Turkey and Europe, a New Perspective

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Executive Summary

For those who still view Turkey in Europe as producing (i) important mutual benefits in terms of a much stronger joint influence on world affairs, (ii) a larger zone of peace and stable democracy with the powerful "example" of a large majority Muslim country inside that zone, projecting ideas and economic strength far into the Middle East, Africa and Central Asia, (iii) an even larger single market encompassing a dynamic economy with stronger positive spillover effects on the troubled southern European economies, and, (iv) potentially deeper cooperation on defence and security issues, it is now time to make a new start. The economic basis for successful Turkish membership in the EU has developed very significantly over the last decade. It is now time for politics to catch up with economics, exactly when Europe as a whole is searching to define its own future. If the EU countries and Turkey have the courage to join forces in this search and build a common future within very flexible European institutions, a great historic opportunity will have been seized.

The past decade

Ten years have passed since December 12-13, 2002, when the European Council took what then appeared the momentous decision to commit itself to starting membership negotiations with Turkey. The actual negotiations started in October 2005.

At the end of 2002, Turkey had just overcome a deep financial and economic crisis. GDP had contracted by 5.7 percent in 2001[1] and inflation stood at 68 percent, after a decade of averaging over 60 percent. The recovery started in the spring of 2002, with GDP growth reaching 6.2 percent that year, a rapid rebound after the steep contraction during the crisis triggered by the exchange rate collapse of February 22, 2001. The road to lower inflation also began in 2002, with inflation cut by more than half compared to 2001. While the recovery was rapid, the crisis took a serious toll. GDP per capita in USD (market prices) stood at 3,519 in 2002, compared to 4,147 in 2000, reflecting a significant real devaluation of the Turkish Lira (TL). Many wondered whether the recovery of 2002, resulting from the "Transition to a Strong Economy" programme launched in April of 2001, would last.

At the time, the Euro was completing its third year after a successful launch in 1999. After initially losing value with respect to the US dollar, it had appreciated by almost 6 percent by 2002 – a trend that would continue for many years. Growth in the EU as a whole was slow, averaging about 1.7 percent in 2001 and 2002, but there was no crisis in the EU or in the Euro-zone. Growth averaged 3.2 percent in Spain and 3.8 percent in Greece over the 2001-2002 period.

Ten years have passed since December 2002. The average annual growth rate of the Turkish economy in constant domestic prices in the decade starting in January 2003,[2] the first year of the Justice and Development Party government, which took office in November of 2002, has been 5.1 percent. During the same decade, GDP has grown at an average annual rate of 1.2 percent in the EU. Thus Turkey has grown almost 5 times as fast as the EU in terms of total GDP and 3.5 times as fast in per capita terms. Tables 1 and 2 (see Annex) provide some key comparisons.

As can be seen from these tables, Turkish per capita income at market prices was about 20 percent of the EU average in 2003 and has grown to more than 30 percent of the EU average, not only because of a significantly more rapid GDP growth rate, but also because of a very significant real appreciation of the TL with respect to the Euro. This appreciation, which was very rapid in the first years of the ten-year period, reversed between 2009 and 2011, and then reasserted itself due to the impact of the Eurozone crisis in 2012. It accounts for roughly one third of the "catch up" of Turkish GDP per capita with respect to the EU average.

Moreover, compared to individual countries, it is interesting to note that Turkish per capita income at market prices in 2012 is close to that of Poland (about 83 percent), 28 percent higher than that of Romania and 52 percent higher than that of Bulgaria. In terms of overall GDP, Turkey is now the sixth largest economy in the EU 27+Turkey group of countries, after Germany, France, the UK, Italy, and Spain, having just moved ahead of the Netherlands. Using purchasing power parity prices, Turkey now has about the same economic size as Spain.

Within the European context, Turkey's growth performance over the last ten years has been very strong, and in terms of other criteria, such as fiscal space and debt-to-GDP ratios, Turkey has some of the most favourable indicators in Europe. This does not mean that the Turkish economy has no vulnerabilities. External shocks can have a major impact on the Turkish economy, as became evident in 2009

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1 According to the new GDP series of the Turkish Statistical Institute (TUIK), revised in July 2012.

2 Assuming a 4 percent growth rate for 2012, which was the official forecast until early Fall 2012. It now seems that the growth rate may be around 3 percent only, but this does not significantly affect the 10-year averages.

when, due to the world financial crisis, Turkish GDP contracted by 4.7 percent. Indeed had it not been for the contraction in 2009, overall Turkish growth performance would have come close to the best "Asian" performance over the last decade. But Turkey unfortunately still suffers from a major weakness, which is a low domestic savings rate in the 13-15 percent range. To finance a moderately high investment rate in the range of 21-23 percent, Turkey needs net capital inflows, i.e. a current account deficit, in the 6-10 percent of GDP range. In the absence of higher domestic savings, a lower current account deficit means less investment and slower growth. But keeping the current account deficit at levels above 6 percent is risky. A reversal of the capital inflows that finance the current account deficit would create an immediate problem for Turkey.

There is, therefore, vulnerability, but it is mitigated by attractive investment opportunities for foreign capital, a geographically diversified composition of foreign savings flowing to Turkey and, both, a low public debt-to-GDP ratio, well below 40 percent in 2012, and low leverage of the private sector with the sum of household and enterprise debt below 80 percent of GDP, compared to multiples of GDP prevalent in much of Europe.

The attractiveness of an investment destination is always relative to that of alternatives. Short of a major political crisis, not foreseen by most observers, Turkey is likely to remain quite an attractive destination over the coming years. This creates the opportunity for Turkey to gradually increase the savings rate and reduce its current account vulnerability, while maintaining the kind of investment rate required by a 5 to 6 percent GDP growth rate and continued employment creation in excess of new entries into the labour force. Table 3 (see Annex) assumes a 5.5 percent GDP growth rate in Turkey and 1.8 percent annual GDP growth in the EU from 2013 to 2023, with 0.2 percent annual population growth in the EU and 1.1 percent in Turkey.[3] It also assumes a modest one percent real annual appreciation of the exchange rate on average over the period. This would allow Turkey to reach close to half of EU per capita income by the 100th anniversary of the Republic, at market prices, and close to two-thirds at purchasing power parity. Turkey would become the fifth largest economy in the EU at market prices and the fourth largest at PPP prices.

A new dynamic with Europe

Given the economic developments of the last ten years in both Europe and Turkey, and the prospects for the next decade, the economic dimension of the EU-Turkey relationship has changed in a fundamental way. Turkey is getting much closer to being an "average" European country, in terms of a set of relevant economic indicators. Were it a member of the EU, it would no longer be among the poorest in per capita terms and could come close to half the EU average by 2023. Moreover, in terms of macro-economic and debt sustainability indicators, it would have been one of the healthier countries in Euro-space over the last few years. If the strong fiscal policies of the last decade continue to be pursued in conjunction with real growth in the 5 to 6 percent range, the public debt-to-GDP ratio will fall well below 30 percent, one of the lowest among major countries, not only in Europe, but in the world.

Of course, very disruptive political developments could threaten this scenario. By "disruptive", I don't mean the unfortunately harsh political language used by competing groups and political actors, or the "normal" difficulties of the political process in a country which, like others, has serious political and cultural fault lines. The economy can handle the everyday roughness of politics provided that there is basic rule of law, basic public order, and that political competition remains within the bounds of a basically democratic and peaceful system. What

would be truly disruptive and could halt Turkey's impressive economic progress would be a breakdown or generalized lack of respect for the rule of law, further escalation of violence linked to acts of terror, failure to advance towards a comprehensive new framework for maintaining fundamental national unity, while ensuring the human and cultural rights and freedoms of all citizens and groups with particular ethnic or religious identities within an overall sense of belonging to a democratic and secular republic. There are also dangers of spillovers from the conflicts in the Middle East coming from the south and east of Turkey's borders. The dangers mentioned above are real and must be taken seriously.

However, while there have been ups and downs in the development of democracy in Turkey, and while very serious challenges remain, with some recent events having caused renewed and entirely justified concern, the direction of long-term political development over the last 20 years has been positive, and political disruptions have not been strong enough to seriously impair economic progress. For the purposes of the argument outlined below, I will assume that despite the current difficulties, political and democratic progress will eventually continue and that the deep common sense and aversion to extreme behaviour that the people of Turkey have again and again demonstrated over the last decades will ensure basic stability in the country. I will also assume perhaps slow, but real progress on the Kurdish issue, fully democratic elections and an improved functioning of the legal system. Furthermore, I assume that Turkey's armed forces will remain fully capable of protecting the territory of the Republic from any significant spillovers of foreign conflicts and that Turkey's foreign policy will pursue a basically peace-oriented and stabilizing role in the region and the world.

If the assumptions described above can be fulfilled, the dynamic of Turkey's relationship with Europe could change very fundamentally in the next ten years. In 2002, Turkey was emerging from a deep economic crisis and its performance in the 1990s had created a perception of a highly indebted country with high inflation, high public deficit, mediocre growth performance, frequent and abrupt devaluations and a fragile economy. In 2012, Turkey is perceived as a country with solid growth performance, moderate inflation, low indebtedness and prudent fiscal and monetary policies. In contrast, the Eurozone is going through a crisis the depth and virulence of which nobody predicted ten years ago. Both the Eurozone and the wider European Union are in, or close to, recession. Germany, as well as a few Nordic countries such as Sweden, seem to be exceptions, but while Germany has been quite successful in keeping unemployment low, recent German growth performance has not been impressive. The average annual German growth rate over the last 5 years has been 0.7 percent.[4] The economic difficulties in Europe have raised truly existential questions, not only for the Eurozone, but for the EU as a whole.

In 2002, when membership negotiations were in principle agreed,

3 A 1.8 percent GDP growth in the EU implicitly assumes that the difficulties of 2011-2012 can be overcome by 2014 or 2015. If the crisis lasts, it would be hard for the EU to attain a 1.8 percent average growth over the coming decade. Note that while the "crisis" is often viewed as a Eurozone crisis, the UK's growth performance has been no better than the Eurozone's performance.

4 Assuming 2012 ends with 0.4 percent GDP growth in Germany.

the EU and the Eurozone seemed to face fairly stable conditions, enlargement to the formerly communist Eastern European countries was about to be accomplished and while the governance issues in such an enlarged Union were subject to intense debate around the plans for a new European "Constitution", the future of Europe seemed fairly predictable. The economic discussions with Turkey were entirely one-sided, and were on how Turkey would adopt the EU acquis, accept the rules of the Union, agree to eventually adopt the Euro like all candidate countries, and simply become part of existing European institutions. Turkey would also be a recipient of EU structural and agricultural support funds, although the amounts would reflect new, less generous formulas than previously in force for earlier accession countries; nonetheless, these funds would be substantial. Many European leaders were far from sincere in their approach to these negotiations, but formally at least, the path that needed to be travelled seemed fairly clear.

At the end of 2012 the future of Europe is far from clear. Survival of the Euro clearly requires much closer political integration of Eurozone countries, a strong common framework on fiscal policy that is adhered to by all members, a banking union in which bank supervision and deposit insurance would be to a large extent centralized, and a stronger role for the European Parliament without which the democratic legitimacy of greater political integration cannot be achieved. These new directions were not present when the EU started negotiations with Turkey. The debate on membership did not include a debate on such possible institutional changes, on either the Turkish or the EU side. Moreover, whether such deeper integration will actually be achieved remains an open question. There is serious opposition to it in Eurozone countries, and the debate has not even started on these issues in Turkey, because membership seems a remote prospect now. Were it to start, there would most likely be serious concern in parts of Turkish society about the degree of sovereignty-sharing that the plans for the Euro-zone contain. Another dimension of the difference with 2002, is that it is now very clear that the United Kingdom, and perhaps some other EU countries, will not adopt the Euro in the near or even more distant future.

If Turkey is to move towards membership in a more flexible European Union that will have to substantially re-invent itself over the coming years around at least two, but perhaps more, sub-areas with varying degrees of political integration, several conditions will have to be met.

First, the EU must abandon the totally one-sided approach to discussions with Turkey and treat Turkey as an "equal". Yes, Turkey must continue to accept much of the EU acquis and continue to adopt many of the European standards and rules. But it is no longer just a large but lower middle-income country without possible alternatives. Turkey has developed a much more dynamic economy, new self-confidence, and much wider global economic and political relations. This must be reflected in the nature of EU-Turkey interactions, both in terms of style and substance.

Second, as said above, the EU must re-invent itself, and, therefore, Turkey must be associated with that process of re-invention. A country cannot advance towards joining a political and economic "construct" that is as ill-defined in terms of its immediate future, as today's EU, without participating in the reflections and debates on the re-invention of Europe. Turkey itself must develop ideas and make proposals on what kind of Europe it would like to see in the future, and how it sees its role in it, and the EU must be willing to listen to those ideas.

Third, both sides must take advantage of new institutional flexibilities that are likely to arise in the process of setting the rules for countries inside and outside the Eurozone. In the foreseeable future, Turkey would be a country outside the Eurozone and, in that sense, similar to the United Kingdom. There will definitely be an even more "differentiated" or what is sometimes called "two-speed" Europe, perhaps even "three- or four-speed" Europe. In fact it may be better not to refer to "speeds" at all, because the end destinations themselves may remain permanently different. European institutions will have to adapt, if the EU is to survive. There may be a "core" European Commission and an "enlarged" European Commission. Turkey and the UK may have commissioners in the enlarged commission, but not in the core one. Or there may be several overlapping commission-type organs, each with a different function, such as economic governance and Eurozone management, foreign policy and defence, foreign trade and environmental negotiations, and labour, migration and social policies. Again, not all countries would be represented in all these sub-commissions. There may be one large European Parliament, with increased powers, but not all Euro-parliamentarians would have voting rights on all matters. For example, on matters that concerned the Eurozone only, British members would not have voting rights, the same would apply to Turkish members.

Such a more "made to measure" Europe may rescue the EU-Turkey relationship from its present impasse. It may suit both those in the EU who are afraid of simply integrating Turkey into a more unified "core EU", and it may suit many in Turkey who are not ready for the type of deep sovereignty sharing that would exist inside such a "core". And yet it would open the way for Turkish membership, a membership that may end up resembling the membership of the UK more than the membership of, say, Italy.

Finally, while Turkey will of course continue to negotiate for its fair share of various EU funds, it should be clear that for the Turkey of the coming decade, these funds will not have the importance and weight they appeared to have in 2002. It should be easier to agree on compromise formulas that recognize the fiscal difficulties of the EU and at the same time acknowledge the still lower income of Turkey and therefore its legitimate claim to some funding from the EU, but also the relatively minor importance of this funding for the Turkish economy.

Conclusion

For those who still view Turkey in Europe as producing (i) important mutual benefits in terms of a much stronger joint influence on world affairs, (ii) a larger zone of peace and stable democracy with the powerful "example" of a large majority Muslim country inside that zone, projecting ideas and economic strength far into the Middle East, Africa and Central Asia, (iii) an even larger single market encompassing a dynamic economy with stronger positive spillover effects on the troubled southern European economies, and, (iv) potentially deeper cooperation on defence and security issues, it is now time to make a new start. The EU and Turkey must look ahead with the realistic and updated perspectives described above.

I believe Turkey would still benefit enormously from EU membership: it would help correct the remaining and, sadly, at times serious weaknesses in the democratic process, it would strengthen Turkey's influence in the region and the world, because it would make Turkey a real decision-maker in many of the dimensions of EU policy, and through this anchoring, it would also add to the long-term vigour and stability of the Turkish economy. The EU would benefit from Turkey's dynamism and it too would become a more powerful global player. Turkey in Europe would ensure that a religious fault line will not develop in the Mediterranean region, threatening peace and stability in the EU itself. Turkey in Europe would be able to help its southern neighbours more effectively in their quest for freedom and prosperity than Turkey on its own.

The economic basis for successful Turkish membership in the EU has developed very significantly over the last decade. It is now time for politics to catch up with economics, exactly when Europe as a whole is searching to define its own future. If the EU countries and Turkey have the courage to join forces in this search and build a common future within very flexible European institutions, a great historic opportunity will have been seized.

Annex

• Table 1* | Overview of GDP growth and inflation in selected EU countries and Turkey, 2003-2012

		10-year change (%)	Annual average rate (%)
Real GDP Growth	Turkey	64.80	5.10
	EU	12.50	1.20
	Germany	12.70	1.20
	Italy	0.40	0.04
	Spain	14.10	1.30
	Greece	1.50	0.15
	Poland	52.00	4.30
	Bulgaria	39.00	3.40
	Romania	39.82	3.41
Price level change	Turkey	143.80	9.30
	Euro-zone	20.30	1.90
Appreciation of Euro/TL Real Exchange Rate		22.87	2.08

* Based on 2012 forecasts and author's calculations
Source: EUROSTAT and TUIK

• Table 2* | Total and per capita nominal GDP levels in selected EU countries and Turkey

		2003	2012
Total Nominal GDP in billions of Euros	Turkey	268	615
	EU	10,104	12,864
	Germany	2,148	2,652
	Italy	1,342	1,590
	Spain	783	1,064
	Greece	172	204
	Poland	192	379
	Bulgaria	18	40
	Romania	53	137
Nominal GDP per capita (in Euros)	Turkey	4,000	8,225
	EU	20,700	25,549
	Germany	26,000	32,406
	Italy	23,300	26,136
	Spain	18,600	23,039
	Greece	15,600	18,024
	Poland	5,000	9,906
	Bulgaria	2,400	5,403
	Romania	2,415	6,436

* Based on 2012 forecasts and author's calculations
Source: EUROSTAT and TUIK

• Table 3 * | Total and per capita nominal GDP levels in selected EU countries and Turkey

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Per capita GDP of Turkey**	32.1	33.4	34.6	35.9	37.3	38.7	40.1	41.6	43.2	44.8	46.5	48.2

***Per capita GDP of the EU = 100*

* Based on author's forecasts and calculations
Source: TUIK