



# COMMENTS ON THE DRAFT OUTLINE OF THE CONTENTS FOR A COUNTRY PROFILE

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My comments are given below under four headings: (i) scope and content of country profile, (ii) links with FEMISE research program, (iii) distribution of tasks and organization, and (iv) data and information access.

## 1. SCOPE AND CONTENT OF COUNTRY PROFILE

The comments on scope and content of country profile are summarized under six headings: (i) macroeconomic performance and prospects, (ii) integration into the global economy, (iii) modernization of economic structure towards a market economy, (iv) modernization of the institutional and regulatory framework towards a market economy, (v) evolution of social structures, and (vi) multi-criterion analysis.

### 1.1 Macroeconomic Performance and Prospects

The section has two subsections: macroeconomic trends and fiscal adjustment and budget reform.

*A. Macroeconomic Trends:* Here my comments concern “Trends in Nominal and Real Exchange Rate and Exchange Rate Management” and “fiscal deficit and debt” as the other items are rather straight forward.

I believe that the section on ‘exchange rate management’ could be included in section 2 “Integration into the Global Economy” as a separate subsection rather than under macroeconomic trends. Trends in nominal and real exchange rates could be discussed under macroeconomic trends. The estimation of the real exchange rate should follow same methodology for all countries under investigation. Here the best estimation method seems to be the estimation of the real effective exchange rate following the IMF approach summarized by Zanello and Desruello (1997). The problems related with the estimation of real effective exchange rates can be summarized under four headings: choice of the price index, choice of the currency basket, choice of weights and choice of mathematical formula. Regarding price index one could use CPI since it is readily available on a monthly basis for a large number of countries. The currency basket should include main competitor countries and main markets of the country under consideration. The weights could be determined using the methodology of Zanello and Desruello (1997). Finally as the formula one could use the relation

$$RER_j = \prod_{i=1}^n \frac{CPI_i / E_i}{CPI / E}$$

where  $i$  is the index that runs over the country  $j$ 's trade partners, and  $w_{ij}$  the competitiveness weight attached by the country  $j$  to country  $i$ .

When considering the fiscal deficit one has to be careful how to define the public sector. In Turkey the public sector comprises the central government, a set of funds, municipalities and local governments, three social security institutions, 49 state economic enterprises and the central bank. Financial public institutions are not formally part of the consolidated public sector. Recently, the losses run by the three main public banks stemming from quasi-fiscal operations that they are performing on behalf of the government turned out to be quite substantial. As a result these losses should be included in the consolidated public sector account. The government debt has to be adjusted accordingly. The transparency of fiscal accounts should be questioned.

*B. Fiscal Adjustment and Budget Reform:* The subsection should include besides the issues mentioned in the draft outline a discussion of the extend of tax evasion in the country and problems related with tax collection. The discussion of personal taxation, corporate taxation and withholding taxes is also a must. But this discussion could be included, if possible, together with the discussion on investment incentives under section 4 "Modernization of the Institutional and Regulatory Framework Towards a Market Economy".

## **1.2 Integration into the Global Economy**

*A. Trade Performance:* Here one could distinguish between (i) agricultural goods, and (ii) industrial goods. When discussing the trade reform emphasis could be placed on the level of protection provided to goods imported on the one hand from EU and on the other hand from third countries. Possible classification of commodities for protection analysis is given in Table 1. In this classification agricultural commodities have been grouped according to HS classification into 27 sectors (EU classification), and other commodities according to SITC classifications into 22 sectors (WTO classification).

When analyzing the level of protection in agricultural and industrial commodities by sectors average level of applied tariffs could be determined. In addition protection provided through non-tariff barriers such as import bans, licensing, prior import deposits, customs procedures, standards specification and quality control inspection should be discussed thoroughly.

*B. FDI Regime:* The analysis of the FDI regime should include besides the issues mentioned in the draft outline a discussion of the foreign investment approval procedures, national participation, transfer of payments for intangible rights and/or services, and repatriation of funds.

*C. Other:* The section should also include a subsection on the foreign exchange regime (exchange controls, current account convertibility, capital account convertibility, multiple exchange rates). Since convertibility of the currency is not achieved by all countries in

the region and the MENA countries have reverted to multiple exchange rates from time to time, it would be appropriate to discuss problems related with exchange controls.

### **1.3 Modernization of Economic Structure Towards a Market Economy**

*B. Privatization:* The section on privatization should include discussion of legal framework of economic activity (legislation concerning property rights, forms of business organization, commercial companies, regulations governing foreign ownership, bankruptcy and liquidation, settlement procedures), structure of ownership, and privatization process including basic legislation on privatization.

*C&D. Functioning of Capital Markets and Bank Restructuring and Financial Deepening:* The discussion of capital markets could be carried under three headings: (i) banking sector, (ii) insurance services and (iii) securities services. It would be appropriate to consider first recent developments in asset share of state-owned banks, asset share of foreign owned banks, ratio of private sector credit to GDP, broad money to GDP, and the spread between lending and borrowing rates. Similar ratios could be calculated for the insurance and securities sectors.

The analysis of financial sector must cover the institutional developments. Since the existence of an independent central bank, competent supervisory authorities, and a regulatory framework are crucial components for the maturation of financial markets, these issues need to be studied in detail.

Prudential supervision and regulation of financial institutions, and transparency and fairness of securities markets are central to a sound and stable financial system. Here some of the EU financial services directives could be taken as the yardstick for evaluation of the financial system. These directives are the first banking directive (77/780/EEC) providing basic principles for the freedom of establishment, the own funds directive (89/299/EEC) providing definition of elements of own funds, solvency ratio directive (89/647/EEC) providing the eight percent capital ratio for banks, the deposit guarantee directive (94/19/EC) making the deposit protection obligatory, capital adequacy directive (93/6/EEC) and amendments (98/31/EC) requiring minimum capital ratios for investment firms and trading departments of banks.

Of these measures one of the main stumbling blocks is the capital adequacy directive. It sets minimum capital requirements to cover market risk in securities firms and in trading departments of banks. It was amended in 1997 to allow banks to define their own capital requirement through value-at-risk models.

Furthermore the section should consider the conditions for entry into the market by domestic and foreign firms and analyze whether foreign firms are given national treatment

## **1.4 Modernization of the Institutional and Regulatory Framework Towards a Market Economy**

The section should include a subsection on the system of taxation. Here emphasis could be placed on the discussion of personal taxation, corporate taxation, withholding taxes and value added tax.

The section could also include a subsection on investment incentives. Here emphasis could be placed on the discussion of tax exemptions (customs duty exemptions, VAT support and investment allowance) and relate it to the system of taxation. Furthermore the subsection should also consider other forms of support (subsidized credit and cash payments). The subsidy provided by various incentives should be estimated. Here the best approach for the estimation of subsidy rates is to use the methodology developed by Dunn and Pellechio (1990).

## **1.5 Evolution of Social Structure**

When discussing the functioning of labor markets one could study the characteristics in formal and informal sectors of the labor market. Analysis of the formal sector should include a discussion of the labor law, social safety nets and social security system. Here emphasis should be placed on regulations on dismissals, minimum wages and the relation between cost of labor to the employer and the net wage received by the worker after deducting from the cost of labor all taxes, social security contributions and other deductions paid by the employer and employee. Defining the informal labor market as the sector that is free from most of the labor regulations and does not pay most of the taxes, and the related charges one could try to estimate the share of informal labor in total employment.

## **1.6 Multi-criterion Analysis**

Here my comments will be rather general. I believe that all MENA countries should use the same methodology. Otherwise in the case of credit/risk rating e.g. one could end up with different results.

Under competitiveness indicators unit labor costs are included. But estimation of unit labor costs require data on wages, labor productivity and exchange rates. In most of the MENA countries data on wages and labor productivity can only be obtained after a relatively long period of time and in some countries reliable data cannot be obtained at all. It seems that a better measure of competitiveness indicator is CPI based real effective exchange rate. But this measure requires careful calculation in cases where convertibility of the currency is not achieved and multiple exchange rates prevail.

## **2. LINKS WITH FEMISE RESEARCH PROGRAM**

It has been stated that within 4 year project framework one study will be conducted per country. It is not clear whether one study per country will be conducted over a four year

period or annually. If we assume that the country profiles will be conducted annually, then cooperation with FEMISE program would be rather restricted since the studies under the FEMISE program are in general more theoretical than the studies required by the country profiles. On the other hand if one final study will come out at the end of four years per country, then cooperation with FEMISE program would be useful. But in this case four years is a long period. Thus to comment on this point I would need more information on the time frame of the study.

### **3. DISTRIBUTION OF TASKS AND ORGANIZATION**

It is stated in the terms of reference of the Country Profile that for each of the 6 sub-themes to be covered by the profile there will be one senior researcher and a junior researcher to follow up on the economic and institutional developments. I believe that this form of organization is quite appropriate.

The methodology that will be followed in the rating section is not clearly specified. As a result it is not easy to comment on this section.

What kind of organizational arrangement would best insure good coordination? This question is very important.

Supposing that the country profiles will be prepared on an annual basis I would consider the following type of organizational arrangement. Each of the five groups covering the five sub-themes [(i) macroeconomic performance and prospects, (ii) integration into the global economy, (iii) modernization of economic structure towards a market economy, (iv) modernization of the institutional and regulatory framework towards a market economy, and (v) evolution of social structures] would prepare their work during a specified period of time. They will submit their work to the theme that will do the study on multi-criterion analysis. Once the methodology that will be followed by this theme is clearly specified and each of the five themes have done their work according to a common methodology results could be achieved. Otherwise there will be chaos.

I would rather consider an organizational structure with five sub-themes. One of these groups could be called the coordinator responsible of writing the final report as well as doing the multi-criterion analysis. If this kind of organizational structure would be accepted then any kind of opinion surveys should be conducted by the five groups covering the sub-themes.

### **4. DATA AND INFORMATION ACCESS**

The data requirements of the Profile are quite substantial. In the following I will comment on data availability and information access in the case of Turkey:

i. The macroeconomic data on GDP, unemployment, inflation, fiscal deficit, domestic and foreign debt and current account balance can be obtained from State Planning Organization, Central Bank of Turkey, Undersecretariat of Treasury, and State Institute

of Statistics. The inclusion of financial public institutions in the fiscal accounts may require some adjustments. One should be able to obtain these figures from IMF sources. The estimation of CPI based real effective exchange rates requires monthly CPI and exchange rate data given in International Financial Statistics CD-ROM of IMF. The CD-ROM is available in Bilkent University, Ankara. On the other hand the data on tax system can be obtained from the Ministry of Finance.

2. Trade data on exports and imports by 12-digit HS classification and 4-digit SITC classification can be obtained from State Institute of Statistics. Tariff data are provided for 12-digit HS classification by the Undersecretariat of Foreign Trade. The data are available in printed version in the Official Gazette. Data on non-tariff barriers can be obtained from Undersecretariat of Foreign Trade. On the other hand data on FDI permits by sectors can be obtained from the Undersecretariat of Treasury. Data on FDI related employment, exports and technology are not readily available. One could contact the Foreign Investment Association in Istanbul. Finally information on foreign exchange regime can be obtained from the Undersecretariat of Treasury.

3. Data on public enterprises can be obtained from the Undersecretariat of Treasury, data on privatization from the Privatization Authority, and data on the financial sector from Undersecretariat of Treasury, Capital Market Board, Bankers Association, and Banking Regulatory and Supervisory Agency.

4. Data on legislative reform can be obtained from experts in the fields. Information on investment incentives can be obtained from the Undersecretariat of Treasury.

5. Data on labor markets can be obtained from State Institute of Statistics and Ministry of Labor.

Finally it should be emphasized that most information in Turkey is available publicly. But some information may require communication with policy makers. In this case interviews may be helpful.

## References

Dunn, D. and A. Pellechio (1990) '*Analyzing Taxes on Business Income with Marginal Effective Tax Rate Model*', World Bank Discussion Paper No. 79, Washington, D.C.: World Bank;

Zanello, A. and D. Desruelle "A Primer on the IMF's Information Notice System", IMF Working Paper WA/97/71, Washington D.C., 1997