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Is Turkey an Economic Exception ?

Conference report from the roundtable organized at Ifri on December 6th, 2011

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IS TURKEY AN ECONOMIC EXCEPTION?

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***Speakers** :*

François FAURE, head of country-risk division at BNP-Paribas

Esen ÇAĞLAR, economist at the Economic Policy Research Foundation of Turkey (*Türkiye Ekonomi Politikaları Araştırma Vakfı* - TEPAV)

Deniz ÜNAL, economist at the *Centre d'Etudes Prospectives et d'Informations Internationales* (CEPII)

Rémi BOURGEOT, expert on emerging economies.

Summary:

This roundtable dealt with the specificities of Turkey's economy, which is completing major economic achievements in particularly difficult times. François Faure analyzed the risks of an economic backlash following the European crisis; Turkey appears indeed in a weaker position than in 2008 and difficult times could lie ahead. Esen Çağlar pointed out how Turkey progressed from a low-technology to medium-technology economy, thus ensuring considerable levels of growth. Yet, a renewed reform agenda is needed if Turkey wants to maintain its economic performance. Deniz Ünal addressed the issue of economic governance under the AKP and the consistency of their economic policy agenda. In any case, Europe will most certainly play a role in the country's economic future. According to Rémi Bourgeot, the Middle East cannot provide an alternative to European markets even if it offers interesting opportunities for the Turkish South East. Turkey's future growth will also depend on its capacity to impose itself as a corridor between Europe and its neighbours energy resources.

CONTEXT

In a context of severe global crisis, the Turkish economy kept recording impressive growth rates over the last two years (8,9% in 2010, IMF forecast 6,6% for 2011). Turkey is the world's 17th economy and is now knocking at the BRICs door. While Western countries have to face enduring economic slowdown, Turkey's resilience appears as a miracle by contrast.

Such a paradox was recently pointed out by Ali Babacan, Turkey's minister of State in charge of Economy. Speaking on December 3rd, 2011 at the Second Global entrepreneurs summit, a U.S. inspired gathering of students and young entrepreneurs devised to encourage American-style business in Muslim countries, Babacan declared that Turkey with its growth would win in the 21st Century against America or Europe: "The fast fish, not the big fish, eats the small fish," Babacan said, apparently hinting at Turkey's impressive catching up with the leading economies of the world. Furthermore, the Turkish leadership has made it clear that it aims to rank amid the top ten by 2023.

This roundtable purpose was to identify and discuss the Turkish assets and resources that can be mobilized to pursue such an ambitious objective, and also the strategies elaborated to support the country's growth on the medium term. To what extent an economy still strongly anchored to Europe can further avoid the turmoil and remain a fast fish? How did Turkish public policies contribute to this growth and what type of governance leap should be accomplished to sustain it in the future?

FRANÇOIS FAURE: "TURKEY IN A WEAKER POSITION THAN IN 2008"

To address these issues, one first has to look at short term figures. The prospects presented by François Faure, Head of the country risk analysis at bank BNP-Paribas, are qualified. From a strictly macroeconomic point of view, the Turkish economy is in a weaker position than in 2008 to withstand the global slowdown.

Turkey's growth is indeed less balanced than it was in 2008. Today, Turkey has to import more in order to meet its domestic demand. The net external demand has dropped from 0 to -5% over the last 3 years (see chart on Faure's PowerPoint, *slide 4*). In the case of an external shock (which is most likely to occur for Turkey in 2012), unbalanced growth is usually followed by a marked recession. The increase in domestic demand was sustained until now by a booming credit expansion and a high current account deficit (10% of the GDP, a record-high in Turkey). Even with energy left aside, there is a structural trade deficit in Turkey (*slide 5*). Besides, there is less room to manœuver for economic policies, especially on the monetary front, where the Turkish Lira is currently depreciating while the real interest rates are close to zero. And if there is some room for budgetary policy, the use of this instrument is threatened by the current account deficit. Turkey also has a more fragile external financing profile. Credit has exceeded the deposits and Turkish banks have to borrow externally to meet domestic demand. Yet the level of external financing is bound to decrease. In fact, there has been a catch-up in the last years. Corporates in Turkey can now obtain foreign exchange index loans from local banks: a lot of deposits have thus been re-appropriated in the country. In the future we cannot forecast such large amount of deposits to grow outside the country (*slide 11*). Turkey's external financial vulnerability is nonetheless still high due to the amount of hot money invested in the country, (purchases of equities and government securities by non-residents). A last negative aspect is that most of the Turkish banks' external debts are located in Europe.

However, on the bright side, Turkey can rely on sounder public finances (lower budget deficit, low debt to GDP ratio). There is also a strong level of fx liquidity, a moderate public and private indebtedness, and an active fx-risk management by banks. Finally, a balance of payment crisis is very unlikely. Nevertheless the main danger for Turkey is credit risk because of the past credit boom and the current level of fx indebtedness of the corporate sector.

ESEN ÇAĞLAR: A VERY SPECIFIC ECONOMIC PROFILE

Peculiarity is a word that seems to suit well the Turkish economy. In order to show its specificity Esen Çağlar, economist at TEPAV (The Economic Policy Research Foundation of Turkey, *Türkiye Ekonomi Politikaları Araştırma Vakfı*), pointed out how in 2009 Turkey was among the fastest contracting economies, while it ranked among the fastest growing economies again in 2010. Turkey's economic story is indeed a bit odd since it faced a complete transformation since the 1980s. It has succeeded in becoming a medium-technology economy: while it was traditionally selling mostly agricultural products, its top-5 export items are by now cars, machinery, automotive, electronics, textiles etc. Besides, Turkey's economy is diversified and not sector alone is dominating. Urbanization has played a large role in the average growth (+4% since the 1980's), reaching levels comparable to Europe.

Thanks to its policy reforms in the 1980's (price reform; financial liberalization; trade liberalization; convertibility of the Turkish lira) and the EU process and other reforms passed in the 2000's (Banking reform, privatization, fiscal and monetary discipline…) Turkey has overpassed Arab countries in terms of GDP per capita. Yet, it has not achieved income convergence with Europe: Turkey's GDP per capita is 40% of the French one, up from 30% in 1980, and a country like South Korea, who was at the same level in the 1980s has outperformed Turkey (see Çağlar's Powerpoint, *slides 6-10*). This gap can be explained with the lack of "second generation" reforms, still to be implemented in Turkey: Public administration reform and decentralization, tax reform and the struggle against informality, solving operational problems of the national legal system, education reform and vocational training, reducing labor market rigidities, health reform etc.

Therefore, it is unlikely for Turkey to enter the top 10 economies before 2023 (the 100th anniversary of the Turkish Republic), as claimed by all political parties in their electoral program in 2011. Attaining such a goal would require a steady growth of 6% per year. Drastic improvement would also be needed in three domains. The first one is productivity: an average Turkish worker produces 32.000$/year against 100.000$ for a French worker. Turkey would thus have to double at least its productivity. It certainly has the demographic resources to do so since it presently faces a demographic window of opportunity. The Turkish population average age is 28 and a lot of young Turks will not retire before another 20-40 years. The second huge challenge lies with the female labor force (only 24% of the labor force is female in Turkey, *slide 14*). There is also a massive need on the education front, since the average number of years of education is only 6.5 in Turkey (against 10.4 in France, *slide 15*), and most important of all, Turkish scores at the PISA levels (OECD Programme for International Student Assessment) are very low, even though some progress has been made in the last years.

To sum it up, Turkey has successfully become a medium-technology economy. Its main objective should now be to improve the quality of education for the Turks if it wants to move beyond and become a high-technology economy. Education, innovation, high-quality exports are the next challenges for Turkey. There are indeed economic risks, as François Faure listed, but the most obvious risk is to lose focus. According to Çağlar, the only reform that was successfully implemented since 2007 in Turkey is the ban on smoking. If Turkey wants to keep attracting funds in a rather gloomy global economic context, it will have to put reforms back on track. Internal political constraints are *de facto* a great threat in that regard.

DENIZ ÜNAL: GOVERNANCE AND ECONOMIC POLICIES IN TURKEY

As far as economic policies are concerned, the main change in the last 10 years has been the enduring political stability achieved in Turkey. According to Deniz Ünal, economist at the Paris-based Centre d'Etudes Prospectives et d'Informations Internationales (CEPII), coalition governments, inflation, debt and economic crisis used to be Turkey's routine. When the AKP (Justice and Development Party, Adalet ve Kalkınma Partisi) came to power in 2002, almost by accident, they had neither a proper economic program, nor the relevant personnel to enforce an economic policy. The country had just faced a massive economic crisis and was almost under the tutelage of the IMF.

With a great deal of pragmatism, they endorsed the reforms introduced by Kemal Derviş, a former World Bank executive who briefly featured as minister for the Economy between 2001 and 2002. Major reforms were thus completed, such as the reduction of public debt and the restructuration of the banking system. Ensuring the independence of the Central Bank was also an important step forward to implement consistent economic policies. Turkish companies could work for the first time in a rather secure environment, with proper access to capital. Capital risk has notably dropped during that period. These economic achievements were AKP's best political asset for the 2011 general elections.

Nevertheless, these important changes that helped sustaining high level of growth rates should not conceal the lack of micro-economic reforms. One main difficulty is the resistance of informal activity and insufficient employment regulation. As Çağlar pointed out, workers' qualification and the rate of women employment remain at historically low levels. Indeed new players, such as Anatolian companies, are now participating in the national economy and providing growth, but micro-economic changes must follow suit if Turkey wants to maintain its growth on the longer run.

RÉMI BOURGEOT: CAN TURKEY DO WITHOUT EUROPE?

One of the available explanations accounting for recent Turkish performance would supposedly be Turkey's distancing itself from Europe and gaining alternative markets, especially in the Middle East. Rémi Bourgeot, an economist expert on emerging countries, thus tackled the theme of the Turkish economy's progressive "orientalisation".

Indeed, there would be no point in denying that Europe's crisis could hamper the development of Turkey/EU economic relations. Turkey's attempts to explore alternatives to European demands are legitimate in such a depressing context. In the last 10 years, the Middle East rose from approximately 10 to 20% share in Turkish external trade. Yet, talking about "orientalisation" does not really make sense. The EU still accounts for half of Turkey's exports, around 40% of its imports and half of FDIs directed to Turkey come from Europe. Besides, Turkish trade with the Middle East is not of the same nature as Turkey/EU economic ties: it is not composed of the same type of products and comes from different regions. Turkey's North, with the industrial region of Bursa, essentially produces industrialized goods that are exported towards Europe. Turkey's South, mostly around Gaziantep, is specialized in low-technology products like cement and exports to the Middle East, especially Iraq. Hence we are not talking about the same structures and there is no substitution between one and the other; they can at best be complementary.

The idea of an "orientalisation" of Turkey's economy has also been supported by the AKP's Middle Eastern diplomatic moves and policies, notably the visa lifting and the Free Trade Agreements (FTA) signed with Syria, Iran, Iraq… There was even a discourse on economic integration *à l'européenne*: Erdoğan brought up the idea of a "*Şamgen*" union, in reference to the *Shengen* zone (Şam meaning Damascus). Yet such prospects seem to be rather far-fetched given the economic disparity and the diversity of political regimes in the region, not to mention the high current political tensions.

In fact, energy is the most important factor driving Turkey's relations with its non-European neighbors. The "zero problem" policy was notably aimed at pacifying relations with energy-provider countries so that Turkey can trade more easily with them. In order to reduce the energy burden (which weights a lot on the current account deficit), Turkey tried to export its middle-technology goods: textile, construction... to countries that were important energy producers and financially solvent. In geopolitical terms, one of the objectives of Turkey's Foreign Policy is to position itself as a regional hub. Located between the main energy resources (Russia, Central Asia, the Middle East), Turkey shares the same essential goal as its neighbors: transporting energy to Europe via Turkey. At the end of the day, the paradoxical outcome of this hub strategy is that it might turn Turkey even more dependent on European demand.

Q/A:

- **Can Turkey be considered as an economic success story?**

Thanks to a closed economy, major Turkish companies emerged and were able to compete internationally when the economy was opened in the 1980s. Today, Turkey's economy is dominated by the private-sector, with main conglomerates leading the way. Ünal noted how the most important groups, gathered in TÜSIAD (Turkish Industrialists' and Businessmen's Association, *Türk Sanayicileri ve İşadamları Derneği*) provide a model not only in terms of economic development but also to encourage women's labor (TÜSIAD's current president, like its predecessor, is a woman). Nevertheless, if Turkey has succeeded in becoming a medium-technology economy, more needs to be done to acceed the next level. The reform agenda should be pursued seriously if Turkey wants to keep growing.

- **Can we forecast the emergence of national *şampiyons (champions)* with the rise of Turkish FDI abroad?**

Çağlar warned against lacks in the economic environment that could prevent Turkey's main companies to produce sophisticated goods and grow worldwide. A bad performing tax system, informal activity, bureaucracy are still blocking economic development in Turkey. A major leap in the conception and implementation of economic policies is still needed in order to support Turkish companies on the international level.

As far as investment abroad is concerned, even though there are some successes (Gründig bought by Beko, Godiva acquired by Yıldız Holding…), there is a also need of a real investment policy. At the moment, the only large scale investment program abroad is about rebuilding ancient ottoman mosques and houses.

- **Whither Turkey's economic relations with the Middle East?**

The economy is now being used by the AKP as an instrument of foreign policy. Turkey has become a major economic power in Iraq; Economic sanctions were recently announced against Syria (even though they will apply to small trade quantities), and the relationship with

Iran is essential to secure Turkey's energy needs. In fact Turkey is very keen on engaging economically with Iran, as it can help lowering its dependency on Russian gas (which amounts to more than 60% of Turkish gas imports). Yet, significant challenges lie ahead. The lack of energy is a major disadvantage for Turkey and the recent upheavals in the Arab world cast uncertainty to the prospect of energy transportation from the Middle East to Europe via Turkey. The Kurdish issue could also be a destabilizing factor both at the internal and external level.

- **Does the Prime Minister manage economic policy alone, or does he rely on a broader team of decision makers?**

One has to stress that Prime Minister Erdoğan is not the only leading figure in the AKP. President Abdullah Gül is also a prominent personality who could also take responsibilities should the necessity arise, as already happened in the past (Gül was briefly Prime Minister in 2002, when Erdoğan was temporarily impeached to do politics). The AKP's economic policies have been relatively pragmatic so far, but it remains to be seen if the party will stick to its reform agenda, which was apparently left apart over the last years.

- **Does Turkey compete economically with France?**

Politics affect negatively Turkish-French economic relations. President Sarkozy's decision to block Turkey's EU membership bid and France's position on the Armenian genocide have in certain cases excluded French companies from call for tenders in Turkey. Furthermore, in regions like the Caucasus, Central Asia and especially in Africa, Turkish companies are gaining economic grounds, sometimes at the expense of French companies. Nevertheless, France is an old-time economic partner of Turkey and one of the main investors in the country: the Renault-Oyak partnership is one example among many. The two economies complement each other: France and Turkey can thus be partners in terms of high technology products and compete as far as low and middle-technology products are concerned.