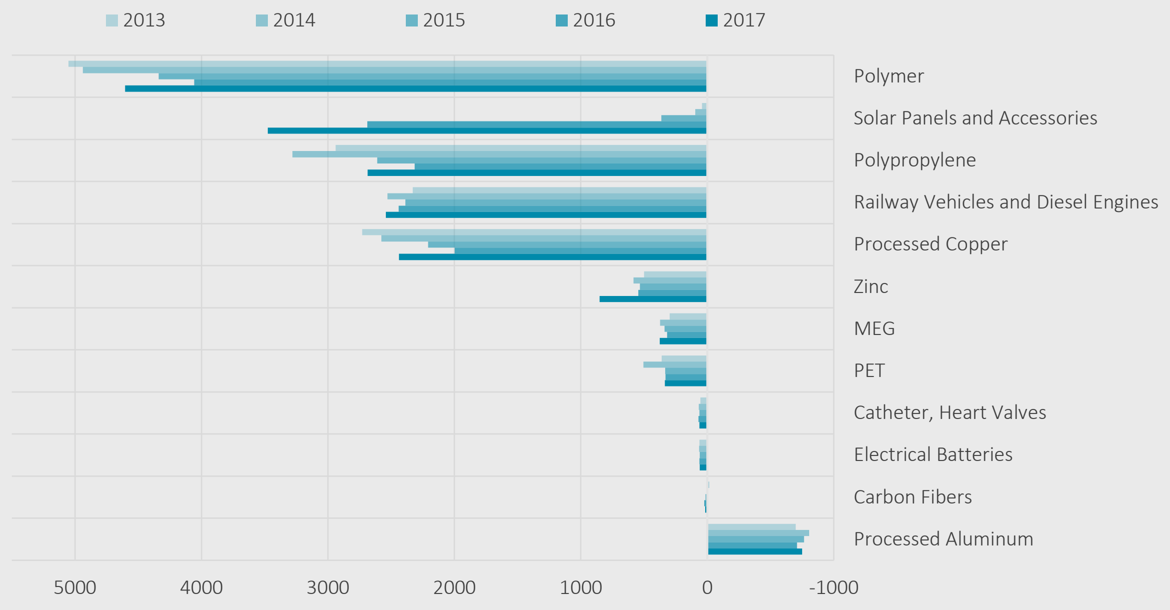
Box 4.2

Products Subject to Project-Based Incentive System and Possible Effects on the Current Account Balance

In the recent period, an incentive system has been introduced for high-to-medium value-added investments in selected products by selected firms that require advanced technology. This system is intended to increase employment and reduce the current account deficit in the medium term through investment incentive certificates to be granted to 23 projects of 19 large-scale firms. The product group to receive incentives covers high-tech imported input products that are important particularly for Turkey's industrial production and exports. This coverage is deemed a significant step towards the elimination of structural factors leading to the current account deficit. This box presents an analysis of the short- and medium-term effects of products covered by the incentive system on Turkey's current account deficit.

Chart 1: Net Imports in Incentivized Sectors by Years (Million USD)



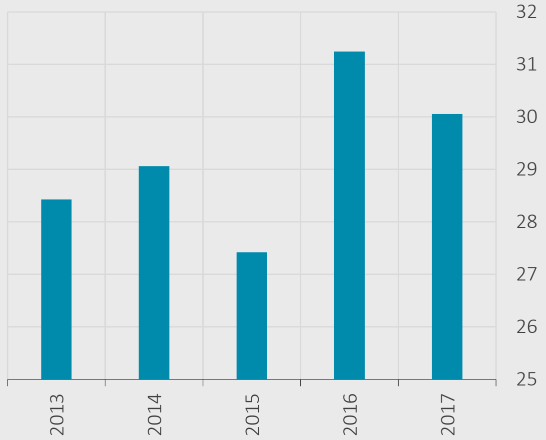
Source: TURKSTAT.

Products covered by the project-based incentive system are mainly composed of imported intermediate goods. Products to be manufactured under the subsidized projects are overall categorized into 12 product groups.[1] Turkey posts a foreign trade deficit in almost all of these products. An analysis of the change in net imports of products covered by the incentive program in the 2013-2017 period reveals that notwithstanding the increases and decreases in imports of most of the products, net imports remained at a certain level. Chart 1 shows net imports in each product group based on 2017 values. Accordingly, products with the highest level of foreign trade deficit are polymer and polypropylene which are the most important input raw materials in industrial production and exports of chemical and plastic products. Net imports of these two products were USD 7.3 billion in 2017. Considering that the current account deficit was USD 47.4 billion in 2017, it is assessed that these two products alone had an unignorably adverse effect on the current account deficit. On the other hand, it is notable that net imports of solar panels and

[1] Processed aluminum, carbon fibers, electrical batteries, heart valves, polyethylene terephthalate (PET), monoethylene glycol (MEG), zinc, railway vehicles and diesel engines, processed copper, polypropylene, solar panels and accessories, polymer.

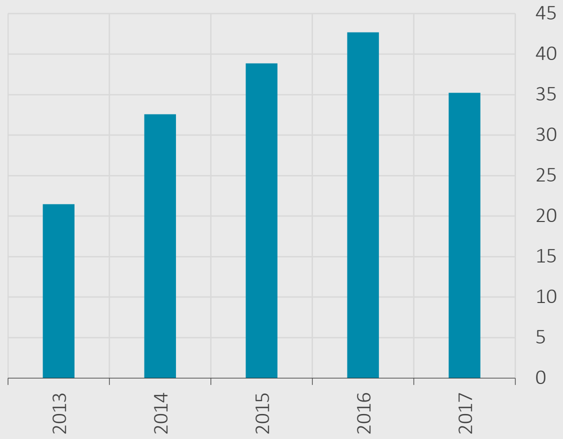
accessories skyrocketed to USD 3.5 billion in 2017 from USD 42 million in 2013. Renewable energy sector investments in the recent years are believed to have been effective in this increase.

Chart 2: Share of Incentivized Products in Net Imports Excl. Gold and Energy (%)



Source: TURKSTAT.

Chart 3: Share of Incentivized Products in Current Account Deficit Excl. Gold and Energy (%)



Source: CBRT, TURKSTAT.

Total net imports of incentivized products increased by approximately USD 3 billion to USD 17 billion in 2017 from USD 13.6 billion in 2013. Likewise, their total share in net imports of intermediate goods excluding gold and energy rose by nearly two points and reached 30 percent in 2017 (Chart 2). In this respect, products under the incentive system have substantially added to net imports. The share of net imports of these products in the current account deficit excluding gold and energy has been hovering around 40 percent for the last four years (Chart 3). On the other hand, a large portion of these products constitutes the main inputs of chemicals and plastics sectors where the industrial production and exports have registered relatively high rates of increase in recent years. This has the potential to further deepen the current account deficit problem in the following years through the imported input channel. Moreover, as renewable energy investments will increase in the upcoming years, imports of solar panels are expected to grow rapidly and push the current account deficit upwards if the domestic production of solar panels remains low. Therefore, it is anticipated that realizing the projects under the incentive system will considerably alleviate the pressure on the current account balance.

To conclude, the project-based incentive system is intended for mostly imported high-tech intermediate products that are required in industrial production and have a considerable share in the current account deficit. Considering that fixed investments in these products will be large scaled, the projects have the potential to increase the current account deficit in the short term particularly via imports of investment goods. Providing selected large firms with these incentives is also believed to be crucial in terms of the success of investments. Accordingly, although the project-based incentive system will unfavorably affect the cyclical component of current account deficit in the short term through high fixed investment costs, it will positively contribute in particular to the structural component of current account deficit in the medium and long term as the products cited above will be largely produced in Turkey.