Durmuş Yilmaz: Economic governance – the Turkish case

Opening remarks by Mr Durmuş Yilmaz, Governor of the Central Bank of the Republic of Turkey, at the Conference on Current Issues in Economic Governance, Ankara, 3 April 2007.

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Ministers, academicians, bureaucrats, guests,

It is an honour for me to address a distinguished audience on such an important issue. The conference will do much service by bringing forward the issue of "economic governance", which we as the Central Bank have emphasized at numerous occasions. Let me thank Bilkent University for creating such a productive environment.

Today, I would like to devote some time to highlighting the importance of principles of good governance in general and economic governance in particular. In the context of economic governance, I would also like to mention some issues on how to create good institutions. Then, I will proceed with the Turkish case and the Central Bank of Turkey. But first of all, I will start by outlining the basic definitions of the concepts I am going to use.

Although the concept of governance is not new at all, in recent years it has started to be widely used in economics, especially in the development literature. While governance, or rather good governance, has been introduced as an effective tool to harness globalisation, it is not easy to define in one sentence because of its many interacting elements.

The definition that I found most meaningful is: irrespective of the size of system, whether it is a country or a small firm, good governance, as a concept, ensures that the rules of the system are equal, fair and clear to everyone.

Although I will focus mainly on economic governance, let me briefly mention that in order to completely grasp the notion of good governance, one has to look at its subtitles. Political governance, legal governance, economic governance, and corporate governance are the most well known among several others.

In fact, these subtitles overlap with each other. For example, political governance has common issues with economic governance, while economic governance has implications on corporate governance.

Accordingly, economic governance is defined as the nature and practice of economic management, regulation and development; or the institutional environment that constraints and coordinates economic action.

Distinguished guests,

Another point associated with the analytic evaluation of governance is that good governance provides a very important set of pillars, which are effectual in the design of an economy. The four of them are the most useful ones for every economy: transparency, accountability, rule of law and participation[1].

First, transparency means that the needed and the necessary information is freely available and directly accessible to those who will be affected by decisions and their enforcement[2].

Second, accountability is a mirror image of the responsibility and liability of an organization or institution for its decisions and actions to those who will be affected. In other words, the accountability is the price that institution pays for its independence. In democracies, every independent institution or organization is accountable to the public and to its institutional stakeholders[3].

Third, the participation principle ensures that every person in the system, in one way or the other, has a voice in the decision-making process[4].

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1 AusAID, (April, 2003). "Economic Governance and the Asian Crisis". Quality Assurance Series.

2 United Nations, Economic and Social Commission for Asia and the Pacific. "What is Good Governance"

3 Ibid.

4 AusAID, (April, 2003). "Economic Governance and the Asian Crisis". Quality Assurance Series.

And last but not least, good governance requires a fair legal framework and impartial enforcement of this legal system that protects property and individual rights and constitutes a strong base for prudent policy-making[5]. This legal structure assigns the principle of the rule of law.

Distinguished guests,

The analysis of good governance brings me directly to the question of why good governance is important.

The good governance provides key institutions and policies for the equitable and efficient allocation of resources, both labour and capital[6]. To put it differently, it allows an economy to yield higher growth rates by using the same amount of factors of production.

The strengthened economic governance across a broad spectrum of policy, administrative and institutional issues, is now widely accepted as a key factor in rebuilding domestic and international confidence in an economy[7].

The increase in the confidence in an economy generates more investment, which in turn leads to more production, more employment and increased welfare.

In lending support to these claims the following empirical work can be cited as evidence: the World Bank study over the period 1964 to 1993 shows that economies with high institutional capability combined with good policies grew nearly eight times the rate of economies with low capability and bad policies[8].

The good governance is also essential for equitable distribution of income. High growth rates have an impact on poverty reduction by supplying more employment to the economy, but do not have direct effects on the redistribution of income. Indeed, good governance principles are the tools to redistribute income equitably, to produce policies for the provision of public health, infrastructure, education and other public goods and services either by directly government or by the private sector in a market, which is regulated and supervised by the government.

Distinguished guests,

However, in the vast literature on the subject, not all scholars think the same. There are some who disagree. They argue that the good governance is not a significant factor for economic growth and for an increase in the welfare of society.

They challenge the findings of empirical studies by arguing that the existence of principles of good governance in a country is impossible to quantify and hence it is hard to compare it with quantitative aggregates in the economy, such as growth, poverty, etc.

There are also other challenges, technical in nature, against the importance of economic governance, such as causality problems and what is called the missing variable threats[9].

However, in the view of our experience in the Turkish economy during the last couple of years, these counter arguments do not provide evidences strong enough to challenge the importance of good governance for economic and social prosperity.

Distinguished guests,

Until recently, Turkey had displayed disappointing performance in good governance principles compared to other emerging economies. In 2000, according to the World Bank's calculations, Turkey ranked 134 among 193 countries in governance indicators.

The thirty-years of high and chronic inflation, the macroeconomic instability and the subsequent crises, the delays in structural reforms, and the poor capability of institutions to deliver prudent policies and to initiate structural breakdown have all been the main determinants of this poor governance structure.

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5 United Nations, Economic and Social Commission for Asia and the Pacific. "What is Good Governance"

6 Brouwer, G. (December 2003). "Macroeconomics and Governance", Treasury Working Paper. 2003-4.

7 Australian Economic and Financial Management Initiative. "Economic Governance".

8 AusAID, (April, 2003). "Economic Governance and the Asian Crisis". Quality Assurance Series.

9 Avellaneda, S. D. (May 2006). "Good Governance, Institutions and Economic Development"

However, after 2001, Turkey has launched one of the largest structural changes in its economy and put significant efforts into implementing good governance principles and searching for a new institutional matrix.

In the context of policymaking, the national programs, which have been supported by the international institutions and backed by the structural reforms, have brought about rule-based policy implementations.

A major development in this regard has been the re-definition of the role of the public sector in the economy.

The combination of the structural reforms and the prudent macroeconomic policies has also triggered efforts to reduce the size of the public sector in the economy. In the last five years, the private sector has been the engine of the economy and the main contributor of the high growth rates.

The Public Fiscal Management and Control Law, the Public Procurement Law and the multi-year budgetary framework have been put into practice in order to enhance the fiscal policy and the incomes policy of the public sector.

Hence, this structure has created a reliable base for the tight fiscal policy involved high primary surplus targets that have been achieved and maintained since 2003.

The Banking Sector Reform, the FDI Investment Law, and the Law on The Protection of Intellectual and Industrial Property Rights are on the list of structural reforms that have produced macroeconomic and financial stability and increased the resilience of the economy against external shocks. Now, the Turkish economy is not one that is crisis prone.

Distinguished guests,

The good governance not only defines the rules of the game but also initiates and determines the structure of institutions. However good the policies may be, if the capacities of the institutions implementing these policies are not matching the rigour of the policies, the policies will not be able to deliver what expected of them.

If I am to repeat myself once more, in the light of the structural transformation in the Turkish economy during the last five years, I can easily say that Turkey is a clear example of the view that governments need to assume a leading role in changing and reforming the existing institutions and in setting up brand new ones[10]. In this respect, newly established independent authorities charged with regulating markets from competition to public procurement and to energy matters might be cited as good examples. However it goes without saying that the most prominent institutional change that took place is the amendment of the Law of the Central Bank of Turkey, which made it independent.

The manifestations of the independence of the Central Bank in the form of greater transparency and accountability together with the inflation-targeting regime contributed to the implementation of a rule-based monetary policy. After the thirty-year period of high inflation, we have experienced single-digit inflation rates.

An independent central bank has constituted and will continue to constitute a corner stone for the structural transformation towards good governance and good institutions in Turkey. The Central Bank of Turkey aims to match the expectations by being a good institution through its independent, transparent and accountable status, policy implementations focused on its sole mandate of price stability and by practices to increase efficiency in institutional design.

Distinguished guests,

Turkey has decidedly taken a significant step in improving governance indicators since 2000. In 2005, it advanced to rank 103 among 216 countries in the governance indicators reported by the World Bank.

However, the continuation of this performance is as important as the recorded performance so far. Hence, we still have a significant way to go and every institution or organization in the economy has its own responsibility.

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[10] Ahrens, J. and Meurers, M. “How Governance Affects the Quality of Policy Reform and Economic Performance: New Evidence for Economies in Transition”

That is why it is essential that there should be a good level of cooperation of the policy makers and of the economic management units in the leading role of the public sector and the current national program. Calls for policy coordination are based on the idea that individual policies, which affect one another, should take each others' objectives and actions into account in order to yield the best possible outcome[11].

In this respect, for example, banks should play a special role in corporate governance in monitoring investments and leading corporate reorganizations.

The private sector should establish medium and long-term strategies, prepare more transparent balance sheets, give importance to modern risk management principles and pay attention to research and development activities in line with corporate governance.

The public sector should assume a supervisory and regulatory role within the scope of the principles of good governance and work towards creating an atmosphere in which the unregistered economic activities and unfair competition are eliminated and thus the private sector can compete in international markets as equal partners.

It is also worth to note that the sequence and prioritisation of reforms are also important. That is to say, one should bear in mind that achieving the best practice on governance in this dynamic economic environment requires a carefully planned long-term reform process.

Finally, I would like once more to remind you that the prerequisite of reaping the benefits of good governance is to maintain macroeconomic stability. That's why, in every step that we will take in the future, we have to be sure to avoid jeopardizing the macroeconomic stability that we have achieved so far.

Distinguished guests,

Good governance principles serve as a blueprint for decision makers both at the economy-wide and firm specific levels to cope with the changing economic environment and the uncertainty that comes with it.

As of today, Turkey is in a position to focus on structural and micro reforms and to improve its own governance structure in line with the European Union membership perspective.

In conclusion, the exchange of views and experiences is an important step to develop a coherent overall sense of economic identity. With this note, I would like to thank Bilkent University once again and wish a successful conference.

Thank you.

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[11] Speech by Issing, O. (2004). "EMU and Economic Governance".