



Turkey's Path to Prosperity in 2023

How to Avoid the Middle-Income Trap Through Inclusive Economic Growth

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Introduction

The Republic of Turkey will celebrate its centennial in 2023. The ruling Justice and Development Party, or AKP, has set 2023 as the year in which a set of ambitious economic goals will come to fruition. According to this vision, by 2023, Turkey will be an economic powerhouse—the world’s 10th-largest economy—with a \$2 trillion economy, a per capita income of \$25,000, and exports amounting to \$500 billion.¹ By comparison, in 2014, Turkey was the 18th-largest economy in the world—down from 17th in 2013—with a gross domestic product, or GDP, of \$800 billion, a per capita income of just more than \$10,000, and \$160 billion in exports. Russia currently holds the 10th spot in world rankings, with a GDP that is roughly twice the size of Turkey’s GDP.² The AKP’s stated goals are ambitious, to say the least, and many economists believe they may be out of reach. Most economists and policy analysts agree, however, that aiming high can do no harm and could possibly carry benefits.

The Western world has a strategic stake in Turkey’s economic success. First, a prosperous Turkey is likely to remain stable and anchored to the West as a reliable and supportive ally. Prosperity often—though not invariably—supports the strengthening of democratic values, a development that would further reinforce Turkish-Western bonds. Second, the West itself stands to gain economically from a wealthier Turkey. In 2015, Turkey was the European Union’s fourth-largest export market and its sixth-largest source of imports.³ Greater wealth also means greater investment opportunities in both directions. Third, a prosperous Turkey could host, employ, and ultimately—if necessary—absorb its swelling Syrian refugee population, making Turkey a more resilient country in its own right and a stronger neighbor and partner for Europe.

So what is possible for the Turkish economy by the end of 2023? What challenges will Turkey face over the next eight years before the republic begins its second century?

If Turkey is to make the significant leap forward outlined by the AKP, the Turkish economy must escape the “middle-income trap”—a reference to the difficulty that many countries emerging from low-income status have faced in achieving continuous growth, rather than plateauing at middling levels of per capita income.⁴ In explaining the dilemma of the middle-income trap, the World Bank argues that:

The factors and advantages that propelled high growth in these [middle-income-trapped] countries during their rapid development phases—low-cost labor and easy technology adoption [from more developed states]—disappeared when they reached middle- and upper-middle-income levels, forcing them to find new sources of growth.⁵

The challenge for Turkey lies in finding those new sources of economic growth. In today’s highly globalized economy, that usually means developing a high-tech sector that can produce goods and services for export as well as for the domestic economy.⁶ These high-tech growth sectors, in turn, require the development of a highly skilled workforce. Today, Turkey’s economy lacks a meaningful high-tech sector and the skilled workforce needed to propel such growth.

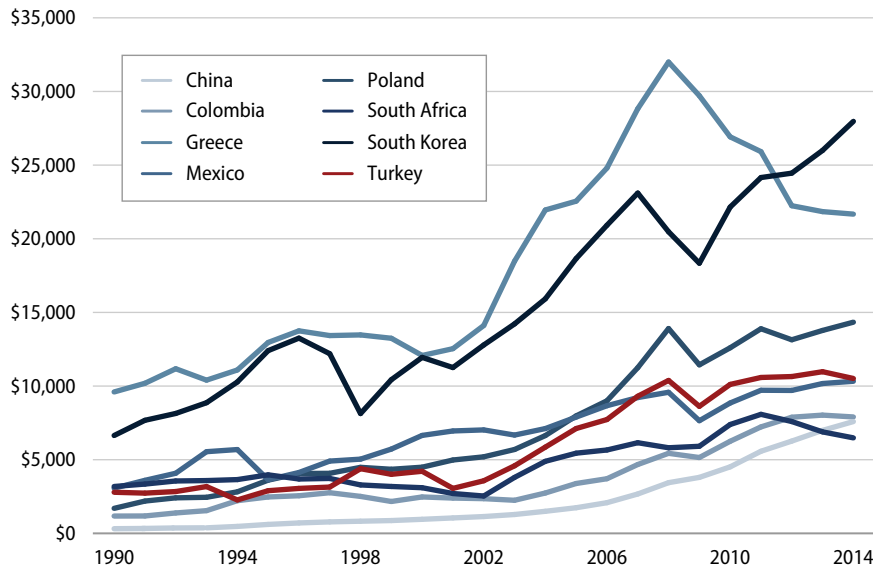
History illustrates the difficulty of moving from being a middle-income country to a high-income one—defined by the World Bank in 2016 as having a per capita income of at least \$12,736. Of the 101 countries that qualified as middle-income in 1960, only 13 of them have emerged as high-income countries more than a half-century later.⁷

Turkey graduated from low-income status to lower-middle-income status in 1955 and remained there for a half-century before being classified as an upper-middle-income country in 2005. According to the World Bank’s 2016 definitions, a lower-middle-income country is one with a per capita income between \$1,046 and \$4,125; an upper-middle-income country has a per capita income between \$4,126 and \$12,735.⁸

Turkey’s economy surged in the first decade of this century, following the financial crisis of 2001, with per capita income nearly tripling from \$3,500 in 2002 to \$10,400 in 2008.⁹ Aside from a dip and then a recovery reflecting the global economic situation in 2008 and 2009, Turkey has been largely stuck at the \$10,000 level ever since.¹⁰ Despite its failure to move into the high-income category, Turkey is clearly at the upper end of the middle-income level; in December 2014, the World Bank described Turkey as being on “the threshold of a high-income economy.”¹¹

FIGURE 1
GDP per capita

In current U.S. dollars



Source: World Bank World Development Indicators from World Bank national accounts data and national accounts data files from the Organisation for Economic Co-operation and Development. See The World Bank, "Data: GDP per capita (current US\$)," available at <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD/countries/TR-KR-ZA-MX-PL-CN-CO?display=default> (last accessed June 2016).

Moreover, Turkey's growth between 2002 and 2012 was largely inclusive, marked by a significant reduction in the poverty rate, major growth in the size of the middle class, and rough parity between the consumption rate of the lower 40 percent of society and that of the national average.¹²

Nor can Turkey be said to be suffering from enduring middle-income-trap status. Economists disagree as to how long a country must retain middle-income status before it is considered "trapped." Some of these definitions qualify Turkey as trapped, while others do not. By any reckoning, however, Turkey's 11 years of being ranked in the upper-middle-income bracket do not qualify its case as severe.

Yet Turkey does face many of the difficulties characteristic of nations caught in the middle-income trap, including persistent current account deficits, an economy based on low- and middle-tech production and services rather than innovation—"industry geared to the 1990s," as one economist said—problems with the rule of law and institutional autonomy, and an inadequate education system.¹³

Improvement in these areas would help Turkey tackle one of its fundamental economic problems—lack of investment, both foreign and domestic—and would thereby help it achieve sustained growth.

According to the World Bank, the elements necessary to escape the middle-income trap are:

*... an economy open to trade and [foreign direct investment], a sustainable macroeconomic framework that delivers low inflation and limits dependence on foreign capital inflows, low demographic dependency and rising labor force participation rates, a good skill base that facilitates the move towards more innovative production, a healthy business climate, and strong economic institutions that provide for the rule of law, [as well as] effective and accountable government.*¹⁴

Elsewhere in the same 2014 report on Turkey, the World Bank asserted that “improvements in the rule of law, in public accountability and transparency, and in the climate for entrepreneurship and innovation will thus be needed for Turkey to complete the transition to a high-income economy.”¹⁵

This discussion paper briefly outlines the issues that Turkey must successfully confront if it is to make major strides toward the AKP’s 2023 goals and obtain high-income country classification. These issues fall into two broad categories: macroeconomic reform and other economic, institutional, educational, and political reforms with an economic impact, with the latter category including institutional, educational, and political reforms. The paper closes with a brief set of recommendations for how Turkey could sequence its needed reforms to achieve its goal of becoming an advanced economy by 2023.

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