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Article

Beyond convergence: Poland and Turkey en route to high income

Central Bank Review (CBR)

Provided in Cooperation with:

Central Bank of The Republic of Turkey, Ankara

Suggested Citation: Raiser, Martin; Wes, Marina; Yilmaz, Ayberk (2016) : Beyond convergence: Poland and Turkey en route to high income, Central Bank Review (CBR), ISSN 1303-0701, Elsevier, Amsterdam, Vol. 16, Iss. 1, pp. 7-17,
<https://doi.org/10.1016/j.cbrev.2016.03.001>

This Version is available at:

<https://hdl.handle.net/10419/217282>

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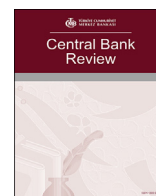
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Beyond convergence: Poland and Turkey en route to high income[☆]



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ARTICLE INFO

Article history:

Available online 9 March 2016

Keywords:

Turkey
Poland
Middle income trap
Economic convergence
Economic liberalization
Economic integration
European institutions

ABSTRACT

This paper compares and contrasts the policy reform experiences of Poland and Turkey en route to high income. For both countries, globalization has presented unprecedented opportunities to catch up, unleashed by integration into European and global markets and the establishment of macroeconomic discipline. These opportunities were reinforced by the creation of economic institutions to strengthen competition and support private entrepreneurship, catalyzed by the convergence process with the European Union. Both Poland and Turkey have shown resilience following the 2008 global crisis, but continued success will require renewed structural reform measures. Dealing with the challenging of aging while at the same time finding a way to sustain productivity growth through greater domestic innovation is shaping Poland's policy agenda. Turkey's structural and demographic potential as well as its strategic location between the markets of Europe and Asia offers attractive value proposition to investors, which could be further enhanced with improvements in business regulations and economic governance.

1. Introduction

The decade before the global economic and financial crisis saw unprecedented convergence in incomes between advanced and emerging market economies. Based on the adoption of prudent macroeconomic policies, emerging markets benefited handsomely from accommodating global liquidity conditions. Thanks to a track record of economic liberalization and structural reforms many middle income countries became attractive destinations for foreign investment and emerged as serious players in the global economy, accelerating a shift in global economic power that had begun in the early 1980s.

This short paper compares the experience of two such emerging markets: Poland and Turkey. The main argument of the paper is that seen against the broader backdrop of globalization and convergence, the stories of Poland and Turkey are surprisingly similar. In Section 1 we argue that the process of economic transition in Poland can be seen as a process of economic liberalization

and integration typical of emerging markets, only of broader scope and condensed in time. Turkey started the process of opening up its economy a decade earlier, but Poland achieved the faster convergence thanks to the scope and depth of its reform efforts launched after 1989. As Section 1.2 elaborates, a key driver of the pace of change in Poland was EU membership, achieved in 2004, just a year before Turkey formally began accession negotiations with the European Union. European integration was critical to Turkey's reform process and resulting economic ascent, too, but the impact was less pervasive and Turkey's convergence was slower than Poland's.

Overall, the message from our analysis is that globalization presents unprecedented opportunities for emerging markets to catch-up, if they open their economies, keep macroeconomic discipline, and reform their economic institutions to strengthen competition and support private entrepreneurship. And these opportunities are compounded for countries on the periphery of the European Union that are offered the prospect of accession, because European institutions function like a “tractor beam” for institutional reform in accession countries allowing confidence to build long before the process of institutional reform has been completed.

The paper closes by casting a look ahead. Both Poland and Turkey have shown resilience during the post-crisis period, but are facing more moderate growth prospects in a less forgiving global environment. Which country has better prospects to converge to

[☆] The views in this paper are those of the authors and do not in any way constitute the official position of the World Bank.

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Peer review under responsibility of the Central Bank of the Republic of Turkey.

the standards of living of the “old” EU members? Drawing on the “middle income trap” literature, the paper comes out with a balanced assessment. Poland's strengths lie in its higher degree of openness, its stronger economic and political institutions, lower degree of inequality and somewhat stronger capacity for innovation. Poland also benefits from less macroeconomic vulnerability, thanks in part to decisive anti-inflation policies around a decade ago. Poland's challenge is to safeguard these achievements and to deal with aging and reform social security arrangements accordingly. Turkey's strengths lie in favorable demographics and the greater remaining potential for gains from the reallocation of labor from agriculture to industry and services. Turkey's challenge is to attract investment and create enough productive jobs to benefit from the demographic dividend. Both countries are likely to see growth above EU averages over the coming decade. Which country will converge faster depends on which country moves more decisively to address its most pressing structural challenges.

The year 2014 is a historic and symbolic year to be writing about Poland's and Turkey's transition experiences. The two countries this year celebrate 600 years of diplomatic relations. Poland also celebrates 25 years of transition from Communism, and 10 years of membership in the European Union. Turkey can look back to over 30 years of experience with economic liberalization, with current account convertibility achieved in 1984. 2015 marked the 20th anniversary of the Customs Union agreement with the European Union and 10 years from the formal start of accession negotiations.

This paper is in no way an attempt to do justice to these very important milestones and achievements. Rather we draw on the large literature summarizing the lessons of the transition experiences in Poland and other countries in Central and Eastern Europe (see for instance [World Bank, 1996](#); [Blanchard, 1997](#); [Roland, 2014](#); [EBRD, 1999, 2010](#); [World Bank, 2009](#); [IMF, 2014](#); [Lipton, 2014](#)), and a recent World Bank study on Turkey's own transition from a state controlled to a market based economy ([Raiser and Wes, 2014](#); see also [Öniş and Webb, 1992](#); [Canevi, 2014](#)).¹ The purpose of this paper is not to evaluate Poland's and Turkey's experiences in their own right, but rather to explore their commonalities. In this vein, the paper also draws on the study of European convergence present in [Gill and Raiser \(2012\)](#).

2. Unleashing the private sector: economic liberalization and the roots of convergence in Poland and Turkey

Poland's economic transformation from a centrally planned to a market based economy has been among the most successful of all former communist countries. Poland's GDP in Euro terms rose sixfold since 1990, its GDP per capita in constant prices more than doubled over the same period as economic growth averaged slightly more than 4 percent. Some would say not since the days of the Polish-Lithuanian Commonwealth, when Poland and Turkey first established diplomatic relations, has Poland felt so confident, have its national aspirations been backed by a clear rise in economic prowess. Turkey is among the more successful emerging market economies that began opening up to the world economy in the early 1980s (China did so in 1978, India in 1991, Latin America also largely abandoned import substitution strategies and multiple exchange rate practices during the 1980s and 1990s). Its GDP has also grown at around 4 percent since the 1980s (and around 3 percent per capita), with acceleration in the first decade of the

2000s, when GDP in Euro terms tripled. Both Poland and Turkey have thus converged to European Union income levels, standing in 2013 at 68 and 55 percent respectively of the EU average in purchasing power parity terms ([Fig. 1](#)). In this section, we trace the roots of convergence back to a common set of basic economic reforms: price, trade and foreign exchange liberalization, sound macroeconomic policies, and a gradual retreat of the state from direct involvement in production.

2.1. A dynamic private sector

The motor of economic convergence in both Poland and Turkey was the same: a dynamic private sector, with a particularly important role played by domestic SMEs. [Gomulka \(2014\)](#) points to the strength of Poland's domestic private sector as a key factor behind the country's shallower transition recession. The rise of a new generation of Turkish entrepreneurs in the growing inland cities of Anatolia has been associated with Turkey's recent economic success and socio-economic transformation ([Atiyas and Bakış, 2013](#)). As a result, Polish and Turkish enterprises delivered among the highest productivity and export growth rates among a group of emerging market peers ([Fig. 2](#)).

2.2. Structural change drives productivity growth

Private entrepreneurship was also the driver behind dramatic structural changes in Poland's and Turkey's economies. However, the nature of structural change was quite different in the two cases. In Poland's case, workers moved from unproductive state-owned enterprises in the industrial sector to service sector jobs (and some manufacturing jobs created by new private enterprises). The reallocation of workers from unproductive to productive enterprises is shown by [EBRD \(2013\)](#) to have been a major driver of the high rate of Total Factor Productivity (TFP) growth in Poland and other transition economies of Central and Eastern Europe. By contrast, TFP in Turkey – whilst also rapid – was driven mainly by the reallocation of labor from agriculture to industry and services. In other words, while within sector labor reallocations were at the core of productivity gains in the transition from communism, in Turkey the transition was from an agrarian to an urban economic structure. Indeed, among a group of peers, Turkey is the only country that saw an increase in employment in industry since 1990 ([Fig. 3](#)). As of 2014, Poland and Turkey had a similar share of employment in manufacturing (around 20 percent), but Poland had a larger services sector, and Turkey still had around 30 percent of employment in agriculture.

2.3. A rapid opening of the economy raised new challenges for macroeconomic and financial sector management

The catalyst of all this dynamic, private sector driven structural change was the move to an open foreign trade regime and the abolition of domestic price controls, ensuring that market signals were allowed to work effectively. The story for Poland is well known – as of January 1990 the vast majority of prices were liberalized, as was foreign trade and a floating exchange rate was introduced (see [Gomulka, 2014](#)). What is perhaps less well known today is the extent to which Turkey's economy in the 1970s was hampered by price controls, closed to foreign competition, and riddled with state intervention. In 1980, Turkey's total exports were a mere US\$ 3 billion, multiple exchange practices abounded, and the government controlled the prices of a substantial number of consumer goods (particularly agricultural products, fuel and imported manufactures). With Turgut Özal's economic reform package introduced in January 1980, Turkey embarked on a more

¹ Martin Raiser and Marina Wes both worked at the EBRD in the mid-1990s and were involved in several of the EBRD's Transition Reports, which since 1994 have provided an annual update of reform progress in the region, including Turkey since 2011, when the country became an EBRD country of operations.

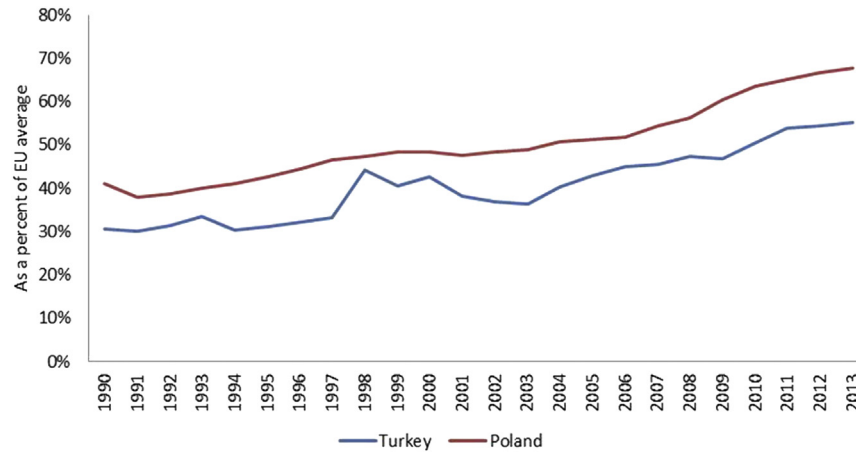


Fig. 1. GDP per capita, PPP, current international \$.
Source: World Development Indicators

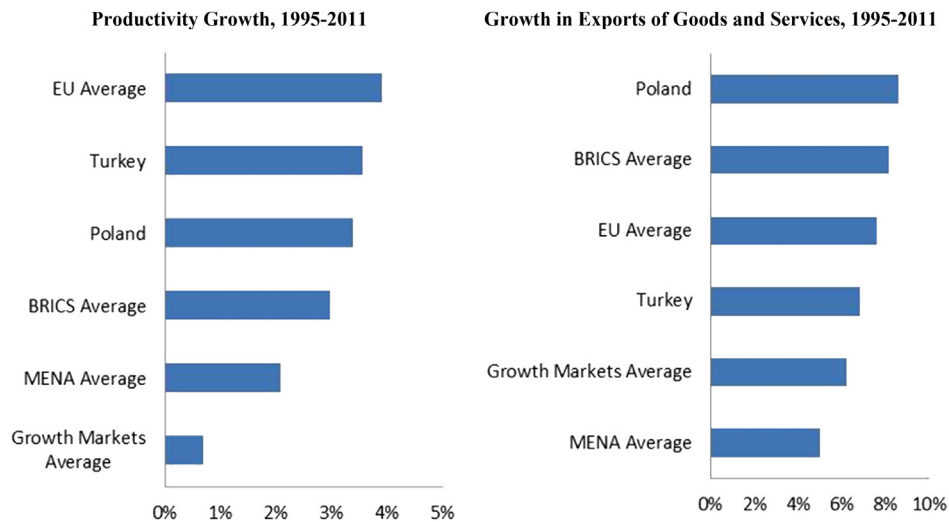


Fig. 2. Polish and Turkish firms deliver.
Source: Penn World Tables; World Development Indicators

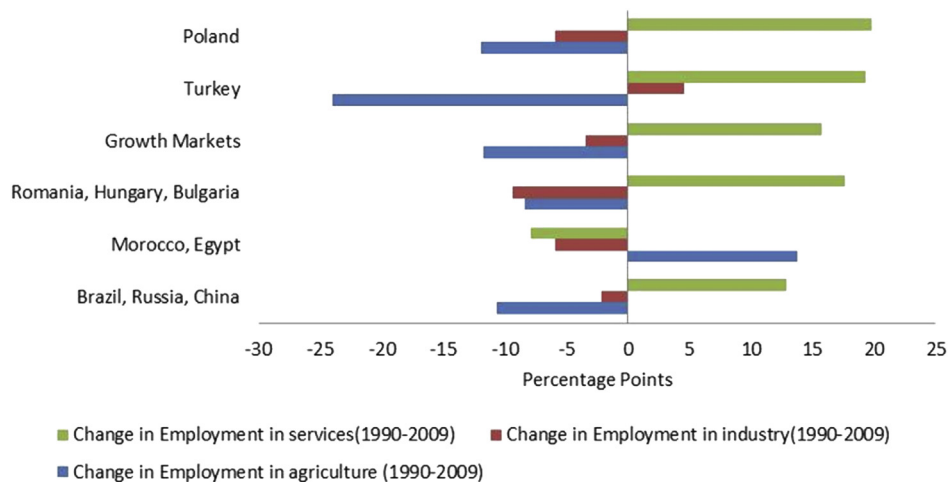


Fig. 3. Different patterns of structural change in Poland and Turkey.
Source: World Development Indicators

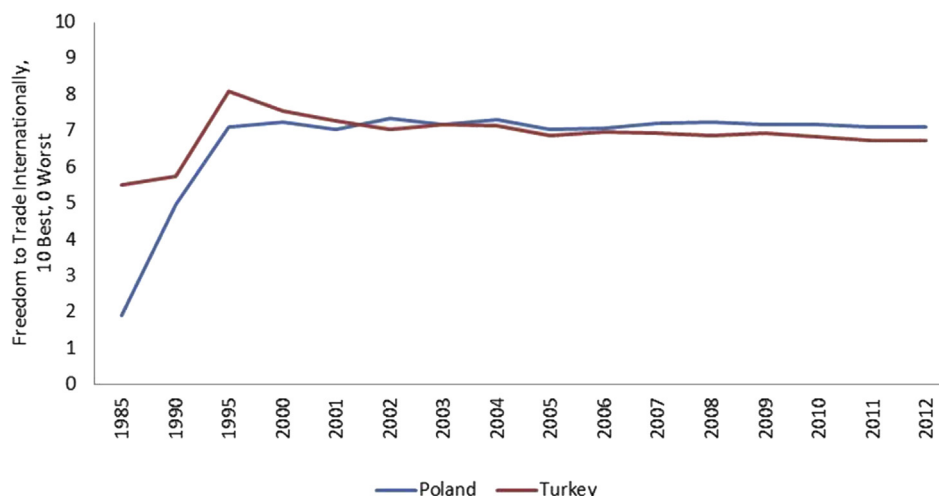


Fig. 4. Economic transition as a special case of globalization.
Source: Fraser Institute

gradual but nonetheless comprehensive process of economic liberalization. Comparative time-series data on price and trade liberalization is difficult to come by. Fig. 4 from the Fraser Institute's indices of Economic Freedom show the time profile of foreign trade liberalization in Poland and Turkey. The curves are remarkably close to one another.

One key challenge faced by economic liberalizers in Poland and Turkey was the question how to deal with the fiscal and social consequences of rapid liberalization. This was compounded in both cases by a history of macroeconomic instability, provoked by unsustainable domestic fiscal and incomes policies. Hence macroeconomic stabilization had to be achieved at the same time as the economy was opened. Both Poland and Turkey owe their success in recent decades to their ability to combine sound macro and financial policies with market based structural reforms. Yet, they learned the relevant policy lessons differently (see Fig. 5 for a summary of basic macroeconomic developments).

Poland spent much of the 1980s in economic crisis. By 1989, GDP was lower than a decade earlier, the economy was flirting with hyperinflation and Poland had stopped servicing its international obligations to western creditors. The economic package introduced in January 1990 thus combined significant fiscal adjustment (primarily through incomes policies leading to a sharp decline in real wages), with a large upfront exchange rate devaluation and a monetary program anchored around targets for the growth in domestic credit, before moving to a floating exchange rate regime by the end of 1991. Poland's progress with macroeconomic stabilization was gradual: inflation did not fall below 10 percent for around a decade, fiscal deficits were above 3 percent of GDP in most years, and public debt has increased by around 20 ppts since the late 1990s to just under 60 percent of GDP today. However, after the deep crisis of the late 1980s, Poland never again lost control over macroeconomic policies. In the face of persistent inflation and rising external deficits in the late 1990s, the National Bank of Poland tightened monetary policy sharply in 2000, bringing inflation down to 5.5 percent the following year, a rate which it has never since exceeded.

Turkey took two decades to digest the need for consistent macroeconomic policies to support the economic liberalization effort. The initial Özal package of 1980, as in Poland a decade later, was combined with upfront exchange rate adjustment, tight incomes and fiscal policies and moderate credit expansion. But towards the end of the 1980s, quasi-fiscal activities proliferated,

reminiscent of Janos Kornai's famous "soft budget constraints" which accounted for the many failed gradual liberalization attempts in Eastern Europe during the 1970s and 1980s. The result was repeated macroeconomic instability, culminating in the crisis of 2001 with high rates of inflation, a run on the banking sector, and a sharp depreciation of the Turkish Lira. Only with the ensuing macroeconomic and structural reform program of 2001–2002 was fiscal policy brought under control and Turkey now counts among the most successful case studies of rapid fiscal consolidation among emerging markets (see Gill and Raiser, 2012; Raiser and Wes, 2014). However, Turkey's inflation rate remains in the upper single digits and external imbalances have caused bouts of macroeconomic volatility in recent years. Turkey's Central Bank may wish to study the NBP's success in anchoring inflationary expectations in the face of significant political resistance around a decade ago and the resulting improvement in Poland's external balances, in contrast to developments in Turkey over the same period.

In one additional respect Turkey and Poland share an interesting commonality: both countries have sound banking sectors that went through the global financial crisis of 2008–2009 unscathed. As Europe is discovering again today, well capitalized and prudently managed banks are a key pillar of successful private sector led growth. Poland and Turkey are among those countries in Europe which have learned to harness the benefits of financial integration and managed the associated risks in a disciplined way.

2.4. A cautious approach to privatization

The third pillar of economic reform programs in both transition and emerging market economies during the 1980s and 1990s was privatization. This is also perhaps the most controversial of all reform policies. Poland's route to privatization was unusual among former Communist countries, as the country largely shunned mass privatization schemes, and instead opted for policies to nurture the growth of new SMEs and to impose hard budget constraints on SOEs to force them to adjust to the market (and limit any fiscal liabilities). Only after several years of transition did Poland privatize some of its flagship SOEs, generally through trade sales to foreign investors. Privatization revenues peaked in 2000 at around US\$ 6 billion (Fig. 6). In this, Poland's route to privatization was similar to Turkey's which undertook an ambitious privatization program particularly after 2001, but has maintained significant state presence throughout the economy. Indeed, according to the OECD,

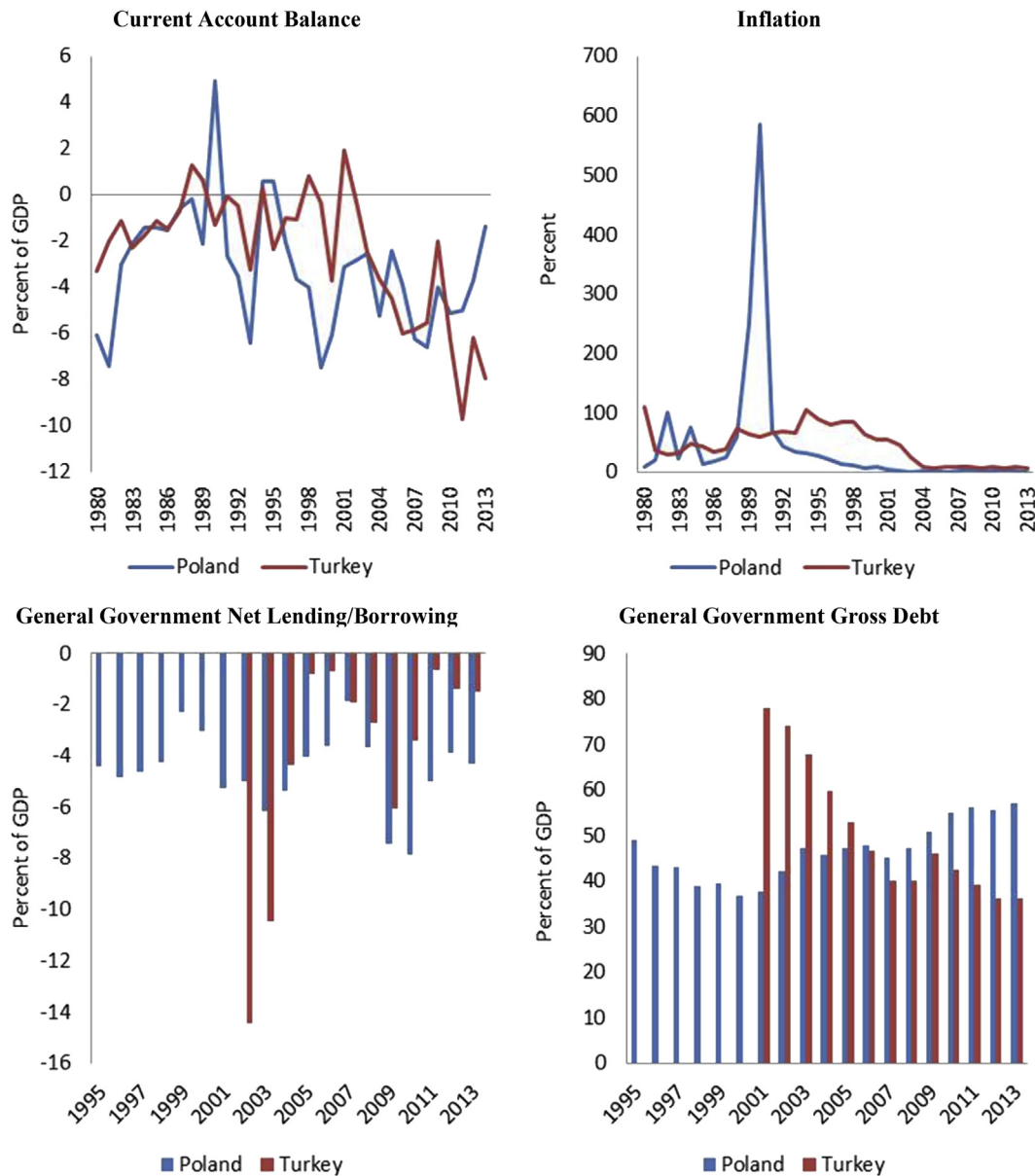


Fig. 5. Sound macro policies were critical to success.

Source: World Development Indicators, IMF World Economic Outlook

Poland and Turkey are among the OECD countries with the highest share of public ownership and state control. While both countries have avoided the political and economic pitfalls of mass privatization, some legacies of a previous period of state led economic development remain.

3. European integration: a convergence catalyst

Like many other countries in the world, both Poland and Turkey have become substantially integrated with the European and global economies during the final decade of the twentieth and the first decade of the 21st century. Turkey's economy has opened up significantly since the 1980s when exports amounted to only 5 percent of GDP against 23 percent today. In the last two decades, the pace of opening up was far more dramatic in Poland, however, where the share of trade in GDP more than doubled to over 90 percent, against just under 60 percent in Turkey (Fig. 7). Poland's and

eastern Europe's export performance more generally set the region apart as one of the most rapidly globalizing parts of the world, rivalling the East Asian tigers (Gill and Raiser, 2012). Turkey's performance is significantly better than that of many countries in Latin America, but lags somewhat behind the pace in Asia and Eastern Europe. In this section, we argue that for both Poland and Turkey, European integration lay at the heart of growing global competitiveness and hence was the motor behind economic convergence.

3.1. EU integration as the motor of globalization and technological upgrading

The key driver of Poland and Turkey's rising global presence has been closer economic integration with the European Union. For Poland, evidently, the key policy anchor in this regard was EU accession itself, achieved in 2004. However, as early as 1991, the Europe Agreement (EA) was signed between Poland and the EU,

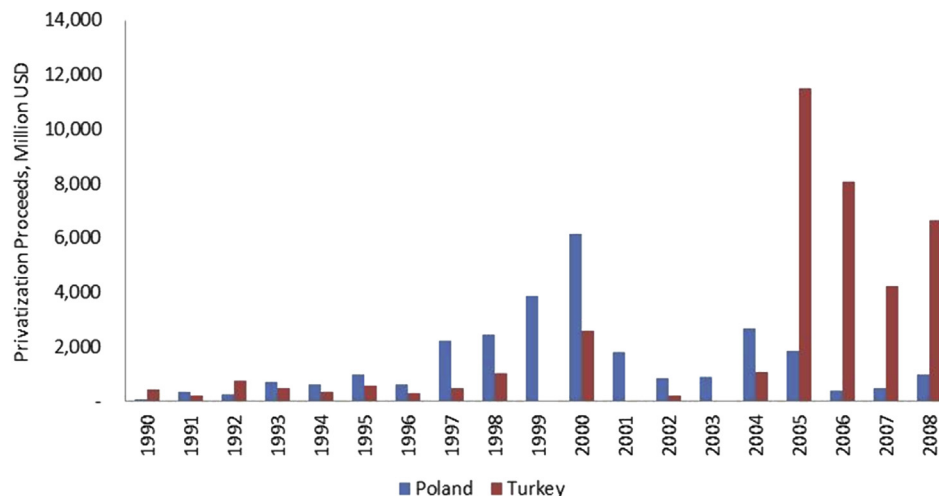


Fig. 6. Privatization followed only after market order was well established.
Source: World Bank Privatization Database

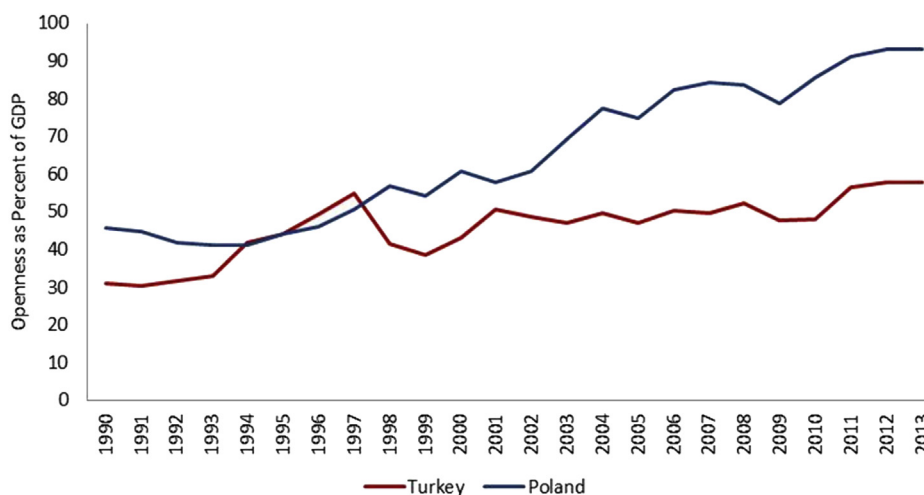


Fig. 7. Poland and Turkey open up to international trade in recent decades.
Source: World Development Indicators

which set up an entirely new framework for EU-Polish mutual economic relationships. Its trade liberalizing measures were to create, over a ten-year time span, a free trade agreement in industry. The Europe Agreement also covered various other areas including trade in select agricultural goods and services, movement of factors, progressive liberalization of cross-border services, and lifting of foreign investment restrictions. The EA thus provided guidance and discipline to Poland's economic transformation well ahead of EU accession.

For Turkey, the Customs Union with the EU, established on January 1, 1996, has been the major instrument of integration into European and global markets. The Customs Union covers trade in industrial goods (including the industrial components of processed agricultural products) and excludes primary agriculture and services. Although Turkish exports of many industrial goods to the EU had been mostly duty free since the 1970s, in Turkey, the Customs Union drove a considerable reduction in tariff and non-tariff barriers and locked in Turkey's liberal regime for manufacturing trade. Between 1996 and 2011, Turkey's exports to the EU increased almost fourfold while Turkey's imports from the EU increased nearly threefold. Bilateral trade between the EU and Turkey

reached US\$148 billion in 2012 making Turkey the EU's sixth largest trading partner and the EU Turkey's biggest (World Bank, 2014).

Export sophistication in both countries has increased significantly since 2000, as the integration with European markets took hold. Although the gap between two countries has somewhat narrowed, Poland's export sophistication level remains considerably higher (Fig. 8, panel 1).

Against the background of increased export sophistication overall, the patterns of technological upgrading have diverged in Poland and Turkey. Turkey has managed to expand its medium tech exports, but failed to increase high tech exports, while Poland successfully increased high tech exports and kept the share of medium tech exports constant. As shown in panel 2 of Fig. 8, Turkey caught up with Poland in the share of medium tech exports to total exports with both standing around 35 percent by 2010. In the area of high technology, there is a clear divergence in performance between Turkey and Poland: while the share of high tech exports in total exports has declined from 8 percent to 4 percent in Turkey since 2000, in Poland it has increased from 8 percent in 2000 to 14 percent in 2010, before slightly declining to 12 percent.

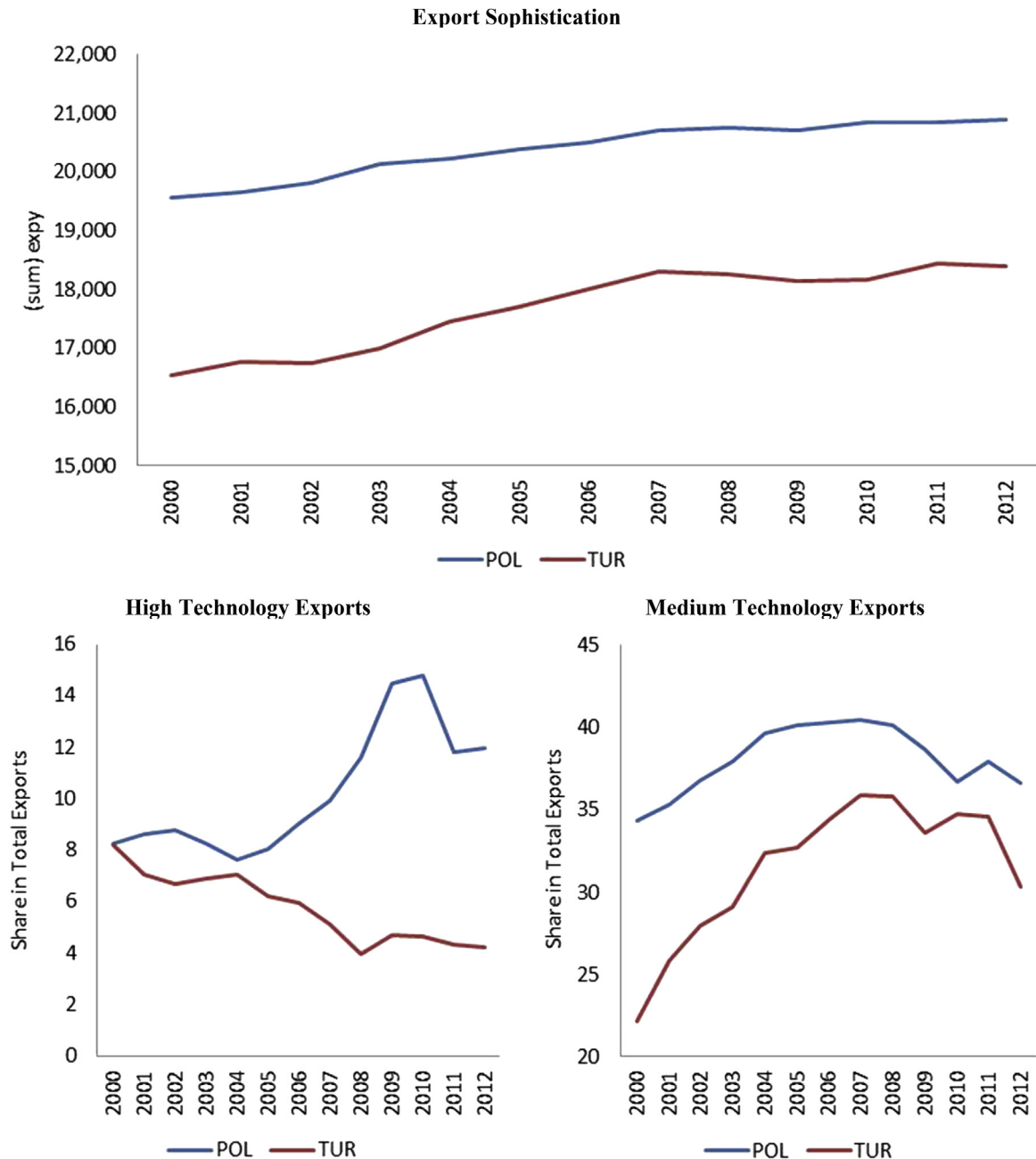


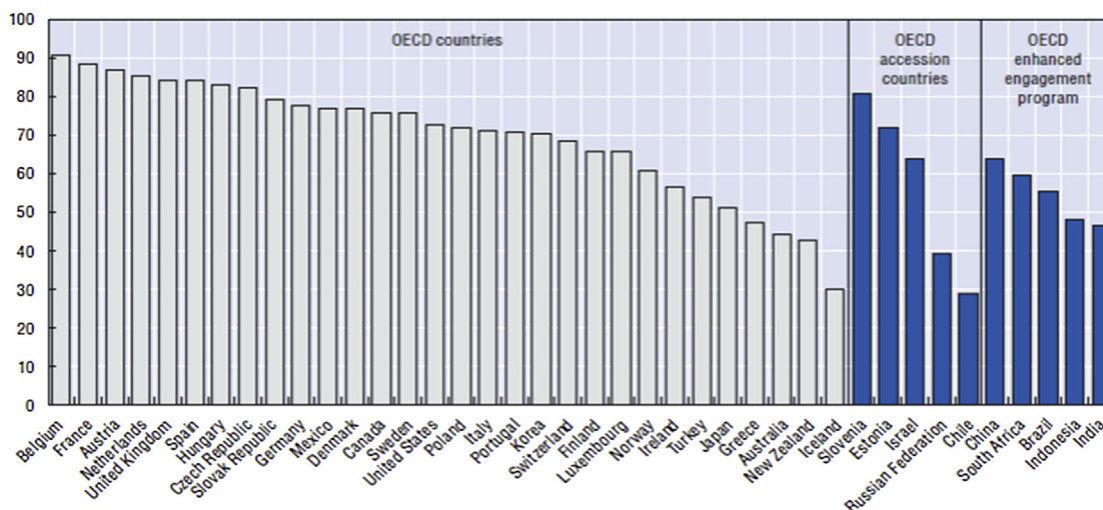
Fig. 8. Export sophistication increased thanks to integration with European production networks.
Source: Raiser and Wes (2014).

The integration into European production networks has been a key conduit for the transfer of technologies. Intra-industry trade is a measure of the extent to which domestic producers are integrated into production networks with trading partners. Fig. 9 shows that the share of intra-industry trade in total trade during the period 1997–2008 was higher in Poland than in Turkey. At the same time, in recent years, between 2001 and 2008, Turkey has seen the second largest increase in intra-industry trade among OECD countries. A big part of this increase is due to Turkey's integration into European production networks for automobiles for instance, which went hand in hand with a dramatic expansion of Foreign Direct Investment (FDI) into the sector. Almost three quarters of all FDI into Turkey comes from EU member countries, with retail, banking, and

energy key sectors in addition to the automobile sector. A similar link between FDI and integration into European and global value chains can be observed in Poland, with automobiles, chemicals, light industry and metallurgy important leading sectors. We come back to the importance of capital flows as a catalyst for economic integration below.

3.2. Improved connectivity has reduced barriers to trade

One advantage that both Poland and Turkey have as a source country for production facilities is good connectivity, particularly with European markets. One empirical measures of the importance of connectivity for trade is the Logistics Performance Index (LPI). It is based on the assessment of logistics professionals

Figure L.2.1. Index of intra-industry trade in manufactures, average 1997–2008¹

1. 2000–08 for South Africa.


StatLink  <http://dx.doi.org/10.1787/845820714132>

Figure L.2.2. Index of intra-industry trade in manufactures, average annual change 2001–08

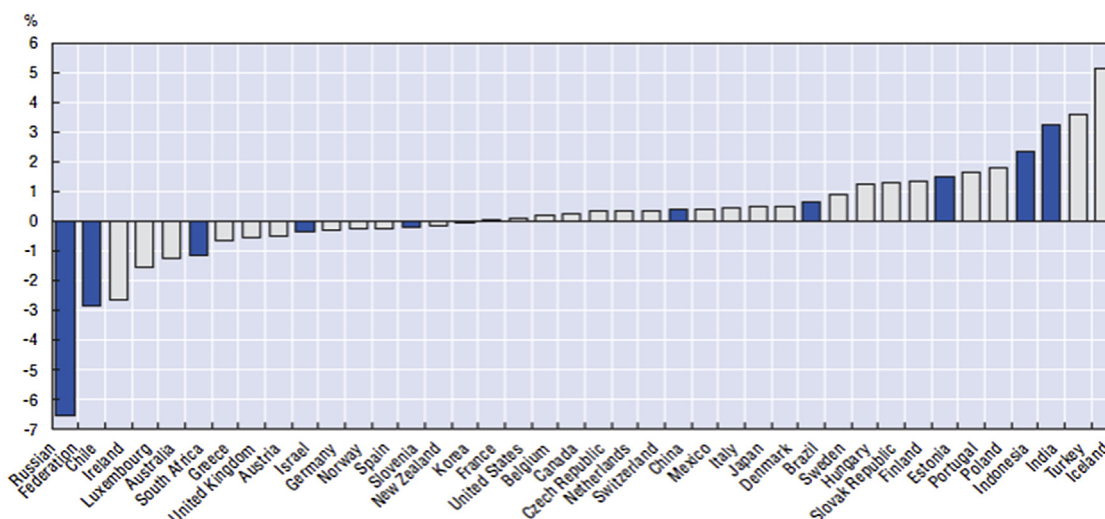


Fig. 9. Growing intra-industry trade reflects integration into production networks.
Source: OECD

located in the country's major trading partners, and is a weighted average of six components that are critical for logistics performance:

- Efficiency of the customs clearance process.
- Quality of trade and transport-related infrastructure.
- Ease of arranging competitively priced shipments.
- Competence and quality of logistics services.
- Ability to track and trace consignments.
- Frequency with which shipments reach the consignee within the scheduled or expected time.

Turkey compares well with its neighbors and current competitors in logistics performance (Fig. 10). It is 30th in global rankings, just below China and above Poland, which occupy the 28th and 31st position respectively.

3.3. Capital flows have been managed prudently by and large, more so in Poland than in Turkey

As mentioned earlier, capital inflows, and in particular FDI inflows, were a catalyst of economic integration and technology transfer in both Poland and Turkey. In this regard, Europe internationally is an exception. It had been assumed based on evidence across emerging markets that there was limited scope for countries to rely on foreign savings to increase investment and accelerate convergence. Europe's Convergence Machine (Gill and Raiser, 2012) has belied the skeptics. In Europe, higher capital inflows have been associated with higher growth rates and faster convergence. However, this overall positive assessment is tempered by the clear evidence of excesses in parts of the European periphery and the costs of European commercial bank deleveraging on the economies of Eastern Europe. Clearly, even in Europe, the benefits of capital

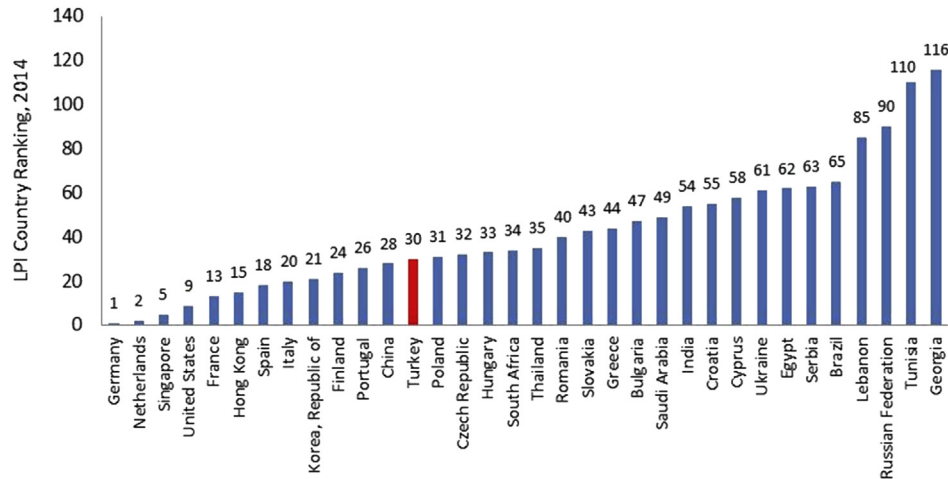


Fig. 10. The logistics performance index.

Source: World Bank Logistics Performance Index

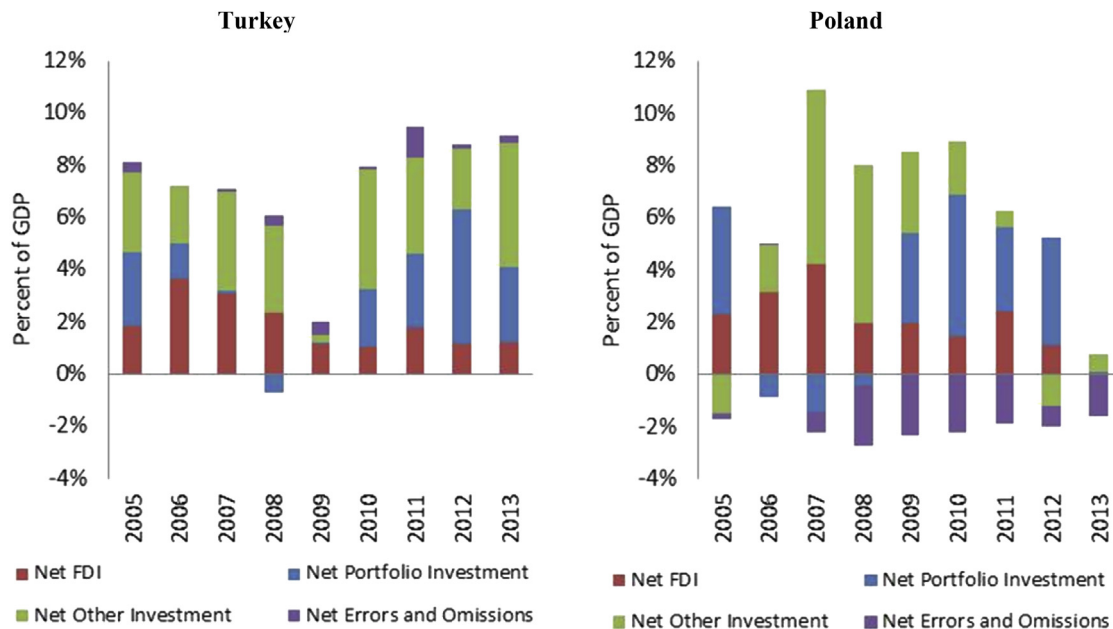


Fig. 11. The composition of capital inflows into Poland and Turkey differed, but not much.
Source: IMF Balance of Payment Statistics

inflows were not automatic and required adequate prudential frameworks and macroeconomic discipline. By and large, both Poland and Turkey have been among the beneficiaries.

While both Poland and Turkey have recorded large capital inflows, the composition of the capital flows between the two countries has been different (Fig. 11). Whereas Poland has relied more heavily on Foreign Direct Investment and structural funds from the EU, the financing of Turkey's capital inflows has been generally of a shorter term nature. This in turn leaves Turkey more vulnerable to shifts in global investor sentiment and a result has made Turkey's growth more volatile.

One way to assess the nature of capital flows and associated risks is to look at changes in the net debt and net equity position of countries. In the Southern European periphery, for instance, the net equity position declined between 2002 and 2007, whereas the net debt position dramatically increased. In other words, investors were leaving, while capital inflows financed public and private

consumption. As shown in Fig. 12, Poland and Turkey both experienced a significant widening of the net equity position between 2002 and 2013 and in Poland's case, also a substantial increase in the net debt position. This attests to a prudent financing strategy by and large, although clearly the composition of financing particularly since 2009 has worsened considerably in Turkey. Poland's much larger net equity position reflects the deeper integration of the country into European production networks and the stronger inflows of FDI over the 2002–2013 period.

4. Escaping from middle income: risks and opportunities

After growing in excess of 4 percent annually for the past two decades, both Poland and Turkey have been confronted with significantly lower growth rates since the global economic and financial crisis. To a significant extent this is related to the slow pace of recovery in the European Union, both countries' largest trading

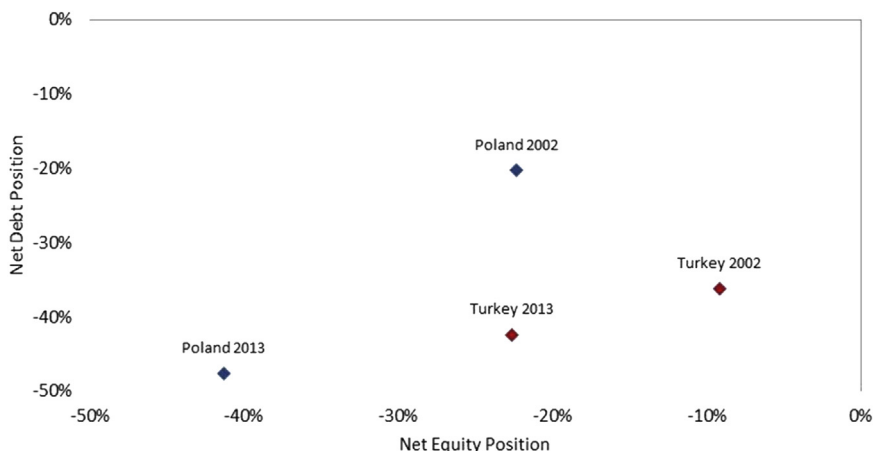


Fig. 12. A balanced approach to foreign investment in both Poland and Turkey.

Source: IMF Balance of Payment Statistics

partner by far. But even over the medium-term, estimates of potential growth have been adjusted downwards to maybe 3.5 percent in both countries.

At the heart of this adjustment is the fact that the gains from productive labor reallocations – whether due to the end of central planning or to the process of industrialization and urbanization – are coming to an end. Future growth will rely far more on productivity improvements within firms, driven by higher rates of investment, innovation and technology adoption. Since this is difficult, it is common for growth in middle income countries to slow down, sometimes to the point that convergence with income levels in the advanced countries stops altogether, and these countries remain “trapped” in middle income (Gill and Kharas, 2007).

A vast literature has sprung up to investigate the existence and determinants of the “middle income trap” (for instance:

Eichengreen et al., 2012, 2013; Bulman et al., 2012; Aiyar et al., 2013, building on earlier work on the duration of growth spells and the causes of growth collapses reviewed in Aiyar et al.). It turns out that a whole range of factors contribute to sustain or hinder growth in upper middle income countries. Aiyar et al. group these factors into four categories: (i) the quality of economic institutions, (ii) the quality of macro policies as reflected in existing imbalances and financial and fiscal buffers, (iii) the extent to which a growing labor force still provides impulses for growth, (iv) the extent to which potential further gains from structural change exist. The resulting “middle income trap risk map” shows a greater risk of a growth slowdown in Poland than in Turkey on account mainly of demographic and structural factors, while Poland outperforms Turkey on the quality of economic institutions. In the area of macro policy, Poland has weaker buffers but Turkey has larger imbalances.

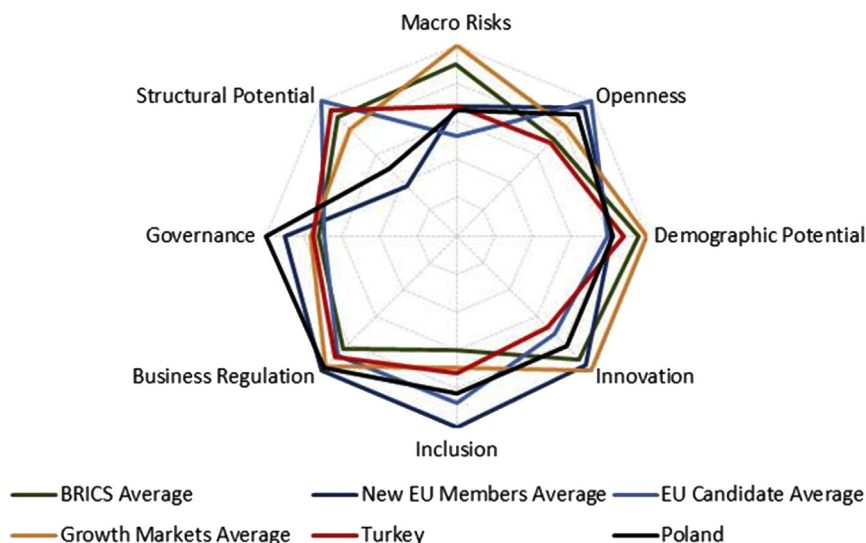


Fig. 13. A middle income trap risk polygon for Turkey, Poland and peers.

Notes: Macro Risks = CPI inflation, Net International Investment Position (%GDP), General Government Debt (%GDP), Openness = Exports + Imports (%GDP), Gross FDI inflows (%GDP), Logistics Performance Index, Demographic Potential = Median Age, Labor Force Participation Rate, Innovation = Mean Years of Schooling, R&D spending (%GDP), Inclusion = Gini coefficient on household expenditures, Business regulation = Distance to Frontier (Doing Business), Fraser Index of Light Regulation, Governance = Fraser Index of Property Rights, WGI Rule of Law, Voice and Accountability, Government Effectiveness, Transparency International Corruption Perceptions Index, Open Budget Index, Structural potential = Share of Employment in Agriculture.

Source: Authors calculations based on data from IMF, World Bank, Fraser, Transparency International, and the World Governance Indicators.

In Raiser and Wes (2014) we expand on the approach in Aiyar et al. (2013) and map out strengths and weaknesses across a total of 20 indicators, grouped into eight dimensions. Instead of creating aggregate indices of vulnerability using coefficients from regression analysis as weights as in Aiyar et al., we identify the best performing country in each category and then use unweighted averages of the percentage difference to the top performer to come up with a risk rating in each of the eight categories. The results of this “best in class” approach are shown in Fig. 13. The larger the surface covered by the resulting risk polygon, the smaller the risk of a growth slowdown.

Poland's main strengths lie in Governance, Business Regulation and to some extent in having a more open economy. Turkey's strengths are related to a young population and growing labor force for the next 15 years at least, and to a still sizeable agricultural sector offering opportunities for productive labor reallocations. By contrast demographics and economic structure are Poland's main weakness, whereas the lack of openness, relatively weak governance and poor innovation potential represent obstacles to the realization of Turkey's growth aspirations. We don't know how these strengths and weaknesses add up, but they indicate a rather different set of policy challenges for Poland and Turkey as the two countries embark on the next stages of their economic transition.

For Poland, the coming decades will be marked as in the rest of Europe by the challenge of adapting the economy, social security systems and public services to an aging population. As the World Bank argues in a forthcoming report, this presents at least as many opportunities as it presents risks. But dealing with the challenges of aging while at the same time finding a way to sustain productivity growth through greater domestic innovation shapes Poland's policy agenda.

For Turkey, the immediate challenge is to mobilize the required domestic and foreign savings to invest in private sector job creation so that the gains from Turkey's demographic dividend are not wasted. To meet this challenge, Turkey would do well to emulate Poland's degree of openness and match the quality of its economic institutions. While Turkey lacks the advantage of EU membership as an anchor for the required institutional reform and as a magnet for greater Foreign Direct Investment, given the country's structural and demographic potential as well as strategic location between the markets of Europe and Asia, it still offers an attractive value proposition to investors, which would be further enhanced with improvements to economic governance and business regulations.

If Poland and Turkey address the challenges outlined above, there is every reason to believe growth could continue at a rate of 4 percent or higher in the coming decades. That would bring Poland close to and Turkey within 25 percent of average EU incomes. Poland and Turkey are two success cases in economic reform and the resulting transition towards market-based, open economies. Their success has coincided with a period of unprecedented convergence in Europe and in the world economy. With appropriate reforms, this story could well continue for some time, for the benefit of Poles, Turks and their European neighbors and friends.

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