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## LIBERAL PERSPECTIVE REPORT

### EXECUTIVE SUMMARY

NO: 23 • DECEMBER 2021



## ECONOMIC FREEDOM IN TURKEY

Editor: İbrahim Enes Özkan





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### **İbrahim Enes Özkan**

Enes Özkan has studied bachelor degree in Marmara University, Department of Economics, and got his master's degree in 2015 from Istanbul University on Istanbul Studies. Conducting his doctorate degree in Economics at Istanbul University, Enes Özkan focuses on behavioral economics and decentralized economic systems, especially cryptocurrencies. Enes Özkan works as a research assistant at Istanbul University, and he is a board member of the Freedom Studies Association.



### **Prof. Dr. Murat Çokgezen**

Murat Çokgezen was born in 1966. He graduated from Istanbul University, Department of International Relations in 1987. Çokgezen has completed his master studies at Istanbul University, Department of Economics. In 1996 he got his doctorate from Marmara University, Department of Economics 1996. He has been working as a professor at Marmara University Faculty of Economics and Administrative Sciences.



### **Dr. Ali Rıza Çoban**

Ali Rıza Çoban has graduated from the Faculty of Law at Dokuz Eylül University in 1992 and got his master's degree from the same university. In 2002 he studied doctorate at the University of Leeds, Faculty of Law in England. After his doctorate, he worked as a faculty member in the Department of Constitutional Law at Kırıkkale University, Faculty of Law. In 2008, he was appointed as a rapporteur at the Constitutional Court. After the individual application was accepted, he was appointed as the Head Rapporteur of Departments in 2011 and took part in the formation and implementation of the individual application system.

Çoban has been active in civil society since 2017; taking part in various projects in the fields of freedom of expression, rule of law, and judicial independence.



### **Dr. Mustafa Eray Yücel**

Conducting his researches in the fields of applied econometrics, macroeconomics and monetary economics, Mustafa Eray Yücel completed his doctorate at Bilkent University in 2005. Having held various positions at the Central Bank of the Republic of Turkey, Dr. Yücel is interested in writing short stories. He is currently working as a lecturer at Bilkent University, Department of Economics.



### **Dr. Özge Öner**

Öner was born in 1986 in Ankara. After completing her undergraduate studies in Marmara University, Department of Economics in 2008, she got her master's and doctorate degrees in Economics at Jönköping International Business School in Sweden. She has been working as an associate professor of Geographic Economics at Cambridge University since 2018.



### **Prof. Dr. Uğur Emek**

Emek was born in 1964 in Emirdağ. After graduating from Ankara University, Department of Business Administration in 1985, he completed his master's degree in Fiscal Policy and Planning at Northeastern University in 1997. In 2005, he received his PhD from Ankara University on Business Administration. He has been working as a professor at Başkent University, Department of Economics.





**Dr. Didem Pekkurnaz**

During her undergraduate studies in Statistics at Middle East Technical University in 2005, Pekkurnaz also studied a minor degree in Economics. After completing her master's degree in Economics at the same university, she got her doctorate from the University of North Carolina at Chapel Hill in 2014. She is currently working as a doctoral lecturer in the Department of Economics at Bařkent University.



The concept of economic freedom, in its most general definition, is the ability of individuals to become self-sufficient and is used as a correspondence of the concept of “economic independence of the individual”. However, in this research where we benefited from the Fraser Institute’s Index of Economic Freedoms of the World (EFW), it is useful to remember the definition made by the Institute itself. In this regard, the “Economic Freedoms” are based on personal choice, voluntary exchange, freedom to enter markets and compete, and security of the person and privately owned property. The Economic Freedom of the World Index analyzes countries in five fundamental areas and measures the extent of support given by countries for the above-mentioned freedoms. The main argument based on this objective is the fact within the framework of the market economy, the economic resources are distributed more effectively in countries where economic freedoms are high.

The Fraser Institute has been publishing an Index of Economic Freedom of the World since 1996. Many significant people in the field such as Milton Friedman, Rose Friedman, Douglass North, Gary Becker, William Niskanen and Gordon Tullock has contributed to the development of the methodology of the Index. As a result of the contributions and subsequent developments, five categories as (1) Size of the Government, (2) Legal System and Property Rights, (3) Sound Money, (4) Freedom to trade internationally and (5) Regulation and their 24 components were constituted. All these components are given a value between 0 and 10, and the average of these values are determining the total score of the category they belong to. The average of the category scores forms the EFW index score of the evalu-

ated country. As the score of a country gets closer to 10, it indicates that the resources in that country are largely distributed through the market mechanism.

In this report, Turkey has been evaluated in all categories, components and sub-components of EFW. There are three reasons to prepare this report even though the index was already published. The first reason is related to the inherent of the EFW. All the data on the index have been compiled from third-party data sources in order to ensure transparency and consistency and for subjective judgments of the authors to not affect the results of the report. As data is not collected continuously and instantaneous, as a part of comprehensive research, some of them are quite old. As a matter of fact, with a report published in 2021, economic freedoms in the world are examined with the data of 2019. In a country like Turkey, where intense changes are experienced in a short period of time, it is necessary to evaluate the changes in some categories which cannot be included in the index with a unique approach. Secondly, there is a need to further examine the factors leading to these scores, instead of evaluation of only index scores in all the categories. Lastly, it was found important that a more in-depth reading and analysis should be made in charette chaired by the authors of the report and with the participation of the experts in their field. Indeed, each topic of the report has been corroborated by the contributions of valuable experts who participated in the charette.

Having a brief look at Turkey's ranking in the index, Turkey's score according to data of 2019, is 6.54. One rank below the least free countries category and placed in the third quartile countries, Turkey ranks 114th among 165 countries examined in the index along with Fiji. When we look at the major countries in the index, the rankings are as follows: Japan 18, Germany 22, Mexico 75, Russia 100, Brazil 109 and China 116. The lowest ranks are war zones such as Syria, Iran, Algeria, the Republic of Congo, Libya and Sudan. At the bottom is Venezuela, which is ruled by a socialist autocratic government.

## **SIZE OF THE GOVERNMENT**

As one of the five areas measured in the Index, the Size of the Government measures the distribution of resource allocation made for non-market (political) purposes. Between 2000-2005, Turkey decreased the share of the



state in the economy and increased its area 1 score. Yet, in the following period, the score experienced a general downward trend.

The five key components of the area 1 criterion are; government consumption, transfers and subsidies, government investment, top marginal tax rate, state ownership of assets. Excluding the 2005 government consumption, until 2019 the score overall remained below 6.93, which was the level in 2000. In 2019, this level decreased to 5.46. The main reason for this decrease is the high increase in the number of public personnel.

The score in Transfers and Subsidies was above 9 until 2005, however, it decreased to 6.21 per cent in 2019. Duty losses have a large share in lowering the score in this section. When it comes to government investment as the third component of the Size of the Government, Turkey's score which was 7.4 in 2000, increased to 10 in 2004 and generally remained at this level in the following years. However, although Public-Private Partnership projects are public projects, these projects are included as private sector projects in Turkey's economic statistics data. Therefore, it should be noted that Turkey's score in this section of Government Investments does not reflect the actual state.

The fourth section of the Size of the Government is the top marginal tax rate, which indicates at what tax rate the earnings in the top income bracket are taxed. Turkey's score in this section was 7 between the years 2004-2018 and this score decreased to 5 in 2019. On the other hand, considering the size of the share of taxes due to the tax system in Turkey, it should be emphasized that the Top Marginal Tax Rate index does not fully reflect the degree of the government control over the resources in the economy through taxes.

Lastly, in the field of state ownership of assets which is the fifth component of the Size of the Government, Turkey's score increased in the early 2000s. However, since 2012, the score has been continuously declining and eventually dropped to a level well below its initial level in 2019. Although it is possible to attribute this decline partly to the decrease in privatizations after 2012 and partly to the establishment of new public institutions engaged in economic activity; the reason for the fall of Turkey's state ownership of assets state score cannot be fully explained within the framework of the index due to the characteristics of the data. Unlike other data, these numbers are a result of survey and a score is created accord-

ing to the answers given by the experts. Consequently, we do not hold the statistics to explain why the score has dropped.

One of the components that determine the ranking of a country in the Economic Freedoms Index is how much of the economic decisions are made politically. In determining score in the size of the government, the government's revenues, expenditures and changes in the value of its assets constitute the main indicators. The escalation of politically made decisions in an economy means restriction to individual decisions therefore freedoms. Turkey is a country familiar with the concept of electoral economy and has held elections 9 times since 2002. In all these processes, the government grew economically for various reasons. Considering that another election period is getting closer, it can be predicted that Turkey's score in area 1 will be decreasing.

## **LEGAL SYSTEM AND PROPERTY RIGHTS**

The protection of the economic freedoms of the individual depends on the existence of a legal system that protects private property and operates in a fair and effective manner. An impartial and well-functioning legal system based on the rule of law is one of the most important prerequisites for economic development. The environment of trust that is necessary for economic development is only possible in societies where the law is developed. Societies, where the rule of law is in function, are also societies where wealth is more equitably distributed.

In Turkey, after 2010, but especially in the post-2013 period, the principle of rule of law was compromised, many freedoms were restricted and the rule of law norms were violated. These negative developments have also been reflected in the economy and the annual income per capita, which was 12,500 dollars in 2012, decreased to 8,500 dollars in 2020. According to the data up to 2019 used in the Economic Freedoms Report, Turkey ranked 114th out of 165 countries.

The Presidential Government System, which was established as a result of the 2017 Constitutional amendments, is a political system where the balance and control mechanisms have been eroded to a great extent, leading to arbitrariness and giving excessive authority to the president, who holds the executive power. The extinguished judiciary independence in recent years is another major source of problems brought by this presi-

dential system. It is fair to conclude that in such a system neither civil and political freedoms nor economic freedoms are guaranteed.

Although the right to property is under constitutional protection in Turkey, it is possible to argue that this fundamental right is not actually under full legal protection due to many problems arising from implementation and legislation. Problems such as the incomplete cadastre procedures, the priority given to rent by the zoning regulations, and the constant changes made on the expropriation law prevent the right to property from being secured and violate economic freedoms in Turkey. Moreover, the constant change of laws and the administration of the country by presidential decrees compromises legal security while reducing predictability, which is vital for the development of the economy.

Lastly, although the loss of military's effect is positive in terms of economic freedoms, the function of the police under the current political regime has become an area that will cause problems in terms of economic freedoms. Therefore, authoritarian practices that have been seen frequently in the recent period and that have hit economic freedoms causes Turkey to fall into lower ranks in both legal and economic indexes.

## **SOUND MONEY**

Regardless of the fluctuations, Turkey showed a continuous improvement in the sound money area from 1975 to 2016. In the 2017-2019 period, however, there was a slight decline and the score in the sound money area was 8.54. Nonetheless, the negative shifts experienced from 2019 to December 2021 should be taken into account. Individual property and the right of choice are very substantial for the concept of economic freedom. It is vital for inflation to be low so that property does not erode and the right to choose is exercised as widely as possible. In addition, low inflation is also very important for the efficient functioning of the markets.

Since 2019, the Turkish economy's record in terms of sound money is not very bright. The economic, institutional and technical gains had been implemented after the 2001 Crisis faded away and the motivation for controlling inflation is lost. The Central Bank of the Republic of Turkey, whose legal and primary duty is to ensure price stability, has stuck in between the demands of the market and political pressures, is (positioned to be) closer to the latter, therefore it is far from fostering and supporting economic

freedoms. The arbitrariness, administrative weakness and volatility that determine the general outlook of the economy, inevitably spoils Turkey's money record. After 2011, the Central Bank gradually moved away from its main duties and became an institution with different concerns such as overcoming the disruptions in the exchange rate level. Currently, financial stability (macro-prudential) policies are being used outside of their purpose, and the expectation management of the monetary policy authority is weakening. There are money-related problems that are not sound both on the level of the financial market and on the household level, and those problems increase the severity of a possible financial crisis.

Due to the weakening of the balance and control mechanisms, which is one of the main problems throughout the country, effective steps cannot be taken to overcome the problems in economic management. In summary, it is not possible within any prudent analytical framework to argue that Turkey's Sound Money Record has been successful. The central banking practice of the last decade has led to the gradual melting of the gains that come with institutional autonomy/independence and the contribution of these gains to the economic freedom of the people.

## **FREEDOM TO TRADE INTERNATIONALLY**

The section on International Trade Freedom (UTS) focuses on the exchange that takes place across national borders. In our modern world, the freedom to trade with people in other countries is a significant component of economic freedom. Turkey is in a relatively better position in the area of freedom to trade internationally compared to the country's overall score in the other areas. However, when the reporting of the last three years is viewed, it is possible to see that the score in this area is in continuous decline. In terms of freedom to trade internationally, Turkey ranked 79th in 2017, 85th in 2018, and in 2019, continuing its decline with the rank of 94<sup>th</sup>.

When viewing the components of these areas, we see that the most important factor that has a positive effect on this score is the absence of black-market exchange rates in Turkey. The sub-component that most negatively affects the score is the property and investment restrictions imposed on foreigners. In the upcoming period, we predict the factors that have the potential to cause a decline in the score of freedom to trade internationally, is going to be various closures due to the COVID-19 pan-

demic and regulations that will adversely affect imports due to the low value of the Turkish lira.

Apart from the overall figure of the score, in recent years, economists have begun to argue that freedom to trade internationally may not be able to create absolute gains, and in fact, by changing production patterns, it may even build new winners and losers. Economists draw particular attention to two points. The first of these is the injustice in the distribution of gains obtained from the trade, between the skilled and unskilled workforce, and the other is how essential democratic institutions are in providing this distribution in a healthy way.

In this sense, Turkey not only paints a black picture with the economic turbulence it has been experiencing recently but also represents a universe of possibilities in a political climate that is capable of changing. Turkish Lira has experienced an unpreventable (or unprevented) devaluation. However, the references to the export-supportive nature of this unfortunate development regarding price stability were not backed by the existed data. As when the exports items are viewed, it is possible to see that many inputs are based on imports. What we see here is the mismatch between monetary policies and an economic plan that prioritizes privatization on intermediate product production.

Another point is that Turkey's international trade relations outside the bloc and the tendency of these bilateral relations to be affected by many conflicts that are the subject of international relations are higher than the countries that trade within the blocs. Unfortunately, "precious solitude" in foreign policy, which has been frequently spoken since 2013, leaves the country in a fragile and lonely place in foreign trade as well. Relations with the EU in the past decade, which are almost in the stage of breaking away, have given Turkey a role of a third party that is only needed in necessary issues such as military engagement and immigrants.

The last matter, we should mention is, of course, climate and trade, specifically the Paris Agreement and the regulations that will have to be followed in the near term. The Paris Agreement, which Turkey has recently ratified, obliges Turkey to solve a serious ecology-economy equation in the near future. As this agreement, aims to support the financial flow in the path of low-emission and climate-resilient development, it also imposes serious responsibilities on the parties to reduce emissions. In order to

fulfil all these responsibilities in the determined calendars, the requirements in trade, economic development and monetary policies, emerge as an institutional structure that can manage them in absolute harmony and simultaneously.

## **REGULATION**

Some public regulations cause limitations of economic activity and hinder the freedom of trade. With the aim of measuring the degree of public interventions that limits the freedom of change in credit, labor and job markets, the Public Regulations Index was created. Turkey has a higher score in this index in the area of credit market regulations compared to the other two areas.

The first component of the Public Regulations Index composes the three main heading of the credit market regulations. Apart from ownership of banks, in the other two, private sector credit and interest rate control, Turkey's score decreased between 2016 and 2019. Factors such as political interferences in the policy rate determined by the Central Bank, frequent changes in presidents, and political pressures on banks to reduce loan rates, especially public banks, caused this decrease in the score.

Between 2002 and 2019, the Labor Market Regulations scores generally followed a horizontal trend. However, in 2018, there was an increase from 4.71 to 5.41 in Turkey's score. The improvement in compulsory military service regulations has contributed to this increase. Although Turkey's labor market rating has improved slightly, it is insufficient on many levels.

Finally, there was a decline in Turkey's business market scores. While in 2016, the score was 6.80 and in 2019 it lowered to 6.43. The most significant reason for the decline in the score is the increasing perception of corruption in Turkey. The inability to adequately fight corruption and even pressures put on corruption investigations and lawsuits enhance the perception of impunity, which in turn leads to an increase in corruption.





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