

## TURKEY'S RISING ECONOMIC CAPACITY

by TURAN AYDIN

"Turkey is well on its way to becoming one of the world's top twenty economies in terms of competitiveness. The GDP is approximately \$164 billion, and almost twice that according to the World Bank's study based on purchasing power parity. The economy has grown at an average annual rate of five per cent for the past ten years, and it ranks at the top among OECD countries. Turkey's domestic market holds 64 million people with a median age of 24.

The US Department of Commerce recognised Turkey's growing economic importance by naming it one of the ten Big Emerging Markets. The Department predicts that by the year 2010, these countries will import more from the United States than Japan and Europe combined".<sup>1</sup>

### INTRODUCTION

The successful liberalisation of the Turkish economy in the 1980s, the adoption of an export-oriented development strategy, the positive state of affairs in the neighbouring regions, the country's geographical position at the crossroads of Europe, Central Asia and the Middle East, all provided high growth in foreign trade and foreign economic relations.

As a result of this, Turkish businessmen became partners with the government in the policy making process and the Turkish public have become more aware of foreign economic policy.

Contractors and exporters were the locomotives of Turkey's efforts toward integration with the world economy and attaining a place among the most developed countries in the world.

### REFORMS IN TURKEY'S FOREIGN ECONOMIC RELATIONS

It is possible to divide the process of reforms in Turkish foreign economic relations after 1980 in three periods.

The main characteristics of the first period, from 1980 to 1987, were: the success of Turkish contractors and exporters in Middle Eastern markets; the speedy diversification of foreign economic relations by firms and countries; the intensification of economic relations with traditional Western partners; and normalisation of relations with the European Community (EC), frozen after the military regime.

A very important element of government policy in this period was its encouragement of exporters and contractors by bearing a significant part of their costs.

The second period began in 1987 with Turkey's application for full membership of the EC and the enactment of the Soviet-Turkish Natural Gas Agreement (NGA). While the application for full EC membership was rejected politely and this fact created a sensitivity in Turkish public opinion, the NGA was the beginning of the 'Eurasian story' in Turkish foreign economic relations. Because of this agreement, Turkish goods and contracting services entered the Soviet market. This process was strengthened by the success of Turkish contractors in their bids for the majority of contracts supported by German government credits for the building of housing for Russian military officers and men withdrawn from Germany.

The disintegration of the Soviet Union and transformation process in Eastern Europe created a boom in economic relations between Turkey and Eurasian countries.

The region became the second largest market for Turkey. A chance for Turkish businessmen to play an important role in Turkish policy towards this region came because of the geographical proximity, historical and cultural links, ethnic links, Turkey's success in adapting to a market economy, speedy growth in sectors producing goods and services in demand in Eastern Europe, and a wise export promotion strategy. The entrepreneurs' successful realisation of this role created an enthusiasm among Turkish people, while the Turkish private sector demonstrated a strong competitiveness in contracting, consumer goods trade and in services.

Another important element in Turkey's foreign economic policy at the time was the steps it took towards strengthening its regional position through founding and developing regional economic organisations.

The implementation of the European Union (EU)-Turkey customs union agreement, 1 January 1996, started the third period of reforms in Turkish foreign economic relations.

#### TURKEY AS A REGIONAL ECONOMIC POWER

The foreign economic relations of Turkey have changed deeply as a result of the liberalisation of foreign trade, diversification of production and increased quality of goods and services. Contrary to the export structure of the other regional states, the proportion of industrial products in Turkish exports is very high at approximately 90 per cent. The proportion of agricultural products in Turkish exports, which was more than 50 per cent at the beginning of the 1980s, has decreased to 10 per cent.

The number of countries to which Turkey exports has increased to 168 and the number of registered active exporters to 14,000.<sup>2</sup>

The increased export/GNP ratio, from five per cent in 1980 to 15 per cent in the 1990s, is another important indicator of Turkey's economic growth.

#### GNP OF SOME EURASIAN AND BALKAN COUNTRIES

(Billion dollars)

Country 1994 1995

Russia 285.7 366.2

Turkey 130.9 167.2

Greece 95.6 111.5

Romania 30.1 35.5

Ukraine 35.9 33.2

Uzbekistan 21.5 21.4

Kazakhstan 13.9 18.3

Croatia 14.0 17.4

Bulgaria 10.2 13.7

Source: New Horizon Economies, Union Bank of Switzerland, 3rd Quarter 1996.

Turkey's 1995 exports increased to \$21.6 billion, a rise of 19.5 per cent against 1994, while imports rose to \$35.7 billion, a rise of 53.5 percent. Of the exports, 51.2 per cent were to the EU (1994: 47.7 per cent), 15.3 per cent to former CMEA countries (1994: 11.95 per cent), and 14.9 per cent to the Middle East (12.4 per cent).

While the EU dominated Turkish imports in 1994 and 1995— accounting for 46.9 per cent and 47.2 per cent, respectively—the second important group of countries was North American Free Trade Agreement countries and, third, the former CMEA countries.

The place of Eurasian countries in Turkish foreign trade has increased permanently. Turkish goods fill a gap in the regional market because they are of better quality than goods produced in other regional states and cheaper than European or Asian goods.

#### TURKISH FOREIGN TRADE WITH EURASIA AND BALKAN COUNTRIES

(Million dollars)	1994			1995		
	Export	Import	Volume	Export	Import	Volume
Russia	820.247	1.046.073	1.866.320	1.238.129	2.082.376	3.320.505
Ukraine	76.243	535.083	611.326	198.534	856.340	1.054.874
Iran	249.816	692.573	942.389	268.434	689.476	957.910
Romania	175.345	228.911	404.256	301.960	367.870	669.830
Bulgaria	133.663	195.321	328.984	183.176	402.029	585.205
Greece	168.499	105.072	273.571	209.952	200.673	410.625
Kazakhstan	131.802	32.294	164.096	150.775	86.631	237.406
Uzbekistan	64.531	78.620	143.151	138.542	61.529	200.071
Azerbaijan	132.116	8.883	140.999	161.350	21.277	182.627
Turkmenistan	84.153	65.558	149.711	56.283	111.826	168.109
Macedonia	60.381	18.666	79.047	76.467	50.364	126.831
Georgia	67.026	25.650	92.676	68.126	50.127	118.253
Slovenia	19.921	31.644	51.565	32.679	35.481	68.160
Albania	59.257	1.527	60.784	56.942	1.274	58.216
Kirgizstan	16.972	4.295	21.267	38.156	5.513	43.669
Croatia	18.494	11.131	29.625	25.257	9.352	34.609
Other*	20.287	9.135	29.222	23.866	38.705	62.571
Total	2.298.753	3.106.594	5.405.341	3.228.628	5.070.843	8.299.471

Source: State Institute of Statistics, Turkey.

\* Other countries are Belarus, Bosnia-Herzegovina, Moldova, Serbia-Montenegro and Tajikistan.

Turkish firms with good markets in the Middle East in the early 1980s lost these due to the decrease in the purchasing power of regional countries (as a result of decreases in oil prices), and the Gulf Crisis and implementation of United Nations sanctions against Iraq.

The positive and negative experiences Turkish businessmen accumulated in the Middle East helped the speedy entrance of Turkish goods into the former Soviet republics and Balkan countries.

Turkish exporters quickly explored and then exploited the lack of consumer goods in these countries and some of Turkey's sectors came to work especially for this market.

Parallel to official exports, there was born a new form of unofficial and unregistered trade, suitcase trading. Planes, boats and buses full of Russians, Central Asians, Romanians, Bulgarians and others came every day to Istanbul, Trabzon, Samsun, Izmir and Antalya for shopping.

The volume of suitcase trade is estimated at \$10 billion annually and \$5 billion-\$6 billion of this form of trade is the export of leather goods, foodstuffs, textiles and other products to Russia.

Suitcase trade is a phenomenon for the Turkish economy because it employs hundreds of thousands of people in marketing and production. This trade also encourages investment in tourism, and air, maritime and motorway transportation.

Suitcase trading creates tax losses, but has some positive effects in the short-run. First, this kind of trade is a school for hundreds of thousands of Eastern Europeans. Many of them, after reaching the necessary level of capital accumulation, have become partners of Turkish foreign trade firms in the official trade area, or partners of Turkish investors in their own countries.

Second, suitcase trading was the main reason for the growth of the number of Eastern Europeans visiting Turkey for touristic purposes. This is valid especially for tourists (mainly Russian) from the Commonwealth of Independent States (CIS), which are the second most numerous group of tourists visiting Turkey.

Third, suitcase trade creates employment for millions of people on both sides of the trade exchange.

But in the long term, it is necessary to provide ways to transform unregistered trade into official trade. The people from Laleli (the Istanbul district at the centre of the suitcase trade) have taken the first steps in this area by opening shops in Russia and other states, adopting official trade methods. But their number is small and the majority of shop owners are concerned about the Russian government's decision to restrict the volume and types of goods in suitcase trading. This decision is part of a wider Russian strategy to limit imports.

The contracting sector is another success story for Turkey in Eurasia. Turkish contractors which, as of December 1995, had undertaken 758 projects at a total value of \$22.9 billion in 33 countries have concentrated their activities in Eurasia and Russia after the decrease of purchasing power in the Middle East.<sup>3</sup>

Turkish contractors began their activities under the NGA and German government's credits and have demonstrated their high quality, speedy and cheap services to become a CIS market leader, breaking the long domination of Finnish and Yugoslavian contractors.

As of December 1995, 39 Turkish firms, members of the Union of Turkish Contractors, undertook 325 projects with total value of \$7.7 billion in ten CIS countries, Estonia and Latvia, and had finished contracting services worth \$4.3 billion. Of these projects, 215 were in Russia and valued at \$5.7 billion.<sup>4</sup>

But the real value of Turkish contracting services in the CIS is higher than this because many firms which are not members of the Turkish Contractors Union have also realised projects worth billions of dollars in these markets.

Turkish foreign trade firms have found ways of establishing normal trade operations after a period of financing trade with Eximbank credits or by barter operations. Annual trade with the CIS and Balkan states leapt to \$7.1 billion officially (\$17-\$20 billion with suitcase trade), from about half a billion dollars-worth with the former CMEA and Yugoslavia.

Turkey's major export items to the region are milk products, vegetable and animal oils, sugar and sugar products, cacao and cacao products, flour and other wheat products, beverages, medicines, soap and detergents, plastics, leather and textile products, building materials, furniture, buses and automotive spare parts.

The CIS and the Balkans' markets gave a boost to new and fast growing economic centres in Anatolia and Thrace (such as Bursa, Denizli, Çorum, Konya, Gaziantep, Çerkezköy and Çorlu).

Businessmen from these centres bravely went to all areas from the Adriatic Sea to Siberia and they have a big advantage against Western competitors because of low prices and flexible market strategies.

The export of investments became another important element of Turkish economic policy in the region.

Russia occupies a special place in Turkish economic policy in the region. Russia became Turkey's second largest economic partner after Germany with \$3.3 billion in official trade in 1995 (fourth after Germany, the USA and Italy), approximately \$5 billion a year in suitcase trading, revenues from one million Russian tourists visiting Turkey in 1995, and contracting works of an annual average value of \$500 million (\$5.7 billion since 1987). (The same figures for Germany are: 1995 bilateral trade of \$10.7 billion, the revenue from two million German tourists visiting Turkey, remittances from Turkish workers in Germany the annual value of which is \$2-\$3 billion, and Turkish companies' contracting services which were valued at \$561 million dollars as of December 1995).

A new era in Turkish-Russian relations opened in 1995 with the enlarging of Turkish firms' trade and contracting activities in various regions of Russia, like north Russia (St. Petersburg, Karelia) Moscow region and central Russia. Thus, Turkish firms which concentrated their activities in the past in Moscow city, south Russia, the Urals and west Siberia have diversified their activities in Russia.

Another new strategy of Turkish firms operating in Russia and other CIS markets was the partial but permanent transformation of trade and contracting activities into investment activities. Koç Holding invested in the automotive industry in Uzbekistan and opened supermarkets in Azerbaijan and Moscow; Enka, the leading construction company in the Russian market with contracts worth more than \$850 million, made its first foreign investment in the Moscow real estate market. Big groups of companies or holdings like Anadolu Group, Bayındır Holding, Bayraktar Holding, Özköseoğlu Group, Neta\_ and others have taken decisions for investment in the region and taken the first steps.

Multinational companies like Coca-Cola, Northern Telecom, Mercedes, Credit Lyonnais, Siemens and General Electric have also channelled an important part of their regional activities through their Turkish subsidiaries.

The end of the civil war in Yugoslavia and the beginning of the process of rebuilding the regions damaged by the war brought new possibilities for economic activities in the Balkans.

Turkish firms have permanently enlarged their trade with Romania, Bulgaria and Macedonia, but only in Romania have they supported their trade activities with serious investments. The number of Turkish investments in Romania has grown to 4000 and among them, investments by Bayındır Holding, Efes Yatırım, Coca-Cola and Bayraktar Holding are the most important. The value of Turkish investments in Romania have reached \$60 million and Turkey has become one of the major investors in that country. In Bulgaria, where approximately 1200 Turkish firms are established, the value of total investments is very small (\$3-\$4 million) and most of the firms are engaging in trade and services. This trend is also valid for Macedonia, but in Albania the number of Turkish firms has increased in the last year and some Turkish firms (like Ginta and Besa Limited) undertook serious projects.

Turkish economic policy in the Balkans is affected by the important place Balkan-origin Turks occupy in Turkish economic life. Hundreds of small and medium-sized entrepreneurs

from Bursa, Izmir and Istanbul, where Balkan Turks are concentrated, work actively for intensification of inter-regional trade and human relations.

The re-establishment of peace in former Yugoslavia will provide new opportunities and will create the chance to solve general problems preventing regional trade such as inefficient transportation systems, customs regulations, etc.

Likewise, Turkish entrepreneurs hope to participate in the process of rebuilding of Bosnia-Herzegovina too.

Turkey has participated in the process of accumulating financial support for the renovation process by giving \$80 million in Eximbank credits (\$20 million was transformed into grants) and playing an important role between Islamic and Western countries for mobilising public opinion and common sense against the inhuman war in Bosnia.

Economic relations with another important member of the Eurasian family, Iran, is way under its potential level. This country may play an important role in the diversification of energy sources for Turkey, especially with natural gas imports, where Turkey's dependence on imports from Russia is very high. Besides, Iran has a strategic location between Turkey and Central Asia while Turkey controls some important links between Iran and Europe. This fact creates new possibilities for economic co-operation too. Unfortunately, economic relations between Turkey and the Middle East were deeply affected by decreases in world oil prices and the Gulf Crisis. The interruption of trade relations with Iraq, which are important for the economic development of southern and southeastern Turkey, have created significant political pressure.

"Under economic and political pressure, the Turkish Government is seeking to normalise ties with Iraq without breaking the UN imposed sanctions".<sup>5</sup> This trend was strengthening after the elections in December 1995 and the election victory of the Welfare Party.

Turkish society and the private sector are concerned by the proclamation of sanctions against other countries in the region too. The implementation of sanctions against Iraq, Iran and Libya, which are the core of Turkey's Middle Eastern economic policy, has been done without economic and political compensation.

#### CUSTOMS UNION WITH THE EU AND TURKISH FOREIGN ECONOMIC RELATIONS

Turkey made its first application to the EC in 1959. As a result of this, the Ankara Agreement was signed and this entered into force on 1 December, 1964. The Ankara Agreement granted Turkey special associate membership to the European Economic Community.

Turkey's second application, in 1987, for full-membership was rejected and, after long discussions, the two parties agreed to implement the original agreement by giving Turkey another special status, as a customs union partner.

"As of January 1st, 1996, all tariffs and customs between the EU and Turkey were abolished and Turkey started applying common tariffs for third countries in some sectors (namely the automotive industry temporarily and agricultural products indefinitely, were treated separately). Those parts of Turkish legal system and regulations dealing with foreign trade are being modified to conform with the rules and regulations of the EU."<sup>6</sup>

The average customs tariff which Turkey applied before the start of customs union was 18 per cent to the EU and 23.7 per cent to third countries. After customs union, these averages decreased to zero for the EU and 6-6.5 per cent for third countries. "Only an abolition of tariffs on trade with EU will cost Turkey more than \$2 billion in government revenue each year."<sup>7</sup>

Furthermore, through this agreement, Turkey has adopted EU regulatory standards in intellectual property rights, consumer protection and competition law.

It must not be forgotten that above all, the foundation of the customs union lies in reciprocal economic interests.

"A giant and unfulfilled market of 60 million people, adapted to global consumer norms, opened before Europe with assent to the Customs Union Agreement ... it is also a trade and production base and a jumping board for the Middle East, Central Asia and countries of the Black Sea and the Balkans .... Turkey's private sector which is extremely dynamic at home and influential in the region, expects in this transition period of the Customs Union to explore new possibilities of co-operation with European firms, to open the door to joint enterprises and to import information, technology and capital. Turkey hopes that the obligation of harmonisation with the Customs Union will bring discipline to the economy. It is also expected that with Customs Union, non-European foreign capital will also find Turkish human resources and dynamism attractive and will seek to take advantage of Turkey as a base for production."<sup>8</sup>

Turkey is the only country that has achieved customs union without becoming a full member of the EU. This fact created a big disadvantage for Turkey, because other EU states nullified tariffs after receiving important structural funds and financial aid.

The available EU structural funds offer a unique chance for building the physical and intellectual infrastructure to bridge the productivity gap between Turkey and the more prosperous member states to the north and west. The EU funded PHARE and TACIS programmes may provide a more competitive position for Turkey in Eastern Europe and in the CIS too. But, unfortunately Turkey will only receive proper financing from the EU if Greece decides to stop blocking the five-year ecu375 million and ecu750 million European Investment Bank loans.

#### EU TRADE WITH BALKAN STATES

##### Import Export

	1993	1994	93/94	1993	1994	93/94	
	(bnecu)	(bnecu)	%	(bnecu)	(bnecu)	%	
Albania	0.40	0.42	6.3	0.08	0.13	58.3	
Bulgaria	1.35	1.67	24.0	0.95	1.34	41.4	
Bosnia-Herzegovina	0.09	0.10	12.6	0.03	0.01	-58.1	
Croatia	2.05	2.86	39.0	1.65	1.81	10.1	
Macedonia	0.67	0.74	10.6	0.53	0.66	24.4	
Romania	2.32	2.65	14.2	1.69	2.51	48.5	
Turkey	11.788.87	-24.7	6.54	7.61	16.2		
Greece	11.2911.65	3.2	4.03	4.28	6.9		

Source: Eurostat, Newsletter Editcom Intrastat 2, 1995

Eurostat, External Trade 8-9, 1995

Greek entrepreneurs which used PHARE, INTERREG and JOPP funds and have a geographical proximity to the region achieved great advantages against other economic rivals. The other reason for this rising economic influence in the Balkans was the fact that the private sector of the biggest regional economic power, Turkey, concentrated their regional economic policy on CIS markets and ignored the Balkan markets after the term of late President Özal.

The blocking of EU structural and regional development programme funds to Turkey is an unfair act as some Western firms are using various forms of financing for their activities in trade, investments and services. The situation in postwar Bosnia-Herzegovina, where Turkish firms are prevented from using funds provided by the EU, is an important argument in this instance.

As a result of bad negotiations in the making of the customs union agreement, Turkey lost the possibility for supporting its firms in the CIS, the Balkans and the Middle East from EU sources. This development took place at the time when the Turkish government also stopped its export promotion policy.

Small and medium-sized enterprises from small Anatolian towns, who became actors in the CIS and Middle Eastern markets between 1987 and 1994, are facing problems after the entrance in to the market of firms using different EU and non-EU funds. These Turkish firms had benefited from the an absence of serious competition in the first years of the transformation of Eastern Europe and their cheap prices and marketing flexibility.

The majority of people working in the industrial sector are working for these firms, which are located in different Anatolian and Thracian towns, producing approximately half the total industrial product. But their share of export products is very small as they do not have marketing possibilities, accumulated capital, possibilities for providing foreign capital nor foreign trade specialists like the bigger firms in Istanbul. The mobilisation of these firms would create an economic boom in Turkey and would give the country a place in the world economy.

The speedy growth of imports from the EU will create short-term imbalances in the Turkish economy too. But this disadvantage will be solved by the education of consumers and Turkish firms' development of medium- and long-term marketing strategies.

The biggest disadvantage of the customs union is the effect on relations between Turkey and third countries.

"Turkey's obligation to automatically implement common tariffs against third countries will create problems for the country in establishing relations with third countries and different co-operation models because decisions affecting Turkish relations with third countries will be taken abroad. Fifteen EU states will take a decision in unison with their political approach, political interest and estimates and Turkey will be obliged to adopt these decisions. If Turkey doesn't adopt these, the customs union will not work. If Turkey adopts them, it will have no freedom in its behaviour towards the Turkic republics, Black Sea Economic Co-operation and Economic Co-operation Organisation."<sup>9</sup>

The above mentioned view is a view of hard-liners in Turkish society. But it is a real fact that the customs union agreement was signed and ratified very speedily due to the political interests of the EU and the Turkish government. The enactment of the agreement before the regulation of relations between Turkey and strategic third countries, or members of regional organisations with free trade agreements have increased opposition, the method of signing and ratification of the agreement.

The fact is that after great enthusiasm in the last months of 1995 and the first months of 1996, Turkey has forgotten the general advantages of the agreement and concentrated its

attention on a struggle with the crazy increase of imports and regulating relations with third countries. This is a very important argument for the view that the customs union is problematic from the viewpoint of policy concerning third countries.

The speedy signing and ratification of free trade agreements (FTAs) will partly solve this problem. The first agreement of this sort is the agreement signed with Israel, 14 March 1996, after three years of negotiations. The signing of FTAs with Russia, other CIS states and Balkan states will compensate for some of the disadvantages of the customs union agreement. It will be in harmony with EU policy toward regional countries too.

Another important fact is that Turkey is historically obliged to work for the signing of FTAs between the EU and the Black Sea Economic Co-operation project and the Economic Co-operation Organisation. In doing so, Turkey will increase the economic experience, knowledge and successes which have been achieved in the last two decades.

The Turkish former president and architect of reforms in foreign economic relations, Turgut Özal, thought Turkey's vocation was to become a critical link in the flow of goods and services between Europe and Asia.

Turkey has achieved great progress on this path. Istanbul has become an economic centre for the Eurasian region. In addition, the export potential of towns such as Izmir, Bursa, Gaziantep and Denizli have brought in billions of dollars. In this period Turkish economic rival in the Balkans, Greece enthusiastically proclaimed Salonika, a city with an export potential of \$1 billion and inefficient infrastructure, as the 'economic capital of the Balkans'. The EU supported this policy by proclaiming this city a cultural capital of Europe. Turkey has the chance to develop a huge number of its cities to a level higher than Salonika.

The Seventh Five-Year Development Plan sets the export targets of Turkey for the year 2000 at \$43.5 billion-\$44.5 billion.<sup>10</sup> This aim is very realistic if Turkey succeeds in reforming its economic legislation and tax system, solves its macro-economic imbalances, mobilises the army of small and medium-sized enterprises and defends the interests of the Turkish private sector in the international arena.

The realisation of its tourist potential will play an important role in the economic development of Turkey too. The number of tourists visiting Turkey increased continuously, reaching 7.7 million in 1995.<sup>11</sup>

The predicted increase in foreign direct investments due to the customs union will increase the competitiveness of the Turkish economy because these investments will bring high-tech innovations and will increase competition in the internal market.

The Southeast Anatolia Project (GAP), which is one of the world's most ambitious regional irrigation, agriculture and energy projects, is another important economic advantage for Turkey. "Upon completion of GAP, the irrigated area of the country will increase 40 per cent and agricultural production will grow by a factor of two".<sup>12</sup>

Major infrastructure projects which are on Turkey's agenda will attract more multinationals and increase contacts between them and their Turkish partners.

The beginning of the peace processes in the Middle East and the Balkans will increase the activities of Turkish contractors, who have demonstrated their high performance in all regions surrounding Turkey.

The protection of the balance between global and regional interests and policies is a big challenge for Turkey in the coming years. It is also the only way to being among the top economies in the twenty-first century.