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TURKEY'S ROAD TO EU MEMBERSHIP: ECONOMIC OUTLOOK

The commencement of the official relations between the European Union and Turkey dates back to 31 July 1959, when Turkey applied for association following the establishment of the European Economic Community. The relations were shaped in accordance with the provisions of Ankara Agreement signed in 1963. As stated in article 28 of the Ankara Agreement, the road to full membership was open, based on Turkey's capacity to fulfill its obligations. The Customs Union, which was envisaged as the final period of the Association, took effect on 1 January 1996 and was perceived in big business circles as a cure-all. On the other hand, small and medium sized companies have been critical of this process. With the Customs Union, Turkey had already become part of the European internal market and was required to adopt large parts of the acquis regardless of the membership process. The 1999 Helsinki Summit marked a turning point in Turkey-EU relations, followed by a positive atmosphere till the accession negotiations started in 2005. As Turkey started negotiations, conditionality rather than incentives were perceived to dominate the negotiation process. The absorption capacity of the Union was also an issue, which basically meant that Turkish accession has the risk of overburdening the EU in budgetary, political and/or institutional terms. Although the progress in accession negotiations constitutes an important anchor for the implementation of political reforms, it was only the economic perspective of Turkish accession which has been looked upon more favourably, while the rest became intertwined with the questions of identity and the future of Europe, a larger question. Turkey's road to EU membership is distinct from the previous enlargements, due to the combined impact of population, size, geographical location, economics and energy security. Given these features, despite the deep impact of the current global crisis on the economies of some member states, Turkey continues to be a functioning market economy in line with the Copenhagen criteria. The paper tries to assess and shed an insight into Turkey's economic convergence and argues that Turkey's EU membership is a challenging but a "win-win" case.

INTRODUCTION

The commencement of the official relations between the European Union and Turkey dates back to July 1959, when Turkey applied for association following the establishment of the European Economic Community (EEC). The EEC Council of Ministers accepted the application and following the negotiations, the Ankara Agreement establishing an association between Turkey and the EEC was signed on 12 September 1963. The agreement envisioned three stages with the ultimate intention stated in the Article 28: "As soon as the operation of this Agreement has advanced far enough to justify envisaging full acceptance by Turkey of the obligations arising out of the Treaty establishing the Community, the Contracting Parties shall examine the possibility of the accession of Turkey to the Community." Thus the road to full membership was open based on Turkey's capacity to fulfil its obligations.[1]

The three stages comprised a five-year preparatory period, a transition period and a final period. A Customs Union (CU) was designed to be completed by the end of the transition period. With the ending of the preparatory period, the responsibilities of the two sides during the transition period were determined in the Additional Protocol, which took effect in 1973. The timetable of the transitional stage was upset by the oil crisis and the following global recession in the mid 1970s, which affected labour recruitment from Turkey, a signal pertaining to the Community's failure to comply with the provisions concerning the free circulation of labour. Another major problem bounced from the extension of concessions by the Community to many developing countries under the General System of Preferences and the Lomé Convention, and also under the Global Mediterranean Policy, which eroded to a large extent the preferences granted to Turkey. Finally, the imposition of quotas under "voluntary export restraint" framework on Turkish textile exports was another factor which strained the relationship. On the other hand, Turkey hit by the oil crisis and the recession was able to reduce tariffs only twice, in 1973 and 1976, and had to delay further tariff reductions on EC manufactured products. It could not even commence the adjustment to the Common External Tariff (CET). Faced with grave economic and balance of payments problems, Turkey presented a plan to revise the stipulations of the Association Agreement and also requested an aid package to revitalize its economy. However, this was not met by a favourable response from the Community and finally in 1978, Turkey took the step of freezing the terms of the Association Agreement under Article 60, which allowed both parties to take the necessary protective measures in case of fundamental sectoral or a regional disruption or disturbance in external financial stability.

The relations of Turkey with the Community came to a standstill after the military intervention in 1980. The fourth financial protocol was suspended, and the volume of trade between the partners began to decrease. The free circulation of Turkish workers in the Community was put off as of 1986. The decline in economic relations was also accompanied by the emergence of diverging views on political issues. The EC's insistence on democracy and the promotion of human rights was interpreted as interference in Turkey's internal affairs. Turkey insisted of identifying the EC solely as an economic entity.

At the beginning of the second half of the 1980s circumstances changed. Turkey's 1980 stabilization and structural adjustment programme brought radical changes in its economic structure. The Community had also reversed its stance, by reactivating the Association Agreement. The Western-oriented business community had already begun voicing the full membership application. This demand was also backed up in

1 From the Ankara Agreement to the 1999 Helsinki granting candidate status, 35 years passed and 6 more years were needed to open the accession negotiations in October 2005. Thus Turkey faces the most extended waiting period in enlargement history.

other circles, not only for economic reasons but also to guard the recaptured democracy. However, it was the economic considerations at the forefront of the domestic discourse when on 14th April 1987 Turkey applied for membership.[2] The Commission, in its reply in 1989, stated that along with the economic and political drawbacks concerning Turkey, the Community would not be able to accept a new member until the completion of the internal market; and suggested the reactivation of the Association Agreement and proposed a set of measures towards increasing cooperation between the partners, including the completion of the CU. This "let's talk about it later" approach from the EC had left no other viable option to Turkey but to take the necessary steps towards finalizing the CU. After two years of negotiations, the Customs Union between Turkey and the EU took effect as of 1st January 1996, based on the Association Council decision 1/95.

The CU between Turkey and the EU signifies much more than a customs union in the technical sense. Apart from the elimination of custom duties, quantitative restrictions and alignment with the Common External Tariff, Turkey had to harmonize its legislation with the Community legislation in relevant trade-related fields such as technical barriers to trade and competition policy,[3] as well as negotiating trade agreements with third parties on the same terms as those concluded by the EU. Thus, the CU implied a considerable degree of "policy dependency" [Misrahi 2006: 2].

"The discussions on the issue of CU were clear enough to show the divergent approaches of the two sides in defining the CU. According to the provisions of the Ankara Agreement, the CU is the end product of the transitional stage during which both parties fulfil their reciprocal obligations. Thus it was supposed to be the first step of an irreversible chain of events leading to full membership."[4] On the other hand, the European side considered the CU nothing more than a way of developing close economic ties with Turkey and consistently refrained from making any reference to a link between the CU and the membership prospect. The EU's ex-Ambassador to Turkey, Michael Lake, explained the situation as follows: "The customs union created misconceptions on both sides. The European side felt that Turkey would be preoccupied with making it work and not press for full membership for the time being, while Turkey had the misconception that the customs union was a stepping stone towards full membership in the next year or two" [Arikan 2003: 82].

Assessing closer relations with the EU as a counter-weight to the inward-looking etatist economic policy, the business community controlled by large enterprises around Istanbul supported the CU. They perceived it as a cure-all that would impose discipline on the domestic market, correct the trade imbalance, and promote foreign investment. On the other hand, the small and medium sized companies, whose demands were pronounced by the Eskisehir Chamber of Industry, were against the CU claiming that tariff dismantling beyond a critical point would eradicate domestic producers [Uğur 1992: 91–92].

2 For further discussion see Balkır [1998].

3 In compliance with its obligations, Turkey adopted the Law on the Protection of Competition before the entry into force of the CU and established the Competition Authority in 1997.

4 For a detailed evaluation of the Customs Union issue see Balkır–Eylemer–Tas [2008]

The CU is one of the many respects, which make the Turkish case of accession quite distinct from previous enlargements. Through the CU, Turkey has already become part of the internal market for goods and was scheduled to adapt large parts of the acquis regardless of what happens to the accession process. The drafters of the Customs Union Agreements had realized that the liberalization of trade would entail painful adaptations and in order to counter balance the adverse impact of such implementations, financial assistance schemes were to be devised together. However, as these financial assistance mechanisms were designed for members, Turkey, being a non-member country concluding a customs union, was deprived of the adequate financial support mechanism.

The CU did not cover agriculture and services. The free movement of the agricultural goods was to be realized after Turkey's adoption of Common Agricultural Policy. From the beginning, the Community granted tariff concessions on agricultural imports and eliminated duties on primary agricultural products by January 1987. Concerning the manufactured agricultural goods, the taxes applied to were separated into agricultural and industrial shares; of which the industrial taxes were removed, while the agricultural share was set to the tax rate applied in the Community. As for the exclusion of the service sector, it still continues in spite of the fact that at present, Turkey has a strong competitive position in a number of service sectors but there is a need for finding a solution to the freedom of establishment which is a crucial condition for cross-border provision of labour-intensive services [Derviş et al 2004: 76].

The trade volume between the two partners has almost doubled since the CU. The opening up of the economy has made Turkey more attractive to foreign direct investment and thus further integrated it into the international division of labour. It has been claimed that unilateral obligations undertaken under the CU would create a barrier for Turkey to enter to the third country markets. However, the data indicates just the opposite and the Turkish experience shows less trade dependency compared to the experience of some member countries after accession, mostly due to its geographical location which facilitates trading with the neighbouring countries. Imports from low cost third countries have partly replaced the imports from high cost EU countries. Thus, the tariff reduction to third countries due to the application of CET has been an important factor in reducing the trade diversion costs of the CU for Turkey.

The CU has given impetus for the modernization of the economic structure resulting in an increased international competitiveness. Turkey's exports both to the EU and non-EU countries have been reoriented from consumption goods to higher value-added goods. Although the export growth of Turkey has been astounding during 2001-2008 (13.9% compared to 4.4% for Euro area [Republic of Turkey Prime Ministry Undersecretariat of Treasury 2010]), the share of the EU in Turkey's exports has decreased. At the year of the CU, EC's share in imports was 55.7% and its share in exports was 54.1%, while the respective figures were 40.2% and 46.0% for 2009 *(see table 1)*.

The openness of the Turkish economy, as measured by the total value of exports of goods and services as a percentage of Gross Domestic Product (GDP), amounted to about 48% of GDP in 2008 [Commission of the European Communities 2009].

Table 1. The Breakdown of Turkey's Foreign Trade By Country Groups (%)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Export															
EU-27	56.4	54.1	51.2	54.9	58.0	56.4	56.0	56.6	58.0	57.9	56.3	56.0	56.3	48.0	46.0
Non EU	43.6	45.9	48.8	45.1	42.0	43.6	44.0	43.4	42.0	42.1	43.7	44.0	43.7	52.0	54.0
Import															
EU-27	50.5	55.7	53.8	55.1	55.4	52.3	47.9	49.8	50.7	49.3	45.1	42.6	40.3	37.0	40.2
Non EU	49.5	44.3	46.2	44.9	44.6	47.7	52.1	50.2	49.3	50.7	54.9	57.4	59.7	63.0	59.8

Source: Undersecreteriat of Foreign Trade, Turkey

The EU's share in Turkey's trade varies from year to year, depending on numerous factors, including international commodity price trends and exchange rate movements. Although Turkey diversified its trade towards new markets, on the whole, trade and economic integration with the EU remains high.

Currently a discussion has been initiated in Turkey[5] to re-negotiate the conditions of the CU since not being in the decision mechanism, Turkey has no voice in the free trade agreements (FTA) concluded by the EU with the third countries, some of which are trade competitors of Turkey, although and disappointingly the EU fails to consider the sensitivities of Turkish industry. Once a FTA is concluded, it opens the entire customs union area of the EU, which also includes Turkey. However, the concession by the third country concerns only the exports originating from EU countries, and not Turkey, which is not a full member. The EU continues to increase the FTAs within the context of its strategy introduced by a communication titled "Global Europe-Competing in the World" dated October 2006 [European Commission 2006].

It has been discussed previously, that the financial assistance mechanisms to counter balance the negative impact of CU was designed for members and Turkey, not being a member, received very little. The EU has always been reluctant to fulfil its financial obligations which caused frustration on the Turkish side.[6] One must admit that the situation has changed for the better after the candidacy. *Table 2* gives the implementation rate for loans and grants prior to the CU and following the CU.

The EU allocated € 21 billion 840 million to the Central and Eastern European Countries under SAPARD, ISPA and PHARE Programmes for the period between 2000 and 2006, while the fund allocated to Turkey was only € 1 billion 748 million for the same period. In 2000, the amount of funding per capita was € 2.7 for Turkey, while the amount per capita for Estonia was € 46 and € 17 for Czech Republic. Overall, the average financial assistance per capita was 9 times more for Central and

5 Haluk Kabaalioglu, president of IKV (Economic Development Foundation), voiced this discussion. See http://www.abhaber.com/haber_sayfasi.asp?id=18487 for more details.

6 The current financial framework runs until 2013; the following one will run until 2018. Assuming accession by 2015, this would mean that the financial framework for the first three years would be decided by the EU-27 or most probably EU-28. Therefore, Turkey will be fully part of the financial framework in the 2018-2024 Round [for details see Derviş et al. 2004].

Table 2. EU Financial Commitments to Turkey

Prior to the Customs Union (1964–1995)	
Commitments	€ 1 605 million (€ 1 152 million loans and € 453 million grants)
Payments	€ 1 005 million (€ 927 million loans and € 78 million grants)
Implementation Rate ■ Loans ■ Grants	% 63 % 80 % 17
Following the Customs Union (1996–1999)	
Commitments	€ 2 275 million (€ 1 507 million loans and € 768 million grants)
Payments	€ 755,3 million (€ 557 million loans and € 52 million grants)
Implementation Rate ■ Loans ■ Grants	% 33 % 37 % 7
Candidacy Process Commitments	
Grants	2000–2003: € 698 million 2004–2006: € 1 050 million
Loans	2000–2006: € 2 520 million
Instrument for Pre-Accession Assistance (IPA)	
	2007–2010 : € 2 256 million
	2011–1013 : € 3 000 million

Source: Turkish Secretariat General for the EU Affairs, www.abgs.gov.tr.

Eastern European Countries [Gençkol 2003]. Although the EU financial assistance to Turkey has increased gradually in time, the amount per capita is still low compared to the amount allocated to the other candidate and potential candidate countries *(see table 3)*.

Table 3: Allocation of Pre-Accession Assistance among Candidate and Potential Candidate Countries

	Population	Total Financial Support for 2007–2010, €	Per Capita Financial Support for 2007-2010, €*
Croatia	4 437 000	589 900 000	132.95
The former Yugoslav Republic of Macedonia	2 022 547	302 800 000	149.70
Serbia	7 498 001	771 100 000	102.80
Montenegro	620 145	131 300 000	211.70
Albania	3 200 000	306 100 000	95.60
Bosnia and Herzegovina	4 000 000	332 000 000	83.00
Turkey	72 000 000	2 256 000 000	31.30

Source: European Commission Enlargement Website,
*Balkir–Eylemer–Tas [2008: 9]

Screening meetings on the chapter of customs union took place at the beginning of 2006 and the report issued on 9 March 2007 highlights the considerable level of alignment of the Turkish customs law on the acquis in the field of CU. On the other hand, the accession of Cyprus in 2004 to the EU has raised a politically sensitive issue and CU became one of the controversial issues on the agenda of accession negotiations. According to the screening report "as long as restrictions on free movement of goods carried by vessels and airplanes registered in Cyprus or where the last port of call was Cyprus remain, Turkey will not be in a position to fully implement the acquis relating to the EU-Turkey customs union" [Screeningreport Turkey 2007]. Following the Commission's recommendation on 29 November 2006 to partially suspend Turkey's EU membership negotiations, EU foreign Ministers decided, on 11 December 2006, to partially suspend negotiations with Turkey for eight chapters including the chapter on CU.[7]

AFTERMATH OF HELSINKI SUMMIT

The Helsinki Summit marked a breakthrough in Turkey-EU relations, at which the membership perspective overcame the long-lasting ambiguity surrounding the Turkish case and ending the debate over whether Turkey is a European country. This was enough to embark the reform process, although it started with the cautious steps taken by the three-party coalition government. The reform process further accelerated after the 2002 Copenhagen Summit, when it was decided that "if Turkey meets the political Copenhagen criteria in 2004, the accession negotiations will be launched without unnecessary delay" [Copenhagen European Council 2002]. Issues previously considered taboo, such as Kurdish rights, civilian control of the military, reinforcing the legal guarantees on freedom of expression, abolition of the death penalty, elimination of State Security Courts, broadcasting in mother tongues other than Turkish in both public and private channels, amendment of the National Security Council were some of the important achievements.

The optimistic environment created by membership perspective, a definite external incentive, reached a peak when the EU decided to open accession negotiations with Turkey on 3rd October 2005.[8] Achieving the EU candidacy status had significantly strengthened the political commitment to economic and political reforms and the commencing of the accession negotiations was expected to be an anchor for implementing them.

However, as Turkey started negotiations, conditionality rather than incentives were perceived to dominate the negotiation process. The EU stated that the negotiations are an open-ended process, the outcome of which can not be guaranteed beforehand. It was also indicated that in the case of Turkish accession "long transitional periods, derogations, specific arrangements or permanent safeguard clauses" was to be expected. The absorption capacity of the Union was also an issue, which basically meant that Turkish accession has the risk of overburdening the EU in budgetary, political and/or institutional terms. As membership perspective got blurred, the accession process lost its attractiveness for the Turkish public, leading to a

7 Chapter 1: free movement of goods, Chapter 3: Right of establishment and freedom to provide services, Chapter 9: Financial services, Chapter 11: agriculture and rural development, Chapter 13: fisheries, Chapter 14: transport policy, Chapter 29: customs union and Chapter 30: external relations.

8 Up to December 2009, 12 out of the 35 chapters of the acquis have been opened, and 8 chapters suspended due to Cyprus conditionality. Croatia, for which the negotiations began on the same date, has already 28 chapters opened out of 35.

decline of support for EU membership. Kramer [2009: 4] rightly points that "fundamental disruption of the logic of conditionality-compliance mainly brought about by the EU's credibility gap, Turkey's accession process has entered a vicious circle, with negative factors and opposing forces on each side reinforcing each other".

From the EU perspective the accession of Turkey was controversial for many reasons. According to Tsoukalis [2006], "Turkey forms a category of its own. Big, poor and different, Turkey presents the biggest challenge for all." It is the largest single country to be included since the UK, with a young and growing population and a GDP per capita below EU average. It is not considered as a genuinely European country by many Europeans and the debate on membership is framed in geopolitical terms and around the politics of identity. Discussion in Europe is marked by fear on one side, the fear of Turkey diluting the Union, fear of mass immigration, fear of cultural clash,[9] and fear of eventual predominance of large ethnic group in EU.[10] On the other hand, there is the fear of missed opportunity by excluding Turkey, a historic chance for Europe to prove its capacity for diversity. Thus the question of Turkey's accession became intertwined with the questions of identity and direction of Europe, a larger question. Opposition to Turkey shifted from measurable variables to ambiguous, abstract debates and discourses on Turkey.

It was only the economic perspective of Turkish accession which has been looked upon more favourable, as a case of "win-win game", because the country is an important market for EU goods and services, it is the seventh biggest trade partner and the EU firms have invested significantly in Turkey. Even considering only the economic criteria the Turkish case is distinct from previous enlargements. The rest of the paper will try to assess and shed an insight into the economic convergence of Turkey to Copenhagen economic criteria and moreover, the Maastricht criteria.

WHAT MAKES TURKISH ACCESSION DISTINCT FROM PREVIOUS ENLARGEMENTS?

As the paper will concentrate only on the economic perspective, one can say that Turkey's distinction lies in the combined impact of population, size, and GDP. *Table 4* gives us the contribution of Turkey to the EU27 with respect to area, population and GDP. However concerning the change in the average per capita, the figure will be different at present as Turkey's GDP per capita increased greatly during the last five years.

With over three million, Turks constitute by far the largest group of third-country nationals legally residing in the EU. Although the impact of Turkey's accession on migratory flows into the EU is a major issue, according to Ugur [2008: 19], the high-

9 The question of Turkey's accession became intertwined with the questions of identity and direction of Europe.

10 According to French President Sarkozy, Turkey is not European in its geography, culture, and history. And therefore it has no place in Europe. In Germany, Angela Merkel's Christian Democratic Union (CDU) was elected in 2005 on a pledge to block Turkish accession and propose "privileged partnership".

Table 4. Comparing the impact of Turkey with the previous enlargements (%)

	Increase in surface area	Increase in population	Increase in total GDP	Change in average per capita GDP	Average per capita GDP (EU15 =100)
From EU-15 to EU-25	23	20	4.7	–8.8	91.2
From EU-25 to EU-27	9	6	0.7	–4.3	87.4
From EU-27 to EU-27+TR	18	15	2.2	–9.1	79.4

Source: European Commission [2004].

est estimates of Turkish migration suggest that the Turkish migrant stock will constitute only 0.7 per cent of EU-15 population, which is equivalent to 1.1 per cent of the labour force. President of the European Commission J. M. Barroso [2010: 4] in his speech on 11 February 2010 stated that due to accelerated ageing, the working age population will be reduced by about 2 million by 2020, and the number of those aged 60+ is increasing twice as fast as before 2007. BusinessEurope [2010: 8], the Confederation of European Business, also emphasizes the demographic ageing as one of the five key challenges facing the EU. "As the European population ages, it creates a demand for new products and services in Europe. But from 2010, it will also result in a decline of the working-age population, with a loss of over 3 million potential workers by 2020 and over 50 million by 2060. If the EU continues to ignore this trend, the EU will not only undermine its social protection systems, but also lose business opportunities and the related jobs and growth". Turkey's relatively young population with an average age around 27 years and with an annual growth of 1.3% can be a valuable contribution to tackle this problem. The new generation is also quite different from 1960's Gastarbeiter profile who moved to Germany seeking work as part of a formal guest worker programme. The quality of education has improved enormously[11] and high labour productivity increases have been accomplished both in industry and service sector since 2002.

Improving the effectiveness of public services, restructuring the health and social security systems, improving energy infrastructure, increasing R&D activities and innovative capacity and increasing productivity in agriculture are some of the main structural challenges ahead. The agricultural sector remains relatively inefficient and highly labour intensive, characterised by unpaid family workers, which leads to a statistically lower rate of unemployment, and requires structural measures to bring into line with Common Agricultural Policy.

There is also the issue of EU's absorption capacity, meaning the institutional and budgetary impact of Turkey. First, the concerns regarding the institutional impact in the decision making mechanisms has been somewhat alleviated by the Lisbon Treaty, through double majority voting. Secondly, estimating the impact of Turkish membership on the EU budget is quite difficult, depending not only on the struc-

11 The net enrolment rate in compulsory education (8 years) increased by almost 10% to over 97%. The net enrolment rate in secondary education also increased, from 56% to 58% [Commission of the European Communities 2009].

ture of the future budget allocations, but also on the structural change in the Turkish economy.[12]

FROM MACROECONOMIC INSTABILITY TO FULFILLING THE MAASTRICHT CRITERIA

This section will try to analyse the present position of the Turkish economy, its transformation into a functioning market economy. Turkey was a closed economy with an import substituting industrialization strategy under high state intervention. Starting with the 1980s, under an IMF programme, the country changed its strategy to an export oriented growth model, which suffered from chronic macroeconomic instability in the 1990s and early 2000s, due to lack of adequate regulatory and institutional framework.

In an attempt to stabilise the economy, Turkey entered into an IMF stand-by agreement in December 1999, which was initially successful but as fiscal consolidation and structural reforms lagged behind, in October 2000, Demirbank, a major investor in government securities reached the point where it could no longer refinance itself on the market. The financial turmoil had disastrous consequences for the real economy, including GDP decline of 5.7% in 2001 and the increase in public debt following the depreciation of the lira. The resulting banking crisis affected about one quarter of the country's 81 banks and the external position weakened as foreign debt rose to almost 60% of GDP in 2000. This was exacerbated by the rise in short-term borrowing. To cope with the crisis, macroeconomic stabilisation and structural reforms were implemented under the 2002 IMF stand-by agreement and the National Programme for Convergence with the EU acquis. Thus the economy recovered via two external anchors; namely, the IMF programme and the prospect of EU membership.

The Turkish economy in the post-2001 era witnessed a successful transformation with an ambitious reform agenda to strengthen the financial sector, banking sector and social sector. The structural reforms implemented since 2001[13] can be grouped as: fiscal policy, monetary policy and incomes policy. The main target of fiscal policy was to implement fiscal discipline, formulating the budget and debt structure in line with the Maastricht criteria.[14] The main objective of monetary policy was to ensure price stability. The incomes policy was to support fiscal and monetary policies in harmony with inflation target. This resulted in a significant decline in the inflation rate. The average inflation rate was 62.7 % per annum between 1983 and 1994, 71.6 % per annum between 1995 and 2001. It declined to 12.5% per annum

12 Uğur [2008: 16] states that "estimates of net budgetary transfers to Turkey range between 5.6–24.6 billion Euros per year. This sum is a significant amount, but relative to the GDP of the Union, it represents a very small percentage, between 0.05–0.2 per cent".

13 The main economic reforms took place in fiscal and monetary policy, tax policy, financial sector prudential regulations, product market regulations, labour market regulations, capital markets, foreign direct investment, and privatisation of state-owned enterprises, infrastructure and agriculture.

14 The tight fiscal policy implemented since the 2001 crisis based on yielding large primary surpluses in order to reduce the public debt stock is being relaxed in the context of the economic crisis.

during 2002 to 2009. Annual inflation fell to 5.3% in August 2009 in line with the inflation targets but also due to lower energy prices and falling domestic demand. Six zeros were dropped from the Turkish lira and the New Turkish Lira was introduced on the 1st January 2005. Dropping six zeros from the Turkish lira was a clear indicator of the determination in bringing inflation to single-digit figures. The exchange rate was also successfully used for achieving price stability under the inflation targeting floating exchange rate regime.[15]

Political stability, fiscal discipline and stable growth, in addition to privatisation, resulted in reduced Public Sector Borrowing Requirement (PSBR) which led to a decrease in interest rates. With the increase of confidence levels in the markets, Treasury was able to raise the average maturity of domestic borrowing. The market mechanism and the efficiency in the private sector were strengthened,[16] the share of the public sector was reduced by privatisation[17] and public administration was restructured.[18] Market regulatory bodies were set up.[19] All these structural reforms improved the competitiveness of the Turkish economy, getting its macroeconomic indicators more in line with the Maastricht criteria. A concrete example is public sector borrowing requirement (PSBR) decrease from 12.1% in 2001 to 1.6% in 2008.

The banking sector reform[20] and measures taken to enhance the autonomy of the Central Bank were critical to the success of the programme. The reforms in the banking sector also resulted in attracting foreign capital into the sector. Turkish banking sector had a strong position against the 2008 global financial crisis, as many announced profit on their balance sheet both in 2008 and 2009.

As the result of structural reforms implemented; Turkey entered a high growth phase, which outperformed most of the European countries. On average, the Turkish economy managed to grow at a rate of 5.9% per annum during 2002-08 and has become the sixth biggest economy in Europe *(see figures 1 and 2).*

GDP per capita also rose from 2 500 US$ in 2000 to over 10 000 US$ in 2008, though still under the EU-27 average.

15 Foreign exchange rates will be determined by supply and demand conditions in the market and the Central Bank will not set any target for exchange rates. However, the Central Bank may directly intervene in the foreign Exchange market via buying or selling interventions on its own initiative, in order to prevent excess volatility in the foreign exchange rates.

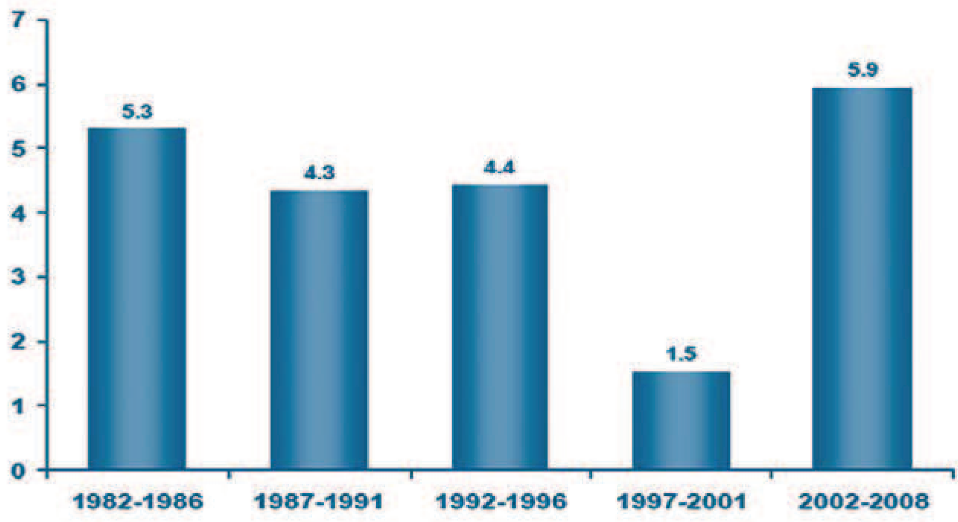
16 The private sector's share of GDP was around 89% in 2009.

17 The total volume of privatisation revenue reached 4.92 billion in 2008 (about 1.5% of GDP).

18 Restructuring of Public Administration: Public Financial Management and Control Law; extending the scope of budget; Budget Accounting Code System and Fiscal Transparency; Strengthening the Supervision and Auditing Base; Strategic Planning in public institutions; Local Administration Reform; Public Procurement Law / Public Procurement Authority; strengthening the statistical infrastructure; Enhancing the Administrative and Institutional Capacities of ISKUR and Turkish Patent Institute; Regional Development Agencies.

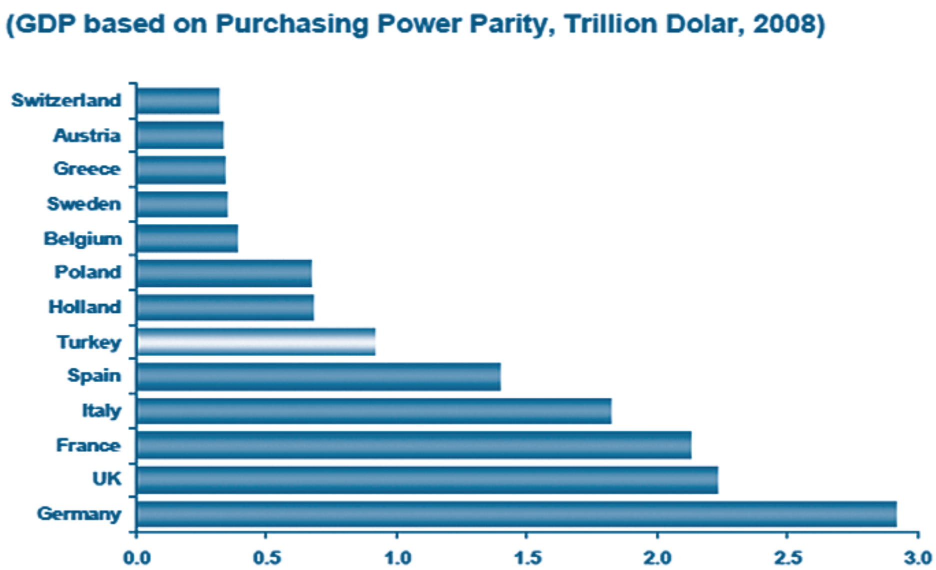
19 Banking Regulation and Supervision Agency; Telecommunications Authority; Energy Market Regulatory Authority; Tobacco, Tobacco Products and Alcoholic Beverages Market Regulation Authority; Sugar Authority.

20 Banking Regulation and Supervision Agency (BRSA) has the authority to take and implement all types of measures for the purpose of protecting the rights and interests of depositors, maintaining confidence and stability in the financial markets, ensuring that the credit system operates efficiently.



Source: Republic of Turkey Prime Ministry Under secretariat of Treasury [2010]

Figure 1. GDP Growth Rate in Turkey (Annual Average, %)



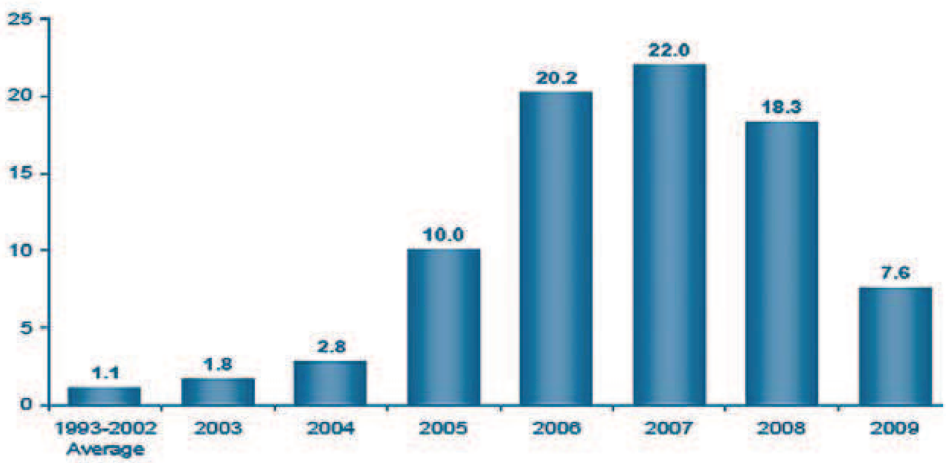
Source: Republic of Turkey Prime Ministry Under secretariat of Treasury [2010]

Figure 2. Europe's Largest Economies

The country's commitment to fiscal discipline in the post-crisis era constitutes another important component of macroeconomic stability. In the post-2001 era, budget deficit / GDP and public total debt stock/ GDP ratios have declined in line with the Maastricht criteria. Turkey outperforms many Euro-zone countries in terms of public debt management, as the country managed to reduce its stock of public debt from 73.7% of GDP in 2001 to 39.5% of GDP in 2008. The economic performance under the current economic crisis, in a way, validates the achievement of Turkey's structural reform process.

Competition Law, SME Strategy and Action Plan, legislation on telecommunication[21] and energy sector[22], all contributed to improving competitiveness of the economy. The contribution of the private sector fixed investment to GDP growth has increased gradually, from 0.6% during 1993-2002 to 2.3% during 2003-2008. As the business environment improved, Turkey's ranking in the World Bank's Doing Business reports improved from 84th out of 155 countries in 2005 to 73rd out of 183 in 2009, and its ranking in the Economic Freedom Index compiled by the Heritage Foundation from 112th out of 161 countries in 2005 to 75th out of 179 in 2009.

Although the CU was not a big impetus, the decision of December 2004 for the opening of negotiations on 3rd October 2005 had a definite positive impact on the FDI inflow, largely driven by inflows from privatisation. The International Finance Institute has announced Turkey as one of the main recipient countries for the inflow of FDI in 2005. Turkey ranked 22nd among top FDI attracting countries in 2005, up from 53rd in 2003 and 37th in 2004 [Republic of Turkey Prime Ministry Undersecretariat of Treasury 2006: 5]. The amount of FDI inflows[23] to Turkey after 2005 reached the level of 20 billion USD per annum, higher than the total recorded for the period between 1980 and 2000 as a whole. The help of an ambitious privatisation programme also had a major impact on the FDI inflow during 2002-2008. The amount of accumulated FDI reached about 76 billion USD, though compared with the FDI boom of central and eastern European countries during their accession process, it is very modest. Around 78% of FDI inflow to Turkey originated from EU member states, which illustrate the keen economic interest in the Turkish market. *See Figure 3* for more details.



Source: Republic of Turkey Prime Ministry Under secretariat of Treasury [2010]

Figure 3. Foreign Direct Investment Inflows (Billion USD)

21 Legislation on Telecommunications Sector: Arrangements in Information and Communication Technologies; National Roaming Regulation and Regulation on Access and Interconnection.

22 Legislation on Energy Sector: The Law on Electricity Market; the Law on Natural Gas Market; the Law on Oil Markets; the Liquefied Petroleum Gas (LPG).

23 The amount of portfolio investments is much less, which reduces the risk of speculative movements.

To conclude, one can assert that EU demands on "reducing inflation and fiscal sustainability" and reforms necessary to attain these has collided with Turkey's priority to ensure a sustainable growth while reducing inflationary pressures and bringing public sector deficit and debt ratios to EU averages. Therefore, the Progress report 2009 states "As regards the economic criteria, Turkey is a functioning market economy. It should be able to cope with competitive pressure and market forces within the Union in the medium term, provided that it continues implementing its comprehensive reform programme in order to address structural weaknesses" [Commission of the European Communities 2009: 33].

IMPACT OF THE GLOBAL CRISIS ON THE TURKISH ECONOMY

The negative effects of the global crisis on Turkey became apparent as the economy contracted in the last quarter of 2008 and in the first quarter of 2009. This was mainly the result of a severe drop in domestic and international demand. Due to the economic contraction, the unemployment rate rose sharply to 13% by mid-2009 and the sectoral shift from agriculture to industry and service sectors came to a standstill if not even temporarily reversed. The Progress Report 2009 points to the fact that "the share of agriculture in overall employment increased from 24.0% to 24.6% between December 2007 and December 2008" [Commission of the European Communities 2009: 33].

Macroeconomic stability has been largely preserved in spite of the severe global economic recession. The impact of the crisis was largely limited to the real sector of the economy. The banking sector has shown outstanding resilience to the global financial crisis, basically due to the prior reforms in the regulatory framework. The government has also adopted a number of measures to mitigate the potential shocks that may arise from the financial crisis. In total, stimulus measures amounted to about 5.1% of GDP.[24] The stimulus packages included the provision of zero-interest loans for SMEs, a tax break for local investors in equities, inducements for Turkish citizens to repatriate savings held offshore, package supporting domestic demand by cutting taxes on the sale of cars, office furniture, IT, houses and machinery used by SMEs for a certain period. The Central Bank maintained the formal inflation targeting regime, and took several measures to ease foreign exchange liquidity in the banking sector, by re-opening the inter-bank foreign exchange deposit market, extended maturities and volumes for the deposits that it places on this market, and other necessary measures. "Overall, the unfolding of the crisis did not jeopardise the functioning of market mechanisms and Turkey continues to be a functioning market economy" [Commission of the European Communities 2009: 37].

24 €27 billion during 2008–2010.

CONCLUSION

Trade and investment have been the two key factors in Turkey's relations with the EU from the beginning. And moreover, it was only the economic perspective of Turkish accession which has been looked upon more favourable, because the country is an important market for EU goods, services and its investment. However, the country's atypical position as being the only country to conclude a customs union with the EU without being a full member has brought about both opportunities and challenges. Practically, Turkey became part of the internal market for industrial goods and took over substantial parts of the acquis regardless of what happens on the accession front. The CU has facilitated the transformation of Turkish industry and modernisation of Turkey's economic legislation, thus contributed to its competitiveness and integration with the global economy. On the other hand, the CU has been far from fulfilling the country's expectations in vital aspects such as adequate financial assistance and the eventual inclusion of agriculture and services. Besides, not being in the decision-making mechanisms of the EU concerning external economic relations, Turkey does not have a voice in the free trade agreement negotiations with the third countries, some of which are trade competitors of Turkey. Therefore, such an asymmetrical relationship is unsustainable in the long term if the country's full membership is not realized.

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