Turkish Economy

Undoubtedly, the Turkish economy is gain greater and greater recognition on the world stage. While still classified as a developing nation, it shows a great deal of promise as a diverse economy with its complex integration to global markets as well as it potential for growth.

Growth as a measurement of Potential and Stability

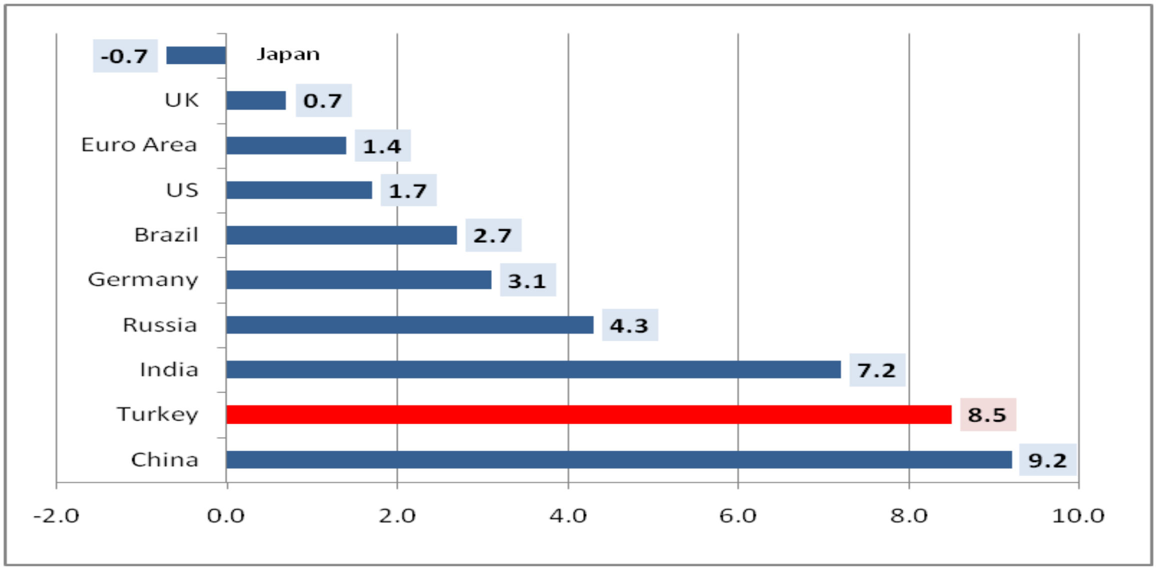
As we can see from figure 1 below, Turkey, the EU, the US and the BRIC countries are all contrasted in terms of their growth predictions from 4 major organizations that produce economic indicators. While India and China perform better than Turkey in most categories, it seems that the country in many ways is on par with Brazil and Russia. When we consider the physical and economic differences between Turkey and these countries, it is surprising that the country can maintain these levels of growth. We also can conclude that Turkey's growth surpasses that of many developed economies such as the US and the Euro Area.

Figure 1: Growth Forecasts

Growth Forecasts for Selected Countries/Country Groups (%)								
		Turkey	**Euro Area**	**US**	**Brazil**	**Russia**	**India**	**China**
IMF	2012	3.0	-0.4	2.2	1.5	3.7	4.9	7.8
	2013	3.5	0.2	2.1	4.0	3.8	6.0	8.2
OECD	2012	2.9	-0.4	2.2	1.5	3.4	4.5	7.5
	2013	4.1	-0.1	2.0	4.0	3.8	5.9	8.5
WB	2012	2.9	-0.3	2.1	2.9	3.5	6.6	7.7
	2013	4.0	0.7	2.4	4.2	4.2	6.9	8.1
	2014	5.0	1.4	2.8	3.9	4.0	7.1	8.4
UN	2012	3.2	-0.3	2.1	3.3	4.4	6.7	8.3
	2013	5.4	0.9	2.3	4.5	4.4	7.2	8.5

While IMF statistics state the Turkish Economy is expected to grow by 3% in 2012 we can see that already in the first two quarters of 2012, the Turkish economy grew by 3,2% and 2,9% respectively, resulting in an average growth of 3,05% in the first half of 2012, essentially surpassing the predictions made.

Figure 2: Turkish Economy's Expansion



Furthermore figure 2 above indicates the expansion of the Turkish Economy in comparison to other economies. With an expansion rate of 8.5% in 2011 the Turkish Economy is showing a rate that is competitive with its BRIC competitors. This figure was well beyond the predicted IMF rate of 7.5%

Financial Markets

If we examine the financial markets, which are a good indicator of the financial health of a country, we can also see a lot of promise as well. While the number of banks essentially stayed the same, the increase in both domestic and foreign branches shows that the movement of capital in Turkey is on the rise. Assets, Equities and non-performing loans or their cash equivalents have also increase over the past year, all indicating an upward trend in the financial sector. Two promising figures we can point to is that total assets of the banking sector increased by 7.8% and reached 1.308 trillion TL by September 2012. Also the Capital Adequacy Ratio of Turkish Banking Sector was 16.49% as of Sept 2012.

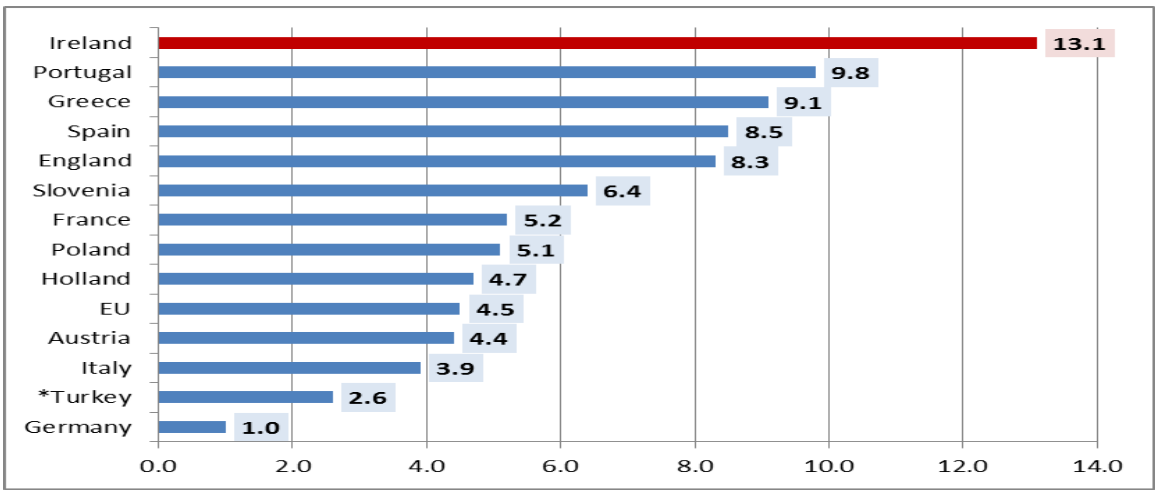
Figure 3: Data on Banking Sector Source: BRSA

Data on Banking Sector	2012 September	2012 September
Number of Banks	48	48
Number of Domestic Branches	10,427	10,813
Number of Foreign Branches	74	79
Number of Total Domestic Personnel Employed	194,106	198,542
Total Assets (Million TL)	1,213,660	1,308,482
Total Equities (Million TL)	141,575	168,151
Net Profit or Loss (Million TL)	14,620	17,090
Nonperforming Loans (Gross) / Cash and Cash Equivalents (%)	2.71	2.95
Net Profit or Loss / Average Equities (%)	1.32	1.35
Liquid Assets with 12 Months of Maturity / Total Assets (%)	70	72
Capital Adequacy Ratio (%)	**16**	**16**

Budget Deficit

One very promising figure shows that the EU defined general government budget deficit/GDP ratio was 2.6% in Turkey in 2011. What this essentially means is that Turkey successfully satisfied the Maastricht criteria of 3%. Turkey has also outperformed 18 other EU Countries, including leaders such as England and France. The Central Government budget deficit/GDP ratio was 1.3% in Turkey in 2011 and this figure shows that on this economic indicator, Turkey outperformed 23 EU Countries. Yet during the January-October 2012, the central government budget deficit has increased to 18.8 billion dollars, meaning Turkey needs to look for ways to reduce this number.

Figure 4: EU Defined Budget Deficit/GDP %



Turkey and EU Integration

This section will discuss both political and economic aspects of Turkish-EU relations

Brief Background to Turkey-EU Relations

When we consider Turkey's relationship with Europe, it's clear that the ties between the two have existed much longer than the "EU" and "Turkey" as concepts. There has always been the movement of people and trade between the two areas. Yet in 1952, 6 countries in Europe, in its attempt to pick up the scattered pieces of WW2, joined together to form the ECSC, the first incarnation of the present-day EU. Turkey has had associate member status since 1963 and formally applied for membership in 1987. Yet the relations gained increasing visibility with the 1995 accession to the customs union. In 1996 a free trade area was established between Turkey and the European Union for products covered by the European Coal and Steel Community. This step allowed Turkey to increase its industrial production destined for exports, while at the same time benefit from EU-originated FDI.

The process however as moved slowly over the last 25 years with Turkey being given candidate country status at the Helsinki summit in December 1999 and then at the end of 2004, the EC issued a report with positive recommendations to the EC, indicating Turkey's degree of compliance with the Copenhagen political criteria. Because of this report the EC decided to start accession negotiations with Turkey in 2005. But the country is still working on completing all the chapters of the aquis and has not been offered a formal date on membership yet.

Foreign Trade and Statistics

As we know, a free trade agreement between the Republic of Turkey and EFTA States was signed on 10 December 1991 in Geneva and entered into force in April 1992. With Turkey-EFTA States, FTA, tariffs and non-tariff barriers are eliminated in trade between the Parties. The Agreement regulates numerous areas such as state monopolies, technical regulations, public procurement, state aid, intellectual property rights, internal taxation, payments, transfers, damping, safeguard measures and, rules of origin.

When the bilateral trade statistics were examined, we can see that the trade volume between Turkey and EFTA States increased to 7,7 billion USD in 2011 and increase of 21% when compared to 2010. Also in 2011, imports from EFTA States were 5,8 billion USD, whereas exports to EFTA States were 1,9 billion USD.

Figure 5: Foreign Trade Volume/GDP (%)

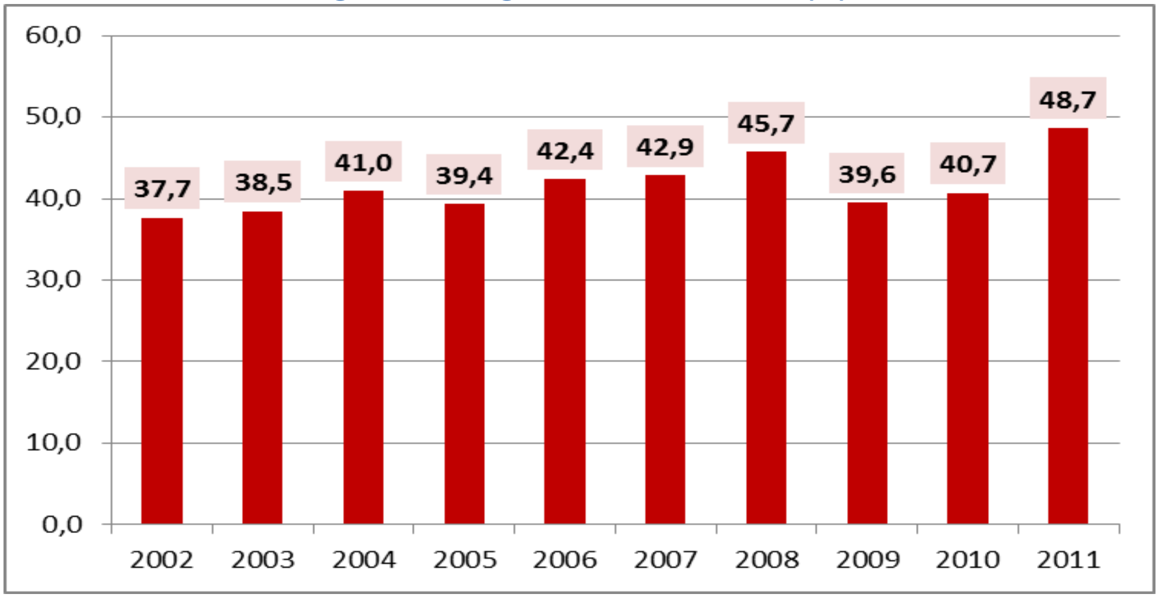


Figure 5 above indicates to us the ratio of foreign trade volume/GDP. Since the global economic downturn, the Turkish trade volume has been on an upward movement with a 2011 figure of 48,7%. Due to this number we can comfortably say that Turkey's full integration into the international trade system is inevitable.

Exports vs. Imports

Imports and Exports are also an important figure to analyze when considering the health of Turkey and a way of determining to what extent the country is working toward fulfilling its promises of abiding by all the requirements of the EU acquis chapters.

Figure 6: Import vs. Exports of Turkey 2011-2015.

(Billion $)	2011*	2012**	2013**	2014**	2015**
Exports	135	149,5	158	172,3	187,1
Imports	240,8	239,5	253	272,2	291,2
Volume of trade	375,8	389	411	444,5	478,3
Balance of trade	-106	-90	-95	-99,9	-104,1
Exports/Imports (%)	56,1	62,4	62,5	63,3	64,3

Actual (Source: TURKSTAT)
***Forecast: Medium Term Programme, Ministry of Development- 10/09/2012)*

Exports

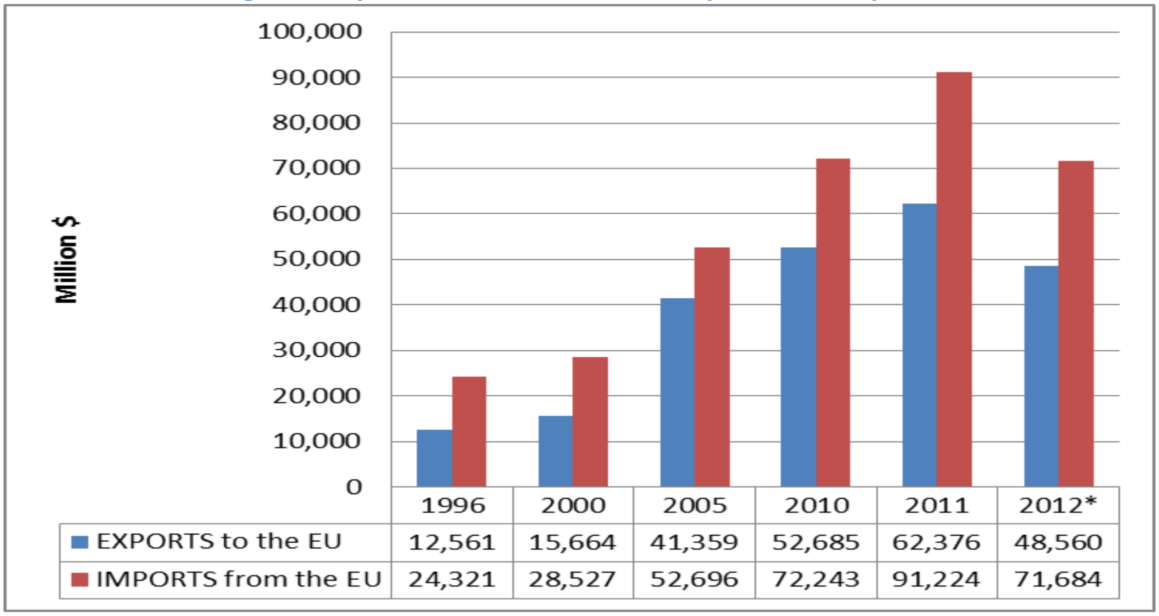
In order to determine how important Turkey is to Europe and vice versa, we can look to export figures to demonstrate the complex links between the country and the trading area. European Countries are the largest trading partners for Turkey accounting for 56% of exports for a total of 63 billion dollars in 2011. In terms of percentage, the trading partners are as followed: Germany 11.2%, UK 8%, Italy 6.95%, France 5.6%, Spain 4.3%, USA 3.88%. Clearly the EU market is significant for Turkey and vice versa.

Imports

Yet despite its export figures, Turkey has a history of importing a great deal of goods, all of which have an effect on its trade balance and ultimately the parity of the Turkish Lira. Turkey's main imports are primarily industrial in nature and result in 95% of all imports. The major problem is that very few industrial items originate in Turkey. Companies' in all sector made decisions not to invest in R&D over the past 3 decades. This choice has meant the country has become an import substitution economy in which it is seen as easier for the country to buy from abroad rather than make long-term investments into developing a homegrown industry. As a result, the foreign trade deficit of Turkey and the EU has increased 2 fold and 6 fold with non-EU countries, ROW in the years between 1995-2008.

Because Turkey's industrial imports cannot compete with their European counterparts, there is also a vicious circle that the profits generated from imports are being used to buy raw materials and assembly parts again from Europe. This shows that Turkey is dependent on European raw materials and parts The following countries are the sources for imports for Turkey: Russia 13.8%, Germany 10.3%, China 7.8%, Italy 6%, USA 4.8%, France 4.6%, Iran 3.9%, UK 3.2%; *total EU imports 40.4%; total Asia imports 27%*

Figure 7: Specific trade with EU in Imports and Exports



	1996	2000	2005	2010	2011	2012*
EXPORTS to the EU	12,561	15,664	41,359	52,685	62,376	48,560
IMPORTS from the EU	24,321	28,527	52,696	72,243	91,224	71,684

Source: Data Source of the Ministry of Economy

As figure 7 indicates both imports and exports with the EU have increase dramatically over the past decade. Yet unfortunately for Turkey the Imports have continued to outpace exports, having a significant effect on the economy.

Bi-lateral Investments and FDI

It must be mentioned that close relations between Turkey and European Countries also exist in bilateral investments. A win-win strategy could be seen in both Turkey's investment to European countries and the investments originating from European Countries. Thus, European countries constituted %72,9 share of Turkey's total investments. Similarly, the foreign investments originating from European Countries has constituted the 73,4% of total FDI in Turkey.

Investment: Reasons and Incentives

In order to encourage European and other country investments to Turkey, a specific agency, "Invest Turkey" was established in 2006. Its sole purpose is to increase FDI to Turkey. The following chart is a list of reasons that the agency prepared in order to encourage investors to bring their money to Turkey. Many of the reasons have to do with economic indicators or major factors that have a large impact on these indicators.

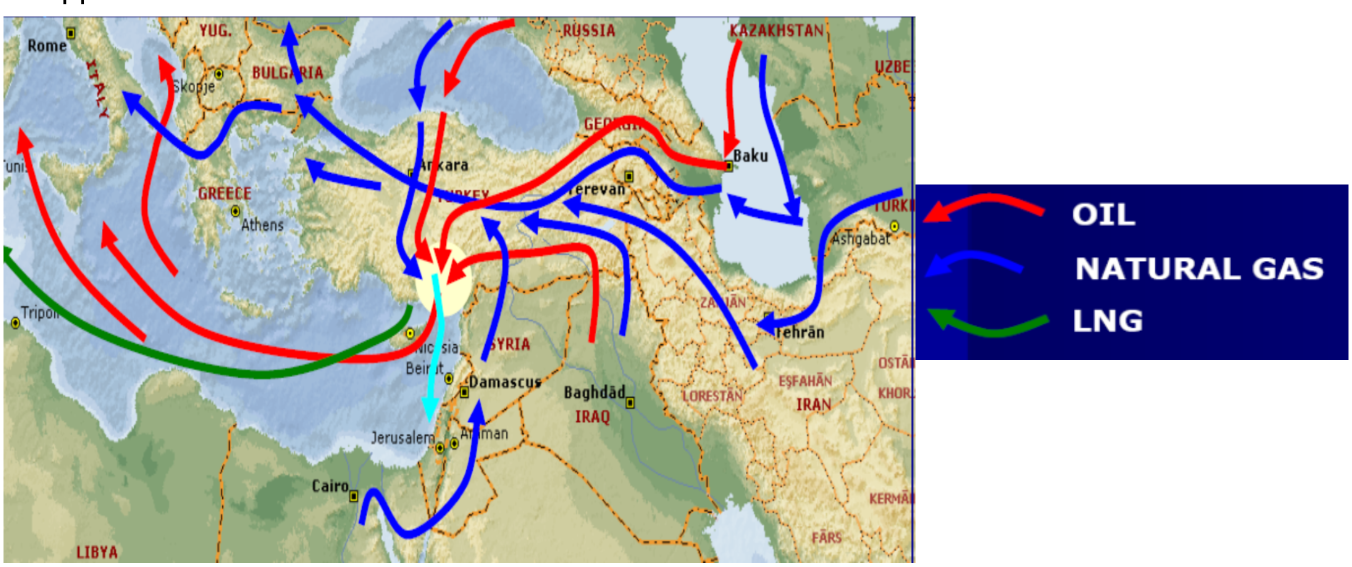
Figure 8: Ten Reasons to Invest in Turkey

10 REASONS TO INVEST IN TURKEY	
1- SOUND ECONOMIC PERFORMANCE	6- CENTRAL LOCATION
2- YOUNG and DYNAMIC POPULATION	7- ENERGY CORRIDOR and TERMINAL of EUROPE
3- QUALIFIED and COMPETITIVE LABOR FORCE	8- LOW TAX RATES and INCENTIVE FACILITIES
4- LIBERAL and INNOVATIVE INVESTMENT CLIMATE	9- CUSTOMS UNION with EU and OPEN ECONOMY
5- INFRASTRUCTURE	10- DOMESTIC MARKET

As we can note the most important reason is Turkey's sound economic performance, which has been demonstrated in the figures above. Also reason 9 is specifically targeted at EU investors because it mentions the customs union.

Energy Investments

A few specific incentives that should be specifically mentioned are reasons 5-6-7 which are all closely related. Turkey has the potential to be the logistic corridor for Europe since it is an energy hub between energy producer and consumer regions. As we can see for oil, natural gas as well as LNG, Turkey is the country that can assist both the seller and the buyer in terms of energy needs. Since Europe needs to ensure that its energy needs are secure, Turkey is the key country with which to negotiate. Its geographic location shows how Turkey will become increasingly important to Europe for the delivery of reliable energy supplies.



Support Measures	General Investment Incentive Scheme	Regional Investment Incentive Scheme	Large Scale Investment Incentive Scheme	Strategic Investment Incentive Scheme
VAT Exemption	✓	✓	✓	✓
Customs Duty Exemption	✓	✓	✓	✓
Tax Reduction		✓	✓	✓
Social Security Premium Support (Employer's Share)		✓	✓	✓
Income Tax Withholding Support *	✓	✓	✓	✓
Social Security Premium Support (Employee's Share) *		✓	✓	✓
Interest Support **		✓		✓
Land Allocation		✓	✓	✓
VAT Refund				✓

There was also a new incentive program established to encourage investment. This will be effective as of the1st January 2012, which is comprised of 4 different schemes that are implemented under different measures ranging from income tax to customs duty exemptions to land allocation.

1- General Investment Incentive Scheme
2- Regional Investment Incentive Scheme
3- Large Scale Investment Incentive Scheme
4- Strategic Investment Incentive Scheme

Future Projects for Turkey and EU integration

There are many areas and new projects in which investors can make economic developments into Turkey. The following list was complied by the Turkish Government so as to encourage investors as well.

- Export Oriented Production Strategy and Input Supply Strategy
- Market Access Strategy

- Supporting Exports
- Trade Remedies
- Restructuring the Incentive System
- Improving the Investment Climate
- Trade Agreements
- Next-Generation Free Zones
- Trade in Services and Turkish Investments Abroad
- Market Surveillance and Inspection
- Strengthening the Organization Abroad

Challenges to EU Integration for Turkey

Yet there are some major challenges to Turkey's accession to the EU especially in terms of economics.

- The impact on the EU would be significant because the Turkish entrance would be different from previous enlargements because of the combined impact of Turkey's population, size, geographical location, economic, security and military potential, as well as cultural and religious characteristics. These factors give Turkey the capacity to contribute to regional and international stability.

- Additionally, the accession of Turkey, which is a lower-middle income country, is going to increase regional economic disparities in the enlarged EU in a way similar to the most recent enlargement, and would represent a major challenge for cohesion policy. Turkey would qualify for significant support from the structural and cohesion funds over a long period of time. A number of regions in present Member States benefiting from structural funds support could lose their eligibility on the basis of present rules.

- Also, agriculture is one of the most important economic and social sectors in Turkey and would need special attention. Continuous rural development efforts and an upgrading of administrative capacity would be required from Turkey to create as favorable conditions as possible to participate successfully in the common agricultural policy.

- Finally, the budgetary impact of Turkish membership to the EU can only be fully assessed once the parameters for the financial negotiations with Turkey have been defined in the context of the financial perspectives from 2014 onwards. <u>The nature and amount of transfers to Turkey would depend on a number of changing factors</u>, such as the EU's policies and any special arrangements agreed with Turkey in the negotiations as well as the budgetary provisions in place at that time, in particular the overall budgetary ceiling. However, <u>it is clear that the budgetary impact on the basis of present policies would be substantial.</u>

This last point is significant for the development of the relationship. The EU is going to have to consider the financial costs that it will entail to accept Turkey as a member. This perhaps is one of the reasons that the accession process has gone on so long. The EU is still undecided about the context in which it wants to accept Turkey. If the process is too costly and does not pose any definable economic benefit for the union, perhaps membership status will not be offered and a privileged partnership agreement of sorts will be drafted.

Conclusion

In general we can see that Turkey is moving closer and closer towards Europe and the EU in terms of its economic links. The final three conclusions perhaps can be made to sum up the relationship between the two entities.

- The population dynamics of Turkey could make a contribution to offsetting the ageing of EU societies. In this context, the EU also has a strong interest in that reforms and investments should be made in education and training in Turkey over the next decade. The workforce of Turkey will be needed to help fuel the economy of Europe due to its ageing population. This is a clear economic tie that will see future development in the coming years.

- The economic impact of Turkey's accession on the EU would be positive but relatively small, both due to the modest size of the Turkish economy and to the degree of economic integration already existing before accession. Since a lot of trade is already occurring between the two, we will not see a tremendous jump in statistics because of the close relationships that already exists between the two. Therefore Turkey's economic output will not add a great deal of capital to the union. In fact due to certain programs such as the structural and cohesion programs, may end up costing the EU a great deal, financially.

- But on a positive note, Turkey's accession would help to secure better energy supply routes for the EU. It would probably necessitate a development of EU policies for the management of water resources and the related infrastructure. Because of their sometimes considerable trans-boundary effects, good implementation by Turkey of other EU policies in the fields of environment, transport, energy and consumer protection would also have considerable positive effects for EU citizens elsewhere.

Additional Information

Information on the chronological development of Turkish-EU Relationship

- 12 September 1963: Ankara Agreement
- 13 November 1970: The signing of the Additional Protocol
- 1 January 1973: Additional Protocol to come into force
- 14 April 1987: Turkey's Application for Membership
- 5 March 1995: The Association Council Decision Establishing the Customs Union
- 10-11 December 1999: Recognition of the Candidate Status of Turkey at the Helsinki Summit
- 8 March 2001: The first Accession Partnership Document issued
- 17 December 2004: European Council decision to start Negotiations with Turkey in Brussels Summit
- 3 October 2005: Start of the Negotiations between Turkey and the EU
- 20 October 2005: Start of the Screening Process
- 13 October 2006: End of the Screening Process