrative fee and fund management fee through the secondary legislation. We will also launch a central tool enabling the comparison of fees, performances and service quality of various pension companies, which is expected to increase competitiveness in the sector. With the new system now in place, we expect that fees will start to decline; early exits will slow down, while participation will go up. In the medium term, increased competition in the sector, based on investment returns may help ensure a more stable private pension scheme and also lessen the need for strong fiscal incentives.

18. The size of the non-bank financial institutions (NBFIs) sector in Turkey remains small. This in turn suppresses domestic savings, and undermines the availability of (longer-term) financing thus in turn holding back Turkey’s competitiveness. The new Capital Market Law (CML) aims to make capital markets deeper, more competitive, and transparent. The law – issued in the Official Gazette on December 30, 2012– promotes the orderly growth of capital markets and contributes to the efficient allocation of funds to projects.

19. The comprehensive and modern framework of the CML is expected to facilitate market development and innovations without compromising on investor confidence and
market integrity. With the promotion of several new investment vehicles, we expect that the CML will introduce increased competition to our economy in which capital markets are largely dominated by banks. In addition, the new investment vehicles will in turn lead to the introduction of new lending instruments. This will help to better match the supply of capital with the myriad capital needs that exist.

20. Together with the CML, the Leasing, Factoring and Financing Companies Law that was enacted in 2012, also aims to increase the role of NBFIs. The new law incorporates financial leasing, factoring and financing company operations under one regulatory scope and aims to establish a reliable legal base for ensuring efficiency and growth of the NBFI sector. The new law also introduces new leasing types, beyond financial leasing, and includes provisions to facilitate operational leasing, sub-leasing, software leasing, sell and leaseback as well as financial leasing transactions to be made from foreign countries. With this new law, we aim to help the NBFI sector grow and improve SME’s access to finance especially by expanding the variety and size of the leasing transactions available for them.

21. We have also introduced a new system for entrepreneurs and early stage companies having difficulties in access to finance by the enactment of a law regarding the promotion of business angel investments on June 13, 2012 and by putting the secondary legislation for implementation into force on February 15, 2013. We expect an increase in the number of angel investors and volume of angel investments which would support early stage companies in terms of institutionalization, guidance and financing. This mechanism will encourage the establishment of innovative startups, increase the dynamism of the economy and contribute to stronger and more sustainable economic growth.

22. Going forward we will be focusing on the structural reforms which will facilitate Turkey’s growth to high-income status in the medium term. Our agenda includes alleviating some of the most binding constraints to doing business, including in resolving insolvency and in dealing with construction permits, further reducing informality along the value chain, and improving access to finance. In this context, strengthening microfinance and fully operationalization of credit registry are areas which we pay attention which will disproportionately benefit smaller firms.

23. We are determined to continue with prudent macroeconomic policies as it is set out in the Medium Term Program for 2013-2015. Strong and sustainable growth with high employment creation and raising the flexibility and competitiveness of the economy are our priorities in the economic agenda. In order to secure even greater economic prosperity, Turkey will continue with developing further the education system, encouraging R&D activities and innovation and improving the efficiency of labor and product markets.
24. Preparations for our tenth Development Plan for 2014-2018 are well advanced. The new Plan is envisaged to continue to focus on key reform areas, including transforming the real economy towards a more innovative and competitive production structure through improving the business environment, enhancing the R&D capacity, deepening financial markets, improving enterprise governance; enhancing human capital and social cohesion; improving the living environment and attaining sustainability.

25. On the basis of these achievements, we request the World Bank's support for our structural reform program by approving the Competitiveness and Saving Development Policy Loan (CSDPL) in the amount of Euro 624,100,000 (USD 800,000,000 equivalent).

Yours sincerely,

Ali BABACAN
Deputy Prime Minister