Turkey and the benefits of supranational regulations

What is the impact of European integration?

GÜL ERTAN ÖZGÜZER

IZMIR UNIVERSITY OF ECONOMICS

Report finalised in December 2012.
Published in April 2013.

IPEMED
- Institut de Prospective Économique du monde Méditerranéen -

IPEMED
- INSTITUT DE PROSPECTIVE ÉCONOMIQUE DU MONDE MÉDITERRANÉEN -

IPEMED, the world Mediterranean Economic Foresight Institute, is a non-profit organisation, which strives to integrate the countries of the North and South of the Mediterranean via economic means. Since its creation in February 2006, it raises awareness of the common future and interests of the Northern and Southern countries of the Mediterranean. IPEMED adheres to the principles of political independence and North-South parity in its governance and operations. It accords priority to the economy, favours an operational approach to projects, and works to a long-term perspective.
Radhi Meddeb is the President of IPEMED; Jean-Louis Guigou, his founder Delegate General.

CONSTRUIRE LA MÉDITERRANÉE

La collection *Construire la Méditerranée* a été créée en 2009 par IPEMED. Les experts d'IPEMED, originaires des deux rives de la Méditerranée, y croisent leurs réflexions pour contribuer au débat sur les grandes problématiques méditerranéennes, féconder une nouvelle approche des relations Nord-Sud et formuler des propositions utiles aux populations des pays du Bassin méditerranéen.

Les études publiées dans la collection *Construire la Méditerranée* sont validées par le Comité scientifique d'IPEMED. Elles sont disponibles sur le site Internet d'IPEMED. **www.ipemed.coop**

DÉJÀ PARUS

Région méditerranéenne et changement climatique,
Stéphane Hallegatte, Samuel Somot et Hypahie Nassopoulos, 2009

Eau et assainissement des villes et pays riverains de la Méditerranée,
sous la direction de Claude Martinand, 2009

Méditerranée 2030. Panorama et enjeux géostratégiques, humains et économiques,
Guillaume Alméras et Cécile Jolly, 2010

Convergence en Méditerranée,
Maurizio Cascioli et Guillaume Mortelier, 2010

Méditerranée : passer des migrations aux mobilités,
Pierre Beckouche et Hervé Le Bras, 2011

Régulations régionales de la mondialisation. Quelles recommandations pour la Méditerranée ?,
coordonné par Pierre Beckouche

Demain, la Méditerranée. Scénarios et projections à 2030,
Coordonné par Cécile Jolly et réalisé avec le Consortium Méditerranée 2030

Tomorrow, the Mediterranean. Scenarios and projections for 2030,
Coordinated by Cécile Jolly and produced with the Mediterranean 2030 Consortium

Partenariats public-privé enMéditerranée. État des lieux et recommandations pour développer les PPP dans le financement de projets dans le Sud et l'Est de la Méditerranée.
Nicolas Beaussé et Michel Gonnet, 2011

La confiance dans la société numérique méditerranéenne : vers un espace.med
coordonné par Laurent Gille, Wahiba Hammaoui et Pierre Musso

Partenariats stratégiques pour la sécurité alimentaire en Méditerranée (Psam)
CHAPITRE I ***État des lieux***
Nahid Movahedi, Foued Cheriet, Jean-Louis Rastoin, 2012
CHAPITRE II ***Besoins et opportunités des coopérations inter-entreprises agroalimentaires en Méditerranée***
Foued Cheriet, Jean-Louis Rastoin, 2012
CHAPITRE III ***La situation céréalière en Méditerranée. Enjeux stratégiques et éléments de prospective***
Nahid Movahedi, Foued Cheriet, Jean-Louis Rastoin, 2012

Pour une politique agricole et agroalimentaire euro-méditerranéenne
Jean-Louis Rastoin, Lucien Bourgeois, Foued Cheriet et Nahid Movahedi, avec la collaboration de Fatima Boualem, 2012

Les dynamiques des ressources agricoles en Méditerranée
Foued Cheriet, Nahid Movahedi, Jean-Louis Rastoin, avec la collaboration de Fatima Boualem, 2011

Le rôle des firmes touristiques dans le développement du tourisme au Maroc
Maxime Weigert, 2012

TABLE OF CONTENTS

EXECUTIVE SUMMARY

THROUGHOUT HER LONG-LASTING relationship with the European Union (EU), Turkey has undergone major changes. First, in order to establish a Customs Union (CU) with the EU, Turkey made significant changes in trade policy as well as in legislation in order to harmonize with the EU in specific areas such as competition, industrial and intellectual property rights. Second, upon recognition of her candidate status at the Helsinki Summit in 1999, Turkey followed a drastic political reform agenda to fulfill the Copenhagen Political Criteria and, accordingly, to initiate accession negotiations. Moreover, economic recovery program initiated following the economic crisis of 2001 under the surveillance of the International Monetary Fund (IMF) and the World Bank, with the full support of the EU, paved the way for a radical structural reform process. Finally, the opening of accession negotiations in 2005 and the ongoing negotiation process over thirty-five chapters, including intellectual property and company law, environment and climate change, with the European Commission has helped Turkey comply with EU standards and norms. As a result of this intensive reform process, Turkey has become an important player in the world economy.

This project has been undertaken to give an overall view of the economic impacts of the reform process undertaken by Turkey in her bid for EU membership and draw up recommendations for the countries involved in the Euro-Mediterranean Partnership (EUROMED) from the experience of Turkey, based on a set of interviews conducted with major players of the Turkish economy.

The CU was a milestone in Turkey's trade liberalization efforts and had great repercussions for the performance and structure of Turkey's foreign trade, as well as her production patterns. Provisions of the CU agreement liberalized Turkish domestic markets and brought predictability, transparency and stability to trade policy, which in turn increased competitiveness of Turkish producers. Turkish industry was able to adapt to the new trade conditions and proved its capacity to cope with competitive pressures and market forces. The increase in the competitiveness of Turkish manufacturing industry contributed to this success. Moreover, Turkish exports underwent a structural change, shifting from low technology sectors to medium technology sectors. Yet, the task is far from complete, as the share of high technology products in Turkish exports remains very low.

Turkey's evolution into a market economy and her relatively good performance after the 2001 economic crisis compared to the previous decades cannot be solely attributed to the EU membership anchor, although this undoubtedly played a significant role in the transition. Along with the EU anchor, many other factors such as the political power's loss of legitimacy in the eyes of the Turkish public in the economic arena, the pressure of the IMF and the World Bank as well as the strong support of the Turkish private sector after Turkey hit the bottom in 2001, gave rise to the reforms that moved Turkish economy further. Without the EU membership anchor, however, the reforms would not have been adopted so rapidly.

Two main macroeconomic reforms pursued in the post-crisis era – Central Bank (CB) independence and establishment of independent regulatory agencies (RAs) – led to a transformation in Turkey's institutions, giving a regulatory role for the state. Two accompanying reforms – financial sector restructuring and enhancement in fiscal policy – helped bring stability to the Turkish economy. In fact, the acquisition of good institutions providing a well-functioning competitive market economy, secure property and intellectual rights, the rule of law and democracy, ensures long-run economic growth and hence the convergence of living standards with those of advanced countries. However, Turkey still seems to have a long way to go to reach her final aim. Good economic outcomes upon the first stage of reforms and the fading away of the EU membership anchor seems to have encouraged the government to retreat from the reform policy agenda and even to move in the opposite direction of *de jure* rules for *de facto* implementation. Major concerns are the practice of the government in the construction industry against competition law and fiscal transparency and amendments in the legislation threatening the independence of regulatory agencies. Moreover, Turkey is polarized by antidemocratic actions of the government contrary to the political reforms once followed in order to meet political Copenhagen Criteria. The practices of the government, stimulated by religious motives both in domestic and foreign politics, and the rising conservatism in Turkish society also raise concerns. Structural weaknesses of the economy with the potential to stagnate productivity growth, the driving force behind Turkey's spectacular economic growth performance during the last decade, are the warning signs that call for further reform efforts.

Therefore, it may be early to conclude that Turkey is a complete success story and, hence, a model for the other countries involved in the EUROMED regional integration, before considering the Turkish long-run economic growth. The Turkish experience highlights the issue of whether the pressure of external forces alone, without a change in mentality spread to the whole society, is able to create good institutions capable of providing economic growth and development.

INTRODUCTION

ON HER WAY TOWARD membership to the EU, Turkey pursued economic as well as political reforms, undergoing a major structural transformation. The reforms regarding "free movement of goods" and "customs union" issues had already begun before the CU agreement with the EU went into effect in 1996. According to the provisions of the CU agreement, apart from abolishing trade restricting measures such as tariffs and quotas, Turkey increased her efforts to harmonize her legislation with that of the EU in specific areas such as competition, state aids, public procurement, industrial and intellectual property and technical barriers to trade. The recovery program, the so-called "Transition to a Strong Economy", was launched after the deep financial crises of 2000 and 2001 and paved the way for tight banking and fiscal policy reforms. Moreover, the granting of institutional independence to the CB and the establishment of several regulatory agencies (the Capital Markets Board in 1982, the Competition Board in 1995, the Banking Regulation and Supervision Agency in 1999, the Energy Market Regulatory Authority in 2001, the Public Procurement Authority in 2002, etc.) reshaped the macroeconomic sphere of Turkey. On the other hand, the political reforms required for the fulfillment of the Copenhagen political criteria, such as the abolishment of death penalty and provision of non-Turkish speaking minorities with broadcasting and limited educational rights accompanied economic reforms after 2002. Furthermore, the opening of accession negotiations in 2005 and ongoing "chapter by chapter" negotiation process with the European Commission has helped Turkey comply with EU standards and norms and transform the structure of her economy.

The volume of exports and imports started to follow an increasing trend in the aftermath of the CU. However, both exports and imports surged after the 2001 economic crisis, increasing by almost four and five folds and reaching 135 billion and 241 billion dollars in 2011, respectively. The liberalization of the domestic market forced Turkish producers to change their attitude and to increase their competitiveness. Turkish industry was able to adapt to the new conditions of trade and proved its capacity to cope with competitive pressures and market forces. Two factors, productivity growth in Turkish manufacturing industry, especially in import competing sectors, as well as the shift of exports from low-technology sectors (textiles, wearing apparel, food products) to medium-technology sectors (machinery equipment, automobile) allowed the Turkish economy to integrate into the production chains of the EU. New markets were available for Turkish exports and new import products were available to Turkish consumers, who were able to benefit from greater diversity of goods at lower prices and higher quality.

The transformation process and Turkey's official status as an EU candidate country made the economy more attractive for foreign investors. To illustrate, before 2005, the average annual foreign direct investment (FDI) was less than one billion dollars despite the CU and Turkey's greater export-orientation. However, in 2005, FDI inflows increased to 9.6 billion dollars, reaching 13.4 billion dollars in 2011.

All in all, in order to develop a market economy Turkey has gone through a series of efforts to integrate with the EU, ranging from political reforms adopted to fulfill the Copenhagen Criteria to changes in the way her government and legal system operate, as well as economic reforms. After going through this intensive reform process, Turkey has become an important player in the world economy.

The aim of this project is to give an overview of the economic impacts of the reform process that Turkey went through on her bid for the EU membership and draw up recommendations for the other countries involved in the EUROMED regional integration from this experience, based on a set of interviews conducted with major players of the Turkish economy. More specifically, the objective of the project is to answer the following three questions:

- What are the main transformations Turkey has gone through on her way toward integrating to the acquis? Are these transformations the key factors or only facilitators of Turkish growth?
- What are the positive as well as negative economic impacts of these cumbersome and costly transformations?
- What lessons can be drawn from the Turkish experience and can these lessons be applied to other countries involved in the EUROMED regional integration?

The first stage of the project was to conduct interviews with 11 major Turkish players – five economic stakeholders, three economists and three regulation specialists[1]. The interviews were intended to get a grasp of the respondents' views regarding the three questions that the project aims to answer. Thus, a request for an interview along with the list of questions that the respondent would be questioned during the interview was sent to the major Turkish players via e-mail[2]. Upon approval, each interview was conducted on-site with the respondents[3]. The interviews that lasted between 30 and 120 minutes covered the most effective and significant reforms affecting the economic sphere of Turkey, the role of Turkey's bid for EU membership on her economic performance and the recommendations of the respondents for the other countries involved in the EUROMED regional integration that could be drawn from the Turkish experience. The results of this series of interviews provided a valuable basis for the project report. As the respondents gave only a general view about the issues covered in the interviews, data, academic works and policy reports have been used to support these findings. Considering that all the respondents see the CU agreement with the EU as a milestone in Turkey-EU relations that paved the way for extensive measures concerning, but not limited to, trade, which had significant repercussions on production, consumption and trade patterns of Turkey, this report devotes a special attention to the effects of the CU. Because this reform process comprises a wide span of reforms ranging from education and culture to financial and budgetary provisions and it is beyond the scope of this study to deal with the technical details as well as effects of each reform, only those emphasized by the respondents as having a significant effect are elaborated.

1. The list of respondents is provided in Appendix 1.
2. The list of questions sent to the major Turkish players and used during the interviews is provided in Appendix 2.
3. Ramazan Yıldırım, the deputy Undersecretary of Ministry of Science, Industry and Technology, instead of giving an interview, sent a note comprising his answers to the questions that would be posed to him during the interview.

The remainder of this report is structured as follows. Section 1 presents a brief literature review. Section 2 discusses the history of Turkey-EU relations and the reform process, first focusing on the CU agreement and its economic impacts and secondly, on the reforms in the post-crisis era. Section 3 presents a general evaluation of the Turkish economy with an emphasis to the prospect of EU membership. Section 4 derives lessons from the Turkish experience for the other countries involved in the EUROMED regional integration.

1 Literature Review

THROUGHOUT HER LONG-LASTING relationship with the EU, Turkey has undergone major changes. First, in order to establish a CU with the EU, Turkey had to make significant changes in trade policy as well as in legislation to harmonize with the EU in specific areas such as competition and industrial and intellectual property. Second, upon recognition of her candidate status at the Helsinki Summit in 1999, Turkey followed a drastic political reform agenda to fulfill the Copenhagen Political Criteria and accordingly to initiate accession negotiations. Moreover, the economic recovery program initiated following the economic crisis of 2001 under the surveillance of the IMF and the World Bank and with the full support of the EU, paved the way for a radical structural reform process. Finally, the opening of accession negotiations in 2005 and the ongoing negotiation process over thirty-five chapters, including intellectual property and company law, environment and climate change with the European Commission has helped Turkey entangle with EU standards and norms. Thus, the transformations undergone in order to comply with the acquis is wide in scope. Moreover, quantifying the effects of these transformations is a hard task. To the best of our knowledge, there is no econometric study that directly analyzes economic impacts of Turkey's integration of the acquis. The quantitative studies that analyze various economic impacts of Turkey-EU relations either evaluate the economic effects of the CU agreement, or the future likely economic impacts of expanding the CU to a deeper integration such as full membership to the EU.

The following two studies, undertaken just after the CU went into force, focus mainly on the likely effects of the CU agreement. Using a static computable general equilibrium model, Harrison, Rutherford and Tarr (1997) estimate Turkey's annual gain from the CU agreement to vary between 1 and 1.5 percent of GDP. In contrast, Mercenir and Yeldan (1997) conclude, in the framework of a calibrated general equilibrium model, that Turkish economy would be affected negatively by the CU, due to the fall in terms of trade, which stems from Turkey's removal of tariff rates. Moreover, they argue that full membership to the EU and, accordingly, abolition of non-tariff barriers would be more beneficial for theTurkish economy.

The focus of the following strand of literature is to predict the likely effects of expanding the CU to a deeper integration by performing numerical simulations. Bekmez (2002) suggests that the Turkish economy will be better off with a deeper integration with the EU in the form of removal of non-tariff barriers and harmonized external tariffs relative to the CU. Nowak-Lehman et al (2007) performed simulations in an extended gravity framework to quantify the impact of expanding the CU to all excluded products, such as agricultural goods. Their results suggest that inclusion of agricultural goods into the CU would lead to a significant increase in agricultural exports. Assuming that trade intensity between Turkey and the EU will increase upon Turkey's accession, Flam (2003) and Togan (2005) predict that full EU membership would increase potential trade flows between Turkey and the EU. Employing a global trade analysis project, Sulamma and Wingren (2007) also suggest that Turkey would benefit from the EU accession in terms of both welfare and output. Lejour and De Mooij (2004) employ a sectoral computable general equilibrium model for the world economy to calculate the economic effects of Turkey's accession to the EU on both parties. Similar to Flam (2003) and Togan (2005), they find that Turkish accession would increase trade flows with the EU. Moreover, their results indicate that the effect of accession to the European internal market, namely, abolishment of non-tariff barriers, are positive and significant for the Turkish economy and positive but meagre for the EU member countries. They also simulate the potential improvement in Turkish institutions resulting from institutional reforms triggered by the EU membership, which in turn implies an increase in Turkey's competitiveness. Their empirical findings suggest that the positive macroeconomic effects of institutional reforms on Turkey are much larger than those of accession to the internal market. Furthermore, they find that institutional reforms not only have positive impact on Turkey but also on the EU. Also, in a dynamic general equilibrium framework, Ertan Özgüzer and Pensieroso (2010) suggest that the improvement of Turkish institutions due to the accession process is welfare enhancing for both Turkey and the EU. Their analysis rests on the hypothesis that adherence to the Copenhagen Criteria and compliance with the acquis leads to an overall improvement in Turkish institutions, which in turn increases productivity in Turkey.

There are also studies which analyze the effects of the CU on Turkish trade. Neyapti et al (2007) employ for the period 1980-2001 an unbalanced panel data set involving more than a hundred and fifty countries to analyze Turkey's trade with all her trading partners. Their regression analysis suggests that after controlling for the real exchange rate and income effects, the CU significantly increased Turkey's overall trade. Their empirical findings also indicate that income elasticities of trade fell over the CU period. Applying a gravity model, Antonucci and Manzocchi (2006) scrutinize Turkey's merchandise trade over the period 1967-2001 to assess whether the preferential treatment of the EU towards Turkey lead to a special relationship between the two parties, but find no robust evidence of additional trade between Turkey and the EU over the CU period.

2 History of Turkey's Bid for Accession to the EU and the Reform Process

The CU Agreement and the Corresponding Reforms

THE LAUNCH OF TURKEY-EU relations goes back to 1959 when Turkey applied for membership to the EU (né European Economic Community). In 1963, the Ankara agreement, creating an association between Turkey and the EU, was signed, which envisaged a three-phase process to establish a CU between the two parties. The first (preparation) phase, which covered the period 1963-1970, was aimed at strengthening the Turkish economy and the EU provided financial assistance. The second (transition) phase started with the Additional Protocol of 1970 and the EU removed all tariffs and quantitative barriers to the imports from Turkey, with some exceptions, including the most important import item of Turkey to the EU, textiles and wearing apparel. Turkey agreed to abolish all tariffs and quantitative barriers with respect to the imports of industrial products from the EU through a timetable of a twelve year adaptation period and a twenty-two year transition period. However, Turkey made little effort to meet these obligations until the rejection of her full membership request in 1987. Even though Turkey subsequently increased her efforts to reduce promised tariffs, it was not able to meet all obligations by 1995. The instability in the structure of the Turkish economy as well as the ambition to become a full member of the EU induced the Turkish government to take a radical step of finalizing the CU process despite the resistance from import competing sectors (Yılmaz, 2010).

The CU Agreement went into force at the end of 1995.
IN 1995, TURKEY-EU Association Council decided to launch the final phase of the process and thus to establish the CU between Turkey and the EU by the end of the year. Under this agreement, Turkey was required to make four significant changes in her trade policy. First, Turkey had to remove all duties and equivalent charges on imports of industrial goods from the EU. The EU, correspondingly, agreed to remove tariffs and quotas on imports of textiles and clothing. Secondly, Turkey was required to harmonize her tariffs and equivalent charges on the importation of industrial goods from third countries with the EU's Common External Tariff. Third, Turkey agreed to progressively adapt to the EU's commercial policy and preferential trade agreements with specific third countries including Free Trade Agreements (FTAs) of the EU. Hence, Turkey started to sign agreements with Central and Eastern European countries including Israel, Macedonia, Croatia, Bosnia-Herzegovina, the Palestinian Authority, Tunisia, Morocco, Syria, Egypt, Albania, and Georgia. Finally, Turkey was also required to harmonize her legislation with that of the EU in specific areas such as competition, state aids, public procurement, industrial and intellectual property rights, and technical barriers to trade.

CU related reforms are under way.

TURKEY HAD TO IMPLEMENT the EU competition rules before the CU went into effect in 1996. Thus, the Competition Law was adopted in 1995 and an independent regulatory agency, the Competition Authority was established in 1997. Moreover, copyrights and patent laws were brought in line with those of the EU and a Patent Institute was established in 1994. Turkey also started to harmonize her technical legislation for industrial products placed on internal market concerning the establishment of sound conformity assessment and market surveillance structures (Togan, 2010). According to the provisions of the CU agreement, barriers to trade resulting from different regulatory practices on goods in both parties would be eliminated and Turkey would align her legislation to the acquis on the removal of technical barriers to trade and all other related technical regulations.

Turkey started to harmonize her legislation regarding technical barriers only after 2001, which prevented her industrial products from entering the EU markets before then. The law on the "Preparation and Implementation of Technical Legislation on products", which provides the legal basis for harmonization with the acquis, came into force at the beginning of 2002 and speeded up the harmonization process [4]. It defines principles for product safety, the obligations of the producers, distributers, conformity assessment bodies and notified bodies; market surveillance and inspection; withdrawal of products from the market; and notification procedures. Turkey has incorporated over 236 of these instruments so far, as well as implementing all directives that require the affixing of the CE (Conformité Européene) marking. The CE marking is mandatory for a product to be placed on the internal market and indicates that the product confirms with the requirements of the directives. The Turkish Accreditation Body (TURKAK), established in 1999, started to receive accreditation applications for conformity assessment bodies in 2001, and became a member of European Cooperation for Accreditation (EA) in 2002. After the signing of required multilateral agreements with EA members in 2008, TURKAK became recognized internationally. After EU's official recognition of Turkey's right to assign notified bodies in 2006, Turkish authorities assigned a number of Turkish notified bodies for several directives. Turkish Standards Institute (TSE), founded in 1954 to issue and implement technical standards for every type of product and service, was given more power with the requirement of the standardization and licensing of domestic and imported products before production. Since 2008, Turkey has a well-functioning quality certification system, consisting of three institutes: TURKAK, the National Metrology Institute, founded in 1992 and TSE. As part of the process of the establishment of these institutions, Turkey has gone through the costly process of the employment of qualified and experienced staff in these institutions, the acquisition of the technical infrastructure and the adoption of technical legislation to comply with that of the EU for the efficient functioning of the system. Nevertheless, additional costs still have to be incurred by the public sector to complete the ongoing process.

Moreover, the CU agreement included the Association Council resolution in order to intensify cooperation between Turkey and the EU in the areas not covered by the EU, such as industrial cooperation, Trans-European net-

4. See Togan (2010) for a comprehensive survey of trade developments and practices in Turkey. This paragraph borrows from this work.

works, energy, transport, telecommunications, agriculture, environment, science, statistics, and consumer protection, etc.

Turkey also took steps to be part of the new international trading regime and was one of the founding members of the World Trade Organization (WTO) in 1994 and has been a contracting party to the General Agreement on Tariffs and Trade (GATT) since 1994. In line with the stipulations of the CU agreement, as well as the Tokyo Round Agreement on Subsidies and Countervailing Duties, most of the export subsidies introduced in 1970s and in 1980s were removed. Moreover, GATT legal subsidies regarding research and development as well as environmental issues were initiated in 1995 (Togan et al, 2007).

Turkey signed the CU agreement with the EU before accession.

TURKEY IS THE FIRST COUNTRY to sign a CU agreement with the EU without becoming a full member. In fact, this agreement was far beyond a CU with free trade and common external tariffs. It also requires the harmonization of Turkish commercial and competition policies. In fact, Turkey liberalized her trade regime unilaterally without pressure from the EU. By this time, the EU had already eliminated most of the tariffs and non-tariff barriers on imports from Turkey. It should also be noted that Turkey was excluded from important aspects of the common market, such as common agricultural policy and free movement of goods and capital. Furthermore, safeguards and contingent protection namely, anti-dumping and countervailing duties, were allowed although an opposite inclination is observed in European agreements where trade defense measures are eliminated. Also, Turkey received a much lower level of financial assistance compared to that granted to the Central and Eastern European countries (Adam and Moutos, 2005).

According to Öniş (2003), the reason for Turkey's preference for the CU instead of a less restrictive free trade agreement was to show her willingness for economic integration with the EU, and thus offer economic commitment for political and democratic reforms.

Some segments of Turkish society were against the CU, claiming that it would be detrimental to the development of Industry, leading to huge losses and bankruptcies, and thus, to the loss of jobs. The government's decision to sign a CU agreement with the EU was opposed by import competing sectors, such as automotive industry. The influence of this industry was so strong that it was accepted as a sensitive industry and Turkey was allowed to implement tariffs above EU rates on auto imports from the third countries. Moreover, Turkey restricted imports of used motor vehicles from the EU for ten years, a period of which has been extended indefinitely in 2008 until Turkey accedes to the EU (Yılmaz, 2010). In contrast, the CU agreement was welcomed by wearing apparel and textiles sectors, since the abolishment of quotas would enable these sectors to gain a bigger and more sustainable share in the European market (Akman, 2012).

Tariffs dropped dramatically after the CU came into force.

AFTER THE CU WENT into force, Turkey went through an extensive liberalization of tariff rates. Tariff rates with the EU declined from 10.2 percent in 1994 to 1.3 percent in 2001, whereas, the tariff rates with the EU's FTAs reduced from 22 percent to 1.3 percent. Most Favored Nation (MFN) applied tariff rates with non-preferential partners reduced from an average of 22 percent in 1994 to 6.9 percent in 2001 and with the Generalized System of Preferences, tariff rates reduced from 22 percent to 2.7 percent (Togan, 1997 and 2000).

Economic Impacts of the CU

INTERVIEWS WITH RESPONDENTS showed that the CU agreement with the EU was the most important step in Turkey's trade liberalization efforts and had great repercussions for the performance and structure of foreign trade as well as production patterns.

The initial impacts of the CU on Turkish trade

FIGURE 1 illustrates exports and imports of Turkey in the period 1990-2011. As expected, reduction of tariff rates on imports had an immediate impact on imports, which increased from 35.7 billion dollars in 1995 to 43.6 billion dollars in 1996 and to 54.5 billion dollars in 2000. However, the impact of the CU on exports was realized only after the 2000-2001 economic crises. In fact, both exports and imports followed an increasing trend thereafter, increasing by almost four and five fold respectively by 2011.

FIGURE 2 shows EU's share in Turkey's exports and imports. The CU agreement had an instant effect on imports from the EU, whose share in Turkish total imports went up from 47.2 in 1995 to 53 percent in 1996. Nevertheless, after this time the share of imports from the EU followed a decreasing trend to reach 45.7 percent in 2003 and 37.8 percent in 2011. Similarly, average growth rate of imports from the EU declined from 9.1 percent over the period 1990-1995 to 1.5 percent in the period 1996-2003. The average growth rate of exports from the EU increased from 7.5 percent to 9.3 percent between the two periods. Share of exports to the EU, on the other hand, declined from 51.2 percent in 1995 to 49.7 percent in 1996, but then increased again to 51.8 percent in 2003.

These observations show that the launch of the CU did not immediately bring about expected implications on trade, especially on exports. There are four main reasons for this. First, the EU had already removed tariff rates on imports of industrial products long before the CU went into effect. With the creation of the CU, the EU removed the quotas on textiles imports but maintained the right to apply non-tariff barriers and anti-dumping duties on European Coal and Steel Community (ECSS) products. Second, the economic crisis in Asia in 1997 and in Russia in 1998, the earthquake that hit the Marmara region in 1999 and finally the following banking crisis in 2001, all severely affected Turkish economy. Third, appreciation of the Turkish Lira (TL) over the period 1996-2003 slowed down the growth of exports. Finally, the harmonization process of legislation regarding technical barriers to trade, which allowed Turkish industrial products to enter the EU market, started with delay (Togan et al, 2005).

FIGURE 1
Volume of exports and imports

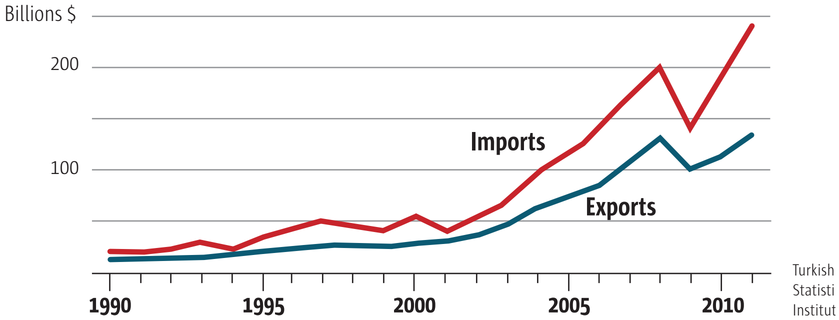
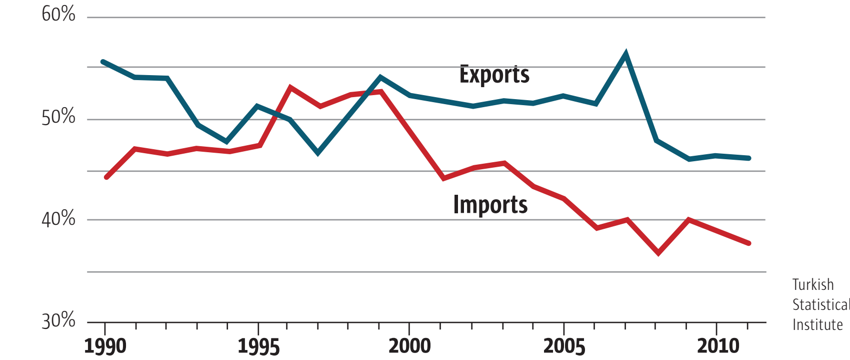


FIGURE 2
Shares of EU exports and imports



The impact of the CU was more pronounced after 2001.

ONLY AFTER THE BANKING crisis in 2001 was the effect of the CU on exports realized. The appreciation of the Turkish Lira coupled with severe contraction in domestic demand forced Turkish exporters to seek new export markets, in addition to the European ones. Remarkable expansions of 15 percent and 31 percent in exports, respectively in 2002 and 2003 were realized despite a 25 percent real appreciation of the Turkish Lira. Exports grew by 21.7 percent on average during the period 2001-2008. Volume of exports shrank by 22.6 percent due to the global economic crisis in 2009, returned to pre-crisis levels in 2011. The volume of imports also followed an increasing trend after 2001 with the exception of the year 2009. The average growth rate of imports is a remarkable 25.8 percent over the period 2003-2008. The surge in imports, especially after 2003, can be attributed to the changing production patterns in the Turkish manufacturing industry.

Respondents believe that the CU was a very important step in opening up the Turkish market to global competition.

THOSE DOMESTIC PRODUCERS that were protected from the threat of international competitors and were subsidized by the government before the CU were forced to compete with international players. In other words, as also emphasized by Kaminski and Ng (2007), provisions of the CU agreement liberalized Turkish domestic markets and brought in predictability, transparency and stability to trade policy, which in turn forced Turkish producers to change their attitude and to increase their contestability. In fact, Turkish industry was able to adapt to the new conditions of trade and proved its capacity to cope with competitive pressures and market forces. This success was made possible by the increases in the competitiveness of Turkish manufacturing industry.

Effects of the CU on the competitiveness of the Turkish industry deserve attention.

AYSAN AND Hacıhasanoğlu (2007) scrutinize the determinants of export performance of Turkish manufacturing sectors, namely, the ability of domestic firms to compete in international markets. Their results show that the most important contributor to the growth of exports in Turkey over the period 1996-2006 was productivity. They also find that Turkish exports shifted from low to medium technology sectors, requiring more skilled labor. Moreover, their findings show that productivity is a significant determinant for explaining the export performance of medium technology sectors.

Özler and Yılmaz (2009) analyze Turkish manufacturing plant level data for 23 three-digit SIC industries over the period 1983-1996 to estimate industry level total factor productivities. They find that the whole manufacturing industry attained an annual average productivity growth rate of 1.9 percent over the mentioned period. Moreover, they show higher productivity improvements in import competing sectors, such as machinery and equipment, resulting from declining protection levels compared to those in non-tradable and export sectors. Taymaz and Yılmaz (2007) use a similar methodology to analyze productivity growth in the period 1984-2000. Although their results show that productivity in manufacturing sectors stagnated after the CU agreement came into force, they also find that import competing sectors exposed to increased import penetration achieved notable productivity growth in this period.

Akkemik (2011) examines the changes in the competitiveness of major Turkish exports in the EU market after the CU, employing dynamic shift-share analysis for the period 1986-2006. His empirical results indicate that the CU had positively impacted on the competitiveness of textiles, iron and steel, and automotive exports as opposed to that of technologically more advanced exports such as electrical machinery, competitiveness of which deteriorated.

Akkoyunlu-Wigley and Mıhcı (2007) test the pro-competitive effect of the CU for the period 1994-2000 by estimating equations of Herfindahl concentration ratio and price cost mark-up for twelve manufacturing industry sectors. They argue that increased imports following the CU caused price cost mark-ups in the manufacturing industry to fall, leading to an improvement in sector's competitiveness.

Turkish exports shifted from low to medium technology sectors.

TURKISH EXPORTS gradually shifted from low to medium technology sectors after the CU came into force. While the share of low-technology sectors such as textiles, wearing apparel, food products and beverages in total exports fell, there was an increase in the share of medium-technology sectors, including machinery and equipment, basic metals and automotive. Respondents believe that the CU agreement with the EU played an important role in this transformation in the sense that the removal of tariffs and the implementation of the EU norms following the CU agreement helped Turkish industry, particularly medium technology sectors, improve its productivity and, therefore, increase its competitiveness in international markets. This rise in productivity and contestability, in turn, caused a technological shift in the composition of exports from low technology products to medium technology products.

Technology intensity of Turkish exports to the EU has changed.

THE CU HELPED STRENGTHEN the trade relationship between Turkey and the EU. Turkey's market share in the EU increased from 2 percent in 1995 to 3.7 percent in 2007. Moreover, EU destined exports, although still dominated by low technology and unskilled labor intensive products, shifted towards medium and high technology products requiring the use of skilled labor. The volume of medium and high technology exports grew by an annual average rate of 21.5 percent between 1995 and 2003, and reached 13,157 million dollars, eight times as much as in 1995. Turkey's share in EU external imports of medium and high technology rose from 0.6 percent in 1995 to 0.9 percent in 2001 and to 2.5 percent in 2004. This radical change in technology intensity of exports was materialized by the entry of Turkish firms into the supply chains of automotive, and information and communication (ICT) technology networks (Kaminski and Ng, 2007).

Ünal Kocaman explains the trade relationship between the two parties in what follows: "Turkey's trade relations with the EU developed after the Customs Union. EU has co-operated with Turkey in a similar way that the US cooperates with China. In a sense, Turkey was like a production park of the EU for automotive, auto parts and textiles industries."

Kaminski and Ng (2007) also suggest that domestic liberalization following the CU and the establishment of macroeconomic stability after the 2001 economic crisis were the two major determinants of export expansion and the structural change in exports.

Izmen and Yılmaz (2009) conclude that the structural change in exports culminated in the period 2001-2005 achieved by the intense reform agenda, which in turn led to an improved business environment, was not sustained due to the weakening in the reform process. They find that the growth rate of medium to high technology products decreased from 17.5 percent between 2001 and 2005, to only 8 percent between 2005 and 2007.

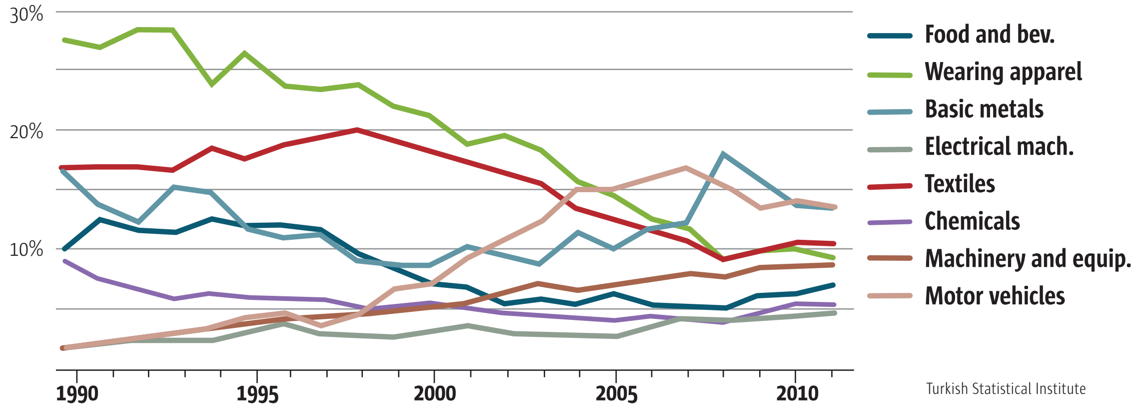
Expansion in manufacturing exports and imports

THE MANUFACTURING sector achieved the highest growth rate both in exports and imports over the period 1996-2011. Manufacturing exports grew by 13.6 percent and 24.5 percent during this period and in the pre-crisis period of 2000-2008, respectively. Manufacturing imports, on the other hand, achieved average growth rates of 9.7 percent and 19.6 percent over these two periods. Therefore, there was a radical change in the share of manufacturing in both exports and imports over time. A synthesis of manufacturing sector shares is of crucial importance in identifying the export performance of Turkey. Figure 3 illustrates shares of manufacturing exports over the period 1990-2011. The increasing trend in automobile (motor vehicles in **FIGURE 3**) and machine and equipment industries is worth mentioning. The share of machine and equipment industry in exports increased from 1.8 in 1990 to 8.8 in 2011.

Outstanding increase in automotive industry's share in exports

INCREASE IN THE AUTOMOTIVE industry's share in exports was remarkable, rising from 2.3 percent in 1990 to 4.3 percent in 1995 and reaching 16.8 percent in 2007, with a 45 percent average growth rate during the period 2001-2007. In fact, the success of automotive industry was unexpected in the

FIGURE 3 Volume of exports and imports



view of the industry's opposition to sign a CU agreement with the EU. Moreover, this sector had been accepted as "sensitive" along with some other import competing sectors such as, shoes, leather products, and furniture. Thus, harmonization to the Common External Tariff on the product of these sectors was completed by 2001. Although protected by high tariffs, automobile imports rose rapidly, accounting half of the market in 1998. As a result, domestic producers were forced to invest to improve competitiveness. Only after the 2001 economic crisis did the automobile industry start to reap benefits of these efforts, achieving remarkable output and productivity growth rates. Labor productivity as well as total factor productivity in the sector increased by two fold between 2001 and 2006 (Taymaz and Yılmaz, 2008).

Declining shares of textiles and wearing apparel in exports despite the positive effects of the CU

FIGURE 3 reveals declining export shares of textiles and wearing apparel industries over time. Similar to most developing countries that depend on abundance of low labor-costs, textiles and wearing apparel industries represented a significant share, almost 45 percent of Turkish exports, at the beginning of 1990s. In fact, the CU agreement was welcomed by the wearing apparel and textiles sectors since the abolishment of quotas would enable these sectors to gain a bigger and more sustainable share in the European market. Yet, the adoption of regulations in imports and exports to comply with the EU norms following the CU brought about an improvement in revealed comparative advantage and competitiveness in the textiles sector in the period 1995-2000 (Karaalp and Yılmaz, 2012).

However, the depreciation of the Turkish lira due to the shift from a currency peg to the floating exchange rate regime in the aftermath of the economic crisis in 2001 reversed the improvement trend. Moreover, admission of China to the WTO in 2001 and the gradual abolition of quotas on textiles and wearing apparel imports by 2005 that existed under the Multi-fiber Arrangement increased China's competitiveness and ultimately decreased Turkey's comparative advantage and competitiveness in these sectors, especially in the wearing apparel sector (Karaalp and Yılmaz, 2012). As a result, the share of the two sectors in total exports of Turkey went down from 36 percent in 2001 to only 19.5 percent in 2011.

Strategic partnership was developed between Turkish producers and EU suppliers.

RESPONDENTS EMPHASIZE that although the production and export structure of Turkey went through a transformation away from textiles and wearing apparel sectors, many firms made strenuous efforts to conform to international standards and to improve the quality of their products in order to increase their competitiveness in the EU market after the CU. As a result, strategic partnership was developed between Turkish producers and EU suppliers, leading to technological development in production and enhancement in management and marketing. Moreover, some Turkish firms were able to create world brands and established new market channels.

As expected, the volume of imports also rose after 2001.

THE VOLUME OF IMPORTS also increased after 2001. Turkey's integration to the global economy through production networks and structural transformation in her exports increased Turkey's dependence on intermediate imports from East Asia (Yılmaz, 2010). While the share of EU imports entered into a decreasing trend especially after 2003, the share of imports from East Asia started to rise dramatically. Yükseler and Türkan (2006) described this trend as the "Asianisation" of imports. The appreciation of euro against dollar after 2001 pushed Turkish exporters to rely on East Asian imported goods, which are quoted in dollars.

Respondents also believe that rise in imports as a result of abolition of tariffs was not harmful to the economy.

BEFORE THE CU AGREEMENT came into force, different segments of society held the widespread belief that the CU would be detrimental to the development of Turkish industry because boom in imports would cause domestic plant closures and job losses[5]. Experience showed, however, that the CU did not lead to the destruction of Turkish industry as feared. The number of closures as a percentage of newly established firms hovered around 1.1 percent until 1997, but then started to increase to reach 2.8 percent in 1998, 5.2 percent in 1999 and 8.3 percent in 2001. However, the rise in the trend could be more attributed to the Turkish economic crises of 1999 and 2001. The industrial production index, on the other hand, increased by 8.7 percent in 1996 and by 11 percent in 1997. Tuğrul Kutadgobilik describes this experience: "After the Customs Union went into effect, Turkish Industry went through a learning curve and domestic firms learned gradually how to adapt to world quality and prices. At the beginning, some firms were forced to shut down and some losses were incurred but sooner than later losses were turned into profits."

The perspective of Turkish consumers changed.

FROM THE VIEWPOINT of the consumers, the surge in imports was indeed beneficial since they had access to a greater number of varieties at lower prices and/or higher quality after the CU. Most respondents suggest that the CU changed the consumption patterns of the households dramatically. The change was not only observed in the consumption of durable goods such as automobiles, home appliances and electrical machinery but also in the food and entertainment sectors. Consumers' home-oriented and traditional eating and drin-

5. For instance, Erzan and Filiztekin (1997) argued that the CU might have negative impact on Small and Medium Enterprises (SMEs) at least in the short-run.

king preferences changed significantly with the opening of restaurant chains, which offer different varieties of food. Erdoğan Göğen thinks that even fast-food chains changed the perception of the consumers and gave them a broader perspective.

All in all, the CU agreement was a milestone in Turkey's integration to the EU and in her transformation to a market economy.

The CU paved the way for extensive measures to reform the Turkish economy, concerning, but not limited to, trade which had significant repercussions on production, consumption and trade patterns.

Turkey's Candidate Status and the aftermath of the 2001 Crisis

Turkey is an official candidate state.

THE HELSINKI EUROPEAN Council's decision in 1999 to accept Turkey as a candidate state on an equal footing with the other candidate states was a milestone in Turkey's quest for accession to the EU. Recognition of Turkey's candidate status means that an Accession Partnership for Turkey will be created, entailing Turkey to adopt the legal framework of the EU, the acquis. Following the Helsinki decision, the EU's influence on Turkey to pursue political and economic reforms increased and Turkish economic and political actors had higher incentives to implement these structural reforms (Öniş and Bakır, 2007).

After the approval of an Accession Partnership and the adoption of the framework regulation to build the legal basis for Turkey's Accession Partnership, Turkey announced her own National Program for the adoption of the EU acquis in 2001. In December 2002, the Copenhagen European Council concluded that "if the European Council in December 2004, on the basis of a report and a recommendation from the Commission, decides that Turkey fulfills the Copenhagen political criteria, the EU will open accession negotiations with Turkey without delay". From 2002 to 2005, the Turkish governments pursued a reform policy agenda to fulfill the Copenhagen Political Criteria and, accordingly, to initiate accession negotiations. The Turkish National Assembly adopted eight legislative packages that reformed the constitutional and legal basis for the rule of law, human rights and democracy.

Accession negotiations are underway.

IN DECEMBER 2004, the European Council decided to launch formal accession negotiations with Turkey from October 2005. Yet, the European Council emphasized that the process of accession negotiations was open-ended, meaning that the eventual membership of Turkey was not guaranteed beforehand.

After the preparation of screening reports for each of the thirty-five chapters of the acquis in 2006, the first chapter to be negotiated, Chapter 25 on "Science and Research" was opened and provisionally closed on the same day. During accession negotiations only thirteen chapters have been opened so far[6]. This is in contrast to the case of Croatia, also granted candidate status in 2004, in which all chapters were opened and closed between the beginning

6. Chapter 20 on "Enterprise and Industrial Policy", Chapter 18 on Statistics and Chapter 32 on "Financial Control" were opened in 2007. Chapter 21 on "Trans-European Networks", Chapter 28 on "Health and Consumer Protection", Chapter 6 on "Company Law" and Chapter 7 on "Intellectual Property", Chapter 4 on "Free Movement of Capital", Chapter 10 on "Information Society and Media" were opened in 2008. Chapter 16 on "Taxation", Chapter 27 on "environment" were opened in 2009. More recently, Chapter 12 on "Food safety", on "veterinary and phytosanitary policy" was opened.

of negotiations in 2005 and June 2011. It should be noted that Chapter 25 on "Science and Research" does not require transposition of EU rules into the national legal order, but requires that the member states ensure the necessary implementing capacities to pursue the Community objectives and activities in this field. Moreover, screening report of Chapter 25 prepared in 2006 had neither opening nor closing benchmark.

The 2001 economic crisis

FOLLOWING THE EAST ASIAN crisis in 1997 and Russian crisis in 1998, Turkey entered into a period of deep financial and economic crisis. A three-year stabilization program backed by the IMF was launched at the beginning of 2000. However, the program ended abruptly when the Turkish economy hit the bottom with the 2001 economic crisis, triggered by the combination of fragile banking system exposed to excessive exchange and interest rate risks, together with the high borrowing requirement of the public sector resulting from discretionary excesses in the fiscal era (Özkan, 2005). A deepening distrust of politicians and the erosion of the government's legitimacy in the eyes of Turkish people forced policy makers to see a different remedy to the economic crisis.

The economic recovery program is on the way.

KEMAL DERVIŞ, a Turkish national Vice-President at the World Bank, was invited to take care of the economy as Treasury Minister. The economic recovery program, the so-called "Transition to a Strong Economy", which was designed by a team led by Mr. Derviş, was launched under the surveillance of the IMF and the World Bank in May 2001. Mr. Derviş, a non-political and accordingly non-elected member of the cabinet appointed from outside, took over the control of the Turkish economy with strong support from the IMF and the World Bank and started to implement the radical policy agenda that any normal Turkish government would have been reluctant to follow. It should also be mentioned that the program was designed as far as possible to coincide with reforms that Turkey had to follow on her way for membership to the EU. The emphasis of the economic program was on tight banking reform as well as a fiscal policy, a flexible exchange rate regime, privatization of huge state enterprises such as giant state telecommunication company – Türk Telekom – and state monopolies of sugar and tobacco and the elimination of government subsidies, especially in the agricultural sector. The main essence of the reform agenda under this program was to establish the institutional and legal base in Turkey to transform a rent-seeking, corrupt and non-transparent political economic system to a modern competitive market economy. In other words, politics would be separated from the economy meaning that state intervention to the economy would be eliminated at maximum and the state would be devoted a regulatory role, instead (Airaudo et al, 2004). The program was appraising a radical transformation in the structure of the Turkish economy.

AKP continued to implement the directives of the recovery program.

JUSTICE AND DEVELOPMENT PARTY (AKP), which came to power after 2002 elections as one-party government in the aftermath of a decade of coalition governments, supported the underpinnings of the economic program designed by Mr. Derviş in its party program. Moreover, the target of full membership to the EU, thus, imperative fulfillment of the requirements of the EU to reach this target, was one of the main pillars of the Party's election propaganda and program. Indeed, the AKP government continued to implement Mr. Derviş's program and adopted most of the reforms proposed. In addition, the AKP government passed comprehensive reforms to achieve the political Copenhagen Criteria and thus to secure an official date from the EU to open accession negotiations.

Reforms in the Post-Crisis Era

IT IS WORTH FOCUSING on political reforms on the one hand, and economic reforms on the other, that the respondents consider as breakthroughs in the period after 2001 economic crisis.

Political reforms

IN DECEMBER 2002, the news that the Copenhagen European Council would open accession negotiations without delay, if Turkey fulfilled the Copenhagen Political Criteria was welcomed with joy in Turkey. The government started to pass the laws such as the abolishment of death penalty and provision of non-Turkish speaking minorities with broadcasting and limited educational rights to fulfill the criteria. All the respondents think that conclusion of the Copenhagen European Council regarding Turkey and Turkish government's eagerness to see the opening of EU accession negotiations with Turkey accelerated the reform process, mainly in political arena.

Economic Reforms

IN ECONOMIC ARENA, on the other hand, two major macroeconomic reforms were of crucial importance for leading to a transformation in Turkey's institutions: first, the independence of the CB; second, the establishment of regulatory agencies, complemented by two other reforms, banking restructuring reform and improvement in fiscal policy.

- **Central Bank independence.** The CB was given the primary task of maintaining and achieving price stability and was vested with *de jure* (legal) "institution independence" to reach its primary goal, through an amendment to law in 2001. Therefore, the CB was given the autonomy to set the monetary policy. The CB was also required to be transparent in the conduct of the monetary policy and publish regular reports on inflation and financial stability. Moreover, the Bank was prohibited from granting advances and extending credits to the Treasury and other public institutions. The Monetary Policy Committee was also founded to allow the inflation target to be set jointly by the CB and the government. The CB adopted an implicit inflation targeting regime during the period of 2002-2005 and the inflation rate gradually decreased to 7.7 percent in 2005 from 68 percent in 2001. Eventually, the CB moved to an explicit inflation targeting regime in 2006 (Alper and Hatipoğlu, 2009). Inflation rate increased slightly to 10.5 percent at the end of 2011, higher than the CB target of 5.5 percent.

Volkan Vural strongly emphasizes the importance of the CB independence as a safeguard against market instability that would prevent international capital outflows. He also characterizes the introduction of the CB independence as the major reform that lead to a structural transformation in the Turkish economy.

Alper and Hatipoğlu (2009) analyze the effect of *de jure* independence of the CB on its success in reducing the high and chronic inflation to single digits by estimating the reaction function of the CB in 2001-2007 period. Their results show that *de jure* independence caused the CB to conduct monetary policy more aggressively against political pressures, indicating *de facto* (actual) independence of the CB. Nonetheless, the 2012 European Commission progress report on Turkey considers the involvement of the government in the setting of the inflation as an obstacle to the independence of the CB. Nilgün Arısan Eralp also thinks that the notion of CB independence is in conflict with joint inflation targeting by the government and the CB. Yet, the same EU report concludes that there is an advanced level of preparedness in the monetary and economic policy chapter.

- **Establishment of regulatory agencies.** Establishing the legal and institutional infrastructure to transform a rent-seeking economy in which market inefficiencies arise due to political influences and short-term pragmatism, into a modern competitive market economy requires delegating a regulatory role to the state as in most advanced economies, including the EU[7]. In these countries, as a result of this changing role of the state in economic arena, the decision making power has been delegated to independent regulatory agencies (RAs) that are organizationally separate from the government, headed by non-elected officials and given financial autonomy. In Turkey, the transition to RAs started in 1982 with the establishment of the Capital Markets Board and continued with the founding of the Radio and Television High Council in 1994, the Competition Board in 1995 and the Banking, Regulation and Supervision Agency (BRSA) in 1999. Subsequently, the transition process gained a momentum and five other RAs in areas of telecommunication, sugar, tobacco, energy and public procurement were founded in the 2000-2006 period. Turkey adopted a EU inspired regulatory framework before the privatization of the giant state telecommunication enterprise – Türk Telekom. Likewise, the Competition Law adopted in 1995, which paved the way for the establishment of the Competition Board, was inspired by the EU model. Moreover, the New Electricity Trading Arrangements of the UK provided the inspiration for the structure of the Energy Market Regulatory Authority, which was formed to regulate the electricity, natural gas and oil industries in 2001. Izak Atiyas emphasizes that even though the framework inspired by the EU might not be the first-best for Turkey, it eliminated the coordination failures and loss of time that could result from power struggles.

The main reason behind the establishment of the RAs was the belief that economic decisions would be driven by principles of efficiency and equity in a competitive environment insulated from political influences which, in turn, would give rise to higher investment, innovation, economic growth and welfare. Yet, the extent to which the RAs succeeded in doing so is a matter of concern. There have been divergences between *de jure* (legal) institutions and

7. Majone (1994) describes regulation as the new border between the state and the economy, namely, the battleground for the ideas on how the economy should be run. He states that regulatory state replaced dirigiste state that depends on government ownership and planning.

de facto (actual) institutions of RAs because of insufficient enforcement capacity or simply due to the political power's ability to affect RAs in practice, regardless of the formal rules[8], according to Izak Atiyas. He gives the privatization of Türk Telekom as an example and concludes that competition in the fixed line telecommunication industry has been rather slow and the market shares of the incumbent operator remained very high[9]. On a positive note, the new Electronic Communications Law that passed in 2008 has moved the Turkish regime closer to the EU framework, which will likely increase competition in the industry.

The Competition Board is regarded as the most competent and professional RA, due to high-skilled personnel and decision mechanism which is relatively independent of the political powers. The decisions of the Competition Board are required to be publicly available and published along with their justifications. This raises the transparency and accountability of the agency. According to Ekrem Kalkan, the competency of the Board relies on its policy of hiring new personnel instead of appointing personnel from other state organizations. However, he is concerned about the law passed in August 2011 that constrains the independence of the RAs, giving the government more power in the decision process. He also adds that more progress seems to be rather difficult without a real change in the mentality and in political attitude. In fact, all the respondents argue that adopting a legal framework – *de jure* institutions – is not sufficient for structural transformation. The actual implementation of the legal framework – *de facto* institutions – is rather important. The Capital Market Law, amended in December 2012, raises more concerns about the functioning of RAs, since the majority of the members of the Capital Market Board will be appointed by the government. In addition, the new Law threatens the right of expression in Capital Markets in the sense that any comment or expert analysis which opposes the government could be subject to judicial investigation[10].

Overall, although the respondents have some concerns regarding current as well as future independence of RAs, they share the common idea that the RAs played a significant role in Turkey's transition to a competitive market economy. Sübidey Togan concludes: "Transforming the institutions is not easy; it started in Great Britain in the 17th century. Thus, Mediterranean Countries have a long way to go".

- **Banking Sector Restructuring Program.** An independent CB requires a sound banking system to conduct an efficient macroeconomic policy and to achieve price stability. Otherwise, the CB could be forced to combat financial instability driven by the tendency of the banks to take excessive risks without raising their capital base. Establishing a powerful supervisory environment which will adopt regulations in order to promote effective risk management and to raise bank capital is the key to solving this problem (Ersel and Özatay, 2007). At the end of 1990s, the Turkish banking system was suffering from structural weaknesses due to factors such as macroeconomic instability, crowding out, systemic distortions caused by the state banks, insufficient risk assessment and management systems and the lacking of effective supervisory environment (Pazarbaşıoğlu (2005). Following the severe banking crisis, the Banking Sector Restructuring Program was launched in May 2001. Refor-

8. See Atiyas (2012) for an excellent evaluation of changing economic institutions, particulary, in the last decade and the gap drawn up between de jure and de facto institions in Turkey.

9. See Atiyas and Doğan (2010) for a review of the Turkish experience of the fixed line telecommunications industry reform.

10. See Uşur Gürses, Hükümet borsadan sonra SPK'ye el koydu!, Radikal daily, December 10, 2012 www.radikal.com.tr/Radikal.aspx?aType=RadikalYazar&ArticleID= 1111379&CategoryID=101)

ming the state owned banks, strengthening private banks and finally promoting an efficient, competitive and sound Turkish banking sector by strengthening the powers of the BRSA and adopting international – particularly EU-standards in banking legislation were the main pillars of the program (Ersel and Özatay, 2007).

First, through restructuring the state banks, the Treasury issued bonds to securitize duty losses of the state banks. Meanwhile, legislation was introduced to prevent duty losses of the banks. Furthermore, operational restructuring enabled the state banks to become more efficient in organization, technology, human resources, financial control and planning and risk management. Second, measures were taken to recapitalize the banks, limit open foreign exchange positions and encourage mergers and acquisitions. Third, insolvent banks taken over by the Savings Deposit Insurance Fund were restructured. Finally, the BRSA was equipped with stronger tools in order to promote an effective supervisory environment (Pazarbaşıoğlu, 2007). Although established in 1999, the BRSA did not start to operate until the following year. Only after the recovery program did it begin to function effectively. As a matter of fact, the empirical analysis of Çetin et al (2010) demonstrated that the BRSA is the RA with the highest level of independence.

Turkish Banking Legislation complies with the EU in many areas and Turkey has fulfilled most of the conditions required for banking sector integration with the EU. In addition, this restructuring process gave rise to a large fiscal burden amounting to one third of GDP (Pazarbaşıoğlu, 2007). In the 2012 European Commission progress report on Turkey, the following terms are used for the financial sector: "Overall, the financial sector has continued to show dynamism and strength thanks to earlier in-depth reforms." The same report indicates a high level of alignment between Turkey and the acquis on financial market infrastructure. Nevertheless, Chapter 9 on Financial Services is one of the eight chapters suspended by the European Council in December 2006 due to Turkey's restrictions on the free movement of goods carried by vessels and aircraft registered in Cyprus. As Nilgün Arısan Eralp argues, "Financial Services Chapter is one of the chapters that would have already been opened, if it had not been for the Cyprus issue. The reason behind the suspension of this chapter is absolutely political. "

The analysis of Aysan et al (2011) for the period 2002-2007 reveals that structural reforms in the banking sector led to cost efficiency gain as well as convergence in the efficiency level of the banks. Average indebtedness of Turkish households increased from 7 percent in 2003 to 28 percent in 2007 and reached 51 percent in 2011.

Although the banking sector became sufficiently resilient to avert external shocks and financial crises after the banking restructuring reforms, it has some weaknesses such as transferring savings to consumer consumption rather than productive investment and inadequate concern for consumer protection and competition (Bakır and Öniş, 2010).

- **Improvement in Fiscal Policy.** Turkey made significant progress in redesigning her fiscal management system in the post-crisis period. Public fiscal management system in Turkey was transformed by three main laws. First, the Law on Regulating Public Finance and Debt Management, adopted in 2002, set principles and procedures for debt management and increased transparency and unity by standard reporting. Second, Public Financial Management and Control Law, enacted in 2003 and came into full force in 2006, established multi-year budgeting, budget scope and execution, performance management and strategic planning, internal control, accounting, etc. Finally, the adoption of the Public Procurement Law in harmony with the EU standard in 2002 was another achievement on this front. Furthermore, the elimination of budgetary and extra-budgetary funds contributed to the transformation in public fiscal management system and brought in fiscal transparency (Kaya and Yılar, 2011).

As result of these policies, a considerable fiscal discipline was attained in the post-crisis era; public debt decreased to under 40 percent of GDP and the general government deficit was kept at 2.1 percent of GDP in 2011 (OECD, 2012). However, there are criticisms regarding the quality and hence the sustainability of the fiscal discipline since uncontrolled expenditures are financed by taxes, especially indirect taxes. For instance, in the 2010 program of general government budget, indirect taxes and direct taxes were raised by 24 percent and 8 percent, respectively, in order to limit expenditure increases (Dedeoğlu, 2010). Given Turkey's unequal income distribution with a GINI index of 40.4 much higher than the EU average of 30.2, raising indirect taxes to comply with the fiscal rule would further deteriorate income distribution.

There are further criticisms regarding the implementation of the fiscal rule, focusing mainly on the anti-transparent budget practices, the failure to implement medium term program completely and the infrastructural deficiencies in the independent monitoring, auditing and sanctioning[11]. Here, a malpractice with respect to fiscal discipline and transparency deserves a special attention. A state owned enterprise, Mass Housing Administration (TOKI), is an institution which was left out of the scope of both public financial management law and action law (Dedeoğlu, 2010). TOKI is equipped with the powers of developing any publicly owned Treasury land for housing, deciding the procedures for housing development, developing construction projects and selecting the company to undertake the project without officially announcing the project or taking bids. Therefore, TOKI creates and distributes rents without the guidance of regulations[12]. In June 2012, floods in the Black Sea province of Turkey killed twelve people, the majority of who were living in the housing blocks built by TOKI. This incident culminated the criticism that the risk of flood, along with other risks such as earthquake, were not taken into account in the design of the mass housing blocks. However, the Urban Planning Minister Erdoğan Bayraktar, also the former chief of TOKI, denied any wrongdoing by TOKI[13].

Ekrem Kalkan thinks that the acts of TOKI are not only against fiscal transparency but also against competition law practice and he strongly criticizes the fact that the state, as in the case of TOKI, acts almost as a monopoly in the construction industry whose multiplier effect on the economy is very high. He adds "It is very problematic that the state manipulates economic output through TOKI, bypassing the competitive market mechanism." OECD (2010) reports that total balance sheet of TOKI has reached 2 percent of GDP and further mentions that it is not clear whether the whole value of its assets and liabilities are included in the balance sheet.

11. See Dedeoğlu (2010) for a comprehensive analysis of the implemantation of the fiscal rule in Turkey and its deficincies.

12. Güven Sak, Why can't the TOKI model deliver any good even with good intentions? TEPAV commentary, 10.07.2012 (www.tepav.org.tr/en/kose-yazisi/s/3352)

13. See Hürriyet Daily News, Flood kills nine people as ministry comes under fire (www.hurriyetdailynews.com/flood-kills-nine-people-as-ministry-comes-under-fire.aspx?pageID=238&nID=24766&NewsCatID=341) , July 5, 2012 and Disaster Training Currciculum (DITAC), Flood Disaster in Samsun, Turkey – 12 people killed, July 10, 2012 (www.ditac.info/news-and-dissemination/news-detail/flood-disaster-in-samsun-turkey-12-people-killed/52dc8f94812b7e63b0de73e017fd998f/)

Again, on a negative note, Sübidey Togan mentions, on the Public Procurement Law, that the Law was passed in 2001 but has been changed eighteen times since then, which represents the reluctance of the government to abide by the Law during the implementation process. He emphasizes that public procurement must also be subject to the rules of market mechanism. The President of the Public Board Authority, Mahmut Gürses, notes that the number of institutions exempted from the Law has risen to sixty since the adoption of the Law in 2001. He adds that Public Procurement Board makes decisions concerning only 4 out of 100 public procurements in Turkey and 19 percent of the decisions are rejected during the judicial process [14]. In fact, 2012 Progress Report of the European Commission mildly reports "…the decree-laws adopted in August and November 2011 raise concerns about the independence of the Public Procurement Board from political interference and about its functional autonomy."

Last but not least, it should be mentioned that the Turkish High Court of Accounts (Sayıştay), which carries out auditing of general and annexed budgets of government offices on behalf of the Parliament, did not audit the general government budget of 2010 and, furthermore, it failed to send to the Parliament a hundred and thirty-two reports prepared regarding the audit of general government budget of 2012. This practice violates the audit function of the Parliament deriving from the "budget right" [15].

Institutional change is important for long-run economic growth.

THE NOBEL LAUREATE economist Douglass North initiated a new line of economic approach, which puts forward the notion that institutions play a significant role in economic development. North (1990, 2005) argues that differences in physical and human capital and technology across countries can only explain immediate but not the fundamental causes of growth. According to him, the differences in institutions present the main explanation for differences in economic growth rates across countries.

Institutions play an important role because they shape both economic and political incentives. Economic incentives are shaped by the extent of enforcement of the property rights and the degree to which laws and regulations are fairly endorsed. Moreover, economic actions, such as capital accumulation and investment in human capital, are determined by economic institutions, which determine the rewards of actions. Political institutions, on the other hand, determine political incentives and the distribution of political power, depending on the form of constraints on politicians and political elites and electoral rules in democracies (Acemoğlu et al, 2005).

Rodrik (2000) identifies the following institutional arrangements conducive for economic progress, but which are absent in poor economies:

- secure property rights;
- regulatory institutions to prevent fraudulent, anti-competitive behavior, and moral hazard;
- social insurance institutions to assure social stability and social cohesion;
- institutions of conflict management;
- the rule of law and clean government.

14. www.ekoayrinti.com/news_detail.php?id=112257

15. www.gazetecileronline.com/newsdetails/8443-/GazetecilerOnline/denetim-skandali-sayistay-raporlari-meclis39e-verm

In a similar vein, Acemoğlu and Robinson (2008) identify three characteristics of good institutions:

- the enforcement of property rights and the rule of law;
- constraints on the politicians and political elites so that they cannot expropriate the resources;
- equal opportunities for everyone.

Yet, as the countries diversify with respect to their history, culture, geography and social norms, there is no unique set of criteria for the good institutions that can be applied to every country. Rodrik (2000) argues that "Institutions need to be developed locally, relying on hands-on experience, local knowledge and experimentation".

All the respondents share the common belief that the reforms that pave the way for good institutions are conducive for long-run economic growth. Ünal Kocaman notes that physical infrastructure relates to the hardware side of the economy whereas institutions correspond to its software side and he argues that the software side of the economy is weak in Turkey, but much weaker in other Mediterranean countries.

3 A General Evaluation of the Turkish Economy and the EU dream

Taking Stock: The Turkish Economy

Turkey's economic performance was strong during the last decade .
STRUCTURAL REFORMS pursued following the economic crisis in 2001 reshaped the structure of the Turkish economy and brought stability. Two main macroeconomic reforms – the CB independence and the establishment of regulatory agencies – along with financial sector restructuring and enhancement of fiscal transparency eliminated uncertainties as regards the Turkish economy and improved business environment. The Turkish economy went through a remarkable recovery afterwards. After shrinking by 9.5 percent in 2001, Turkish real GDP grew by 5.2 percent on average between 2002 and 2011. By the end of 2005, inflation rate fell below 8 percent after decades of high and chronic inflation, though it rose to over 10 percent in 2011. Nominal and real interest rates also declined sharply. The public net debt declined gradually from 66.4 percent of GDP in 2001 to less than 28.8 percent by 2010.

Opening of accession negotiations triggered FDI inflows to Turkey.

MOREOVER, THE REFORM agenda pursued after the 2001 economic crisis along with the decision of the EU to open accession negotiations increased confidence in Turkey and led to a surge in capital inflows. Before 2005, average annual FDI inflows to Turkey were less than 1 billion dollars, despite the CU and Turkey's greater export-orientation (Dutz et al, 2005). The EU's decision to open membership negotiations was a strong signal to investors that Turkey would sustain economic reforms, marking the turning point in FDI flows to Turkey (Izmen and Yılmaz, 2009)[16]. As a result, FDI flows increased to 2.5 billion dollars in 2004 and 9.6 billion dollars in 2005, reaching 13.4 billion dollars in 2011. Volkan Vural considers that FDI inflows are still low compared to some countries.

A long way to catch-up with the EU.

ALTHOUGH TURKEY went through a structural transformation to integrate with the world, as well as to become a competitive market economy during the last decades, it still has a long way to go to catch up with the more advanced countries, especially while considering that Turkey's GDP per capita is only 22 percent of the EU-15 average in 2011. The aim of being one of the top ten countries in the world with a $25,000 GDP per capita by 2023 as envisioned by the Turkish Prime Minister Recep Tayyip Erdoğan calls for increasing structural reform efforts.

Productivity growth: an important determinant for Turkish economic growth

TURKEY'S AVERAGE annual growth performance of over 5 percent during the last decade through 2011 was mainly the result of two developments: employment growth and productivity growth (OECD, 2012). Labor productivity growth in an economy can be achieved in one of two ways. First, productivity can grow within economic sectors through capital accumulation, technological change or reduction of misallocation across plants. Second, labor can move across sectors, from low-productivity sectors to high-productivity sectors, increasing overall labor productivity in the economy (Mc Millan and Rodrik, 2012). Turkey achieved a 3.1 percent annual growth rate in labor productivity between 1990 and 2005, 45 percent of which is due to structural change resulting from movement of labor from low-productivity to high-productivity sectors. During 1999-2008 the contribution of structural change component to the annual labor productivity growth of 5.6 percent is 38 percent. In both periods the contribution of structural change to the labor productivity growth is remarkable in the sense that structural change has been growth enhancing in Turkey (Mc Millan and Rodrik, 2012). Calculations of the authors also show that in the period between 1990 and 2005, magnitude of the structural change component of Turkey is greater than those of all Latin American countries, all high income countries, and most Asian and African countries, lagging behind only Thailand and Ethiopia. An update of the study of Alam et al (2008) for the OECD Survey in 2012 indicates also that structural change has been the central channel of productivity growth during the last decade.

16. Redefinition of FDI and adoption of the new FDI law in 2003 contributed to FDI inflows (See Dutz et al, 2005).

Slowdown in employment creation rate of the manufacturing sector and the lower productivity of the service sector in Turkey raise doubts over sustainable economic development.

IT IS OF CRUCIAL importance for Turkey to maintain the structural transformation that enables movement of labor from low productivity to high productivity sectors in order to sustain her high economic growth performance in the future. However, slowdown in employment creation rate of the manufacturing sector and the lower productivity of the service sector are two concerns against Turkey's sustainable economic growth (Rodrik, 2010). Rodrik believes that Turkey should follow an industrial policy through which dialog mechanisms will be established to create cooperation between the private sector and the public sector.

Production in manufacturing sector is in decline.

CHINA, INDIA, Indonesia and Russia have risen to the highest ranks of global manufacturing and joined the world's fifteen largest manufacturing industries in 2010. However, Turkey is not currently on this list, although it ranked 13th in 1990 and 15th in 2000 (Mc Kinsey, 2012).

TEPAV team analyzed the merger and acquisition transactions reported to the Turkish Competition Authority larger than 25 million TLs in turnover, or 25 percent in market share. These were then categorized as either manufacturing and industry transactions or services and energy transactions. It should also be mentioned that these were the transactions of twenty-one industrial conglomerates listed in ISO1000 – the traditional large manufacturing conglomerates of Turkey. The number of entries and exits to manufacturing and services turned out to be almost equal in period 2000-2006, whereas net entries into services outnumbered those to manufacturing in the period of 2007-2010. This means that the traditional industrialists of Turkey are increasingly involved in the services and energy sectors, while they are exiting from manufacturing sectors [17].

High current account deficit and the low saving rate are weaknesses of the Turkish economy.

DEPENDENCE OF THE CURRENT account deficit, reaching 10 percent of GDP in 2011, on foreign borrowing and the short-term nature of most capital inflows are important areas of concern for financial stability and economic growth. At the same time, domestic savings rate shows a decreasing trend over the years, remaining around 13 percent in 2011, a rate which is lower than in most EU countries.

Productivity gap between informal and formal sectors is a drag on the economy.

ACCORDING TO THE Turkish Statistical Institute household survey results, 28.3 percent of the male labor force is employed in the informal sector. This figure is as high as 51.3 percent for the female labor force. It is essential to shift informal employment to formal employment. Registered firms exploit economies of scale, benefit from new technologies and produce quality products with export orientation. In contrast, unregistered firms depend on old technologies and produce low quality products for the domestic market. Pro-

17. See Ussal Şahbaz, De-industrialization: A Dangereous trend in Turkish Economy? www.tepav.org.tr/en/kose-yazisi-tepav/s/2357

ductivity growth in Turkey is below potential because of the informal sector (OECD, 2012). Formal manufacturing sector's average labor productivity level is about five times as high as that of informal manufacturing sector.

Improvement in human capital is required to sustain productivity growth.
IN 2009, 69 PERCENT of the Turkish adult population had an education level of below upper secondary education. The average expected time in education reached 13.7 years for boys and 12.9 years for girls in 2009, still below the EU averages. In the 2009 Programme for International Student Assessment (PISA) test, 60% of 15-year-old Turkish students could not solve simple mathematical problems. Turkey's average score of 454 in mean science performance still ranks far lower than the OECD average of 501 (OECD, 2012). Most respondents agree that increasing levels of education resulting in an improvement of Turkish human capital is crucial for strengthening economic growth.

Turkey produces medium-technology products.
IN 2009, ONLY 3.5 PERCENT of Turkish exports were high technology products. In the World Economic Forum's Global Competitiveness Index for 2012-2013, Turkey moved up by 16 places to 43rd position out of 144 countries. Turkey's competitiveness benefits notably from her large domestic as well as foreign market size. In the report, Turkey is categorized as a country in transition from efficiency driven economy to an innovation driven economy, but lags behind other economies in this category in terms of technological readiness. At the same time, Turkey ranks only 55th in innovation. Ahmet Yücel says "Although Research and Development expenditures of Turkey doubled since 2003 to reach 0.8 percent by 2011, it is still below the EU average of around 2 percent". Murat Kalsın points out that Turkey is required to make a jump to avoid middle income trap. He emphasizes the crucial importance of producing high technology products and to this aim, investing more on Research and Development (R&D).

In summary, Turkey needs to make further reforms.
THE RESPONDENTS call attention to the significance of making further reforms, including education, innovation and formalization of the economy, to boost productivity growth in Turkey. Therefore, it may be early to conclude that Turkey is a success story without taking into account structural economic weaknesses and the long-run economic growth.

EU Dream: Before and after Opening of Accession Negotiations

Turkish public gave support to EU membership.
2002 OPINION POLLS showed that there was strong pro-EU consensus with 74 percent of the Turkish public in favor of the prospect of accession to the EU (Çarkoğlu, 2003).

Launch of EU membership negotiations in 2005 was also welcomed with enthusiasm and hope by large segments of the Turkish society. The conclusion of the paper written by Şevket Pamuk at the beginning of 2007 clearly illustrates how the EU membership anchor increased the expectations for Turkey's economic potential to realize: "...the membership process is likely to create a stronger institutional framework for economic change. For the economy, the key contribution of the goal of membership will be the strengthening of the political will to proceed with the institutional changes that may raise the water level in the glass and carry Turkey's economy to a new level.[18]"

Enthusiasm and hope for EU membership has faded away.

THE INTERVIEWS conducted with eleven respondents revealed that the enthusiasm and hope for the EU membership reflected in the previous paragraph by Şevket Pamuk seems to have already faded away. In fact, the respondents have a point. Soon after accession negotiations started, relations of Turkey and the EU have stalled and deteriorated. As a result, little progress has been achieved in Turkey's accession process. Suspension of the opening of eight chapters for political reasons regarding Cyprus in 2006, the explicit opposition of Nicolas Sarkozy, the former president of France, to Turkey's EU membership, the French government's suspension of four more chapters regarded as directly related with full membership in 2007 and, lastly, the circulation of the notion of a "Turkish privileged partnership" instead of a full membership diminished the enthusiasm of Turkish citizens and policy makers. During the accession negotiations between Turkey and the EU, only thirteen chapters have been opened and one chapter has been provisionally concluded. The reason why some of the chapters of the acquis have not been opened yet is political rather than economic. According to Tuğrul Kutadgobilik, financial and budgetary provisions, financial services and fisheries chapters are some of the chapters that have not been opened to negotiations for purely political reasons.

The reform process has come to a standstill following the opening of accession negotiations.

ABOVE ALL, Turkish government seems to have lost its appetite for reforms after the beginning of the negotiation process. Moreover, Turkey seems to be retreating from the agenda of the EU accession process although there is much left to do. The government seems to be reluctant to enact more laws and seems to have a tendency to retract some of the reforms that have already been made. Volkan Vural states that the reform process came to a standstill just after the opening of accession negotiations.

Izak Atiyas explains the reason for the government's reform fatigue mood as follows: "The ruling party might be thinking that the EU membership anchor and, thus, pursuing the reform policy agenda, is not as useful as it used to be". Otherwise, seeing that the European economy is in decline whereas Turkish economy is on track despite the global slowdown, the government might be thinking that Turkey no longer needs the EU. Whatever the reason is, it seems that integration with the EU and being a full member has lost its charm in Turkey. Nilgün Arısan explains what the EU now represents for Turkey: "EU membership has become a non-issue in Turkey".

18. See Pamuk (2007).

Respondents think that Turkey needs to continue to make reforms to comply with the acquis, irrespective of the possibility of EU membership.
IT IS POSSIBLE that Turkey will become a member of the EU at the end of this process. However, the reforms made during this accession process have a greater significance than becoming a member of the Union. These reforms have been changing and are going to change the institutions for Turkey's own benefit. Therefore, Turkey has a lot to gain by making and implementing the reforms that are conditioned by the EU. As Murat Kalsın says "Turkey must continue to follow the reform policy agenda with earnest to comply with the acquis. However, this effort should not be aimed at becoming a member of the EU. When Turkey fulfills the criteria for accession to the EU, Turkish public should decide whether to accede to the EU or not. "

Turkey is becoming an anti-democratic and conservative country.
THE GOVERNMENT, which has been appreciated once by large segments of the society as well as the EU for making democratic reforms such as the expansion of Kurdish rights, the abolishment of death penalty and civilian control of the army, is now criticized for its anti-democratic moves, such as restricting press freedom and imprisonment of numerous journalists, the majority of whom work for Kurdish media outlets.

Over 8,000 pro-Kurdish suspects, including academics, lawyers, journalists, writers and politicians accused of membership to Kurdistan Communities Union (KCK) have been prosecuted since the launch of KCK operations in April 2009[19]. Moreover, Prime Minister Recep Tayyip Erdoğan's consideration of reinstatement of the death penalty following the upsurge in Kurdish militant violence in November 2012 was seen as an attempt to move Turkey further away from EU membership.

It is generally agreed that conservatism and religiosity in Turkey are on the rise. In fact, results of 2011 World Values Survey show that Turkish society, indeed, is getting more conservative (Esmer, 2011). Empirical findings of Göksel (2013) indicate that conservatism is an important determinant in explaining the low labor force participation of women in Turkey. Only 28 percent of female working-age population was active in the labor market in 2011, against an EU-27 average of 65 percent.

The new education reform known as the "4+4+4" bill is in line with Recep Tayyip Erdoğan's statement about nurturing "a pious generation" and raises risks for creating a more conservative and religious society. The new bill extends the compulsory executive eight years of education to twelve with the creation of a three-tiered system, which allows children to enroll religious Imam Hatip schools after four years. For regular schools optional Koran courses are introduced for children as young as 11 years-old. Furthermore, female students at regular schools will be able to wear headscarf in Koran lessons. TUSIAD raised its doubts regarding the ability of the education system to produce a "well-educated, pluralist, and liberal society".

Turkey is not doing well in international rankings, either. The Economist Intelligence Unit's Index of Democracy for 2011 ranks Turkey 88th out of 167 countries, only three places above Tunisia. Moreover, in the same report, Turkey is mentioned as one of the countries whose score for media freedom has deteriorated since 2008. Similarly, the World Economic Forum's 2011

19. www.guardian.co.uk/world/2012/sep/10/turkey-journalists-trial-terrorism-kurd

BOX 1 Criticisms to the EU on different aspects

Open ended nature of accession negotiations deteriorate Turkey's incentive for reforms

Uğur (2010), in a political economy setting, finds that open-ended framework for accession negotiations where timing and modality of EU membership is not guaranteed in advance can be a factor in the reduction of a candidate country's efforts to make structural reforms that would converge the economy to the EU level. Therefore, the EU's weakening commitment to Turkey's membership can explain the reluctance to make further reforms. He suggests that the commitment of the EU and the candidate country to integration and reform process must be renewed periodically through negotiations.

Turkish citizens must move freely between Turkey and the EU

Ahmet Yücel says that in order for the CU to be more effective for both of the parties, capital, persons and services must also be able to move freely, along with the products. However, the EU requires Turkish citizens to obtain a visa to enter the EU. Erdoğan Göğen thinks that this restriction on Turkish citizens creates an unfair competition between Turkish exporters and European producers, since Turkish exporters have limited opportunity to promote their products in the EU.

FTAs of the EU with third countries lead to unfair competition

According to the provisions of the CU agreement, Turkey is subject to the EU's trade regime and therefore, the EU can sign FTAs with third countries without consulting Turkey. Ahmet Yücel notes that FTAs of the EU with the third countries is disadvantageous for Turkey because these countries can already access Turkish domestic markets via the EU which make them reluctant to sign FTAs with Turkey. He concludes that FTAs between the EU and third countries create competitive conditions that are not favorable to Turkey.

Global Gender Gap Index ranks Turkey 122nd out of 135 countries. The U.S. Commission on International Religious Freedom in its Annual Report of 2012 designated Turkey as a "Country for Particular Concern", a category reserved for the countries whose governments either engaged in or tolerated "particularly severe" violations of religious freedom. In the same report, Turkey is criticized for failing to recognize religious minority communities, such as Alevis and the Greek and Armenian communities. The recently released 2012 Progress report of the European Commission criticizes Turkey for slowing down democratic reforms concerning democracy, freedom of expression and the rule of law.

Ünal Kocaman says that the government is motivated by religious factors in both domestic and foreign politics, which raises the risk of polarization. He adds "Both ethnic and religious polarization prevent synergy and pluralism, resulting in economic development and growth coming to a halt. Moreover, the expectations of rising conservatism and, accordingly, erosion in life styles might reduce the motivation of liberal entrepreneurs to invest in Turkey. In the same vein, there is a danger of brain-drain due to the demotivation of well-educated and liberal minded people." **BOX 1**

4 The Turkish Experience: Lessons for the EUROMED Regional Integration

Turkey's experience in the making of reforms is unique.
THE AIM OF FULL MEMBERSHIP to the EU with almost full support of Turkish public has been the anchor for Turkey in the making of structural reforms. Because other countries are not geographically part of Europe they have no prospect of EU membership. Still, Turkey's strong economic performance, resulting from the achievement of a series of reforms that has transformed the economy to a market based one, may bring inspiration to these countries.

Turkish private sector's full support to the reform policy agenda played a critical role in the transition.
THE EMERGENCE of a private sector independent of the state would help the reform process to be pursued. The challenge is whether the state as the holder of the political power will allow an independent private sector to flourish and accumulate capital, and most importantly, turn into an economic as well as a political power. Emergence of a private sector independent of the state calls for a mentality change.

The CU agreement was a milestone in Turkey's integration to the EU and in her transformation to a market economy. In the same vein, FTAs signed with the EU can be an anchor for the other countries by setting the quality standards of their products in order to compete with products in the EU market.
THE CU PAVED the way for extensive measures to reform the Turkish economy concerning, but not limited to, trade, which had significant repercussions on production, consumption and trade patterns. Following the CU agreement, Turkey has undergone a costly process of harmonizing her legislation with that of the EU in specific areas, such as competition, state aids, public procurement and industrial and intellectual property rights to compete with international competitors in the EU as well as in other markets. Turkish exports not only boomed in the early 2000s but also the share of higher technology exports increased in total exports. Yet, the task is far from complete for Turkey. Each country in EUROMED partnership, apart from signing an FTA with the EU, may adopt EU policies that would change the economy to a competitive market economy and enhance growth.

Turkish experience shows that supranational regulations give an incentive to a country to pursue a set of reforms only to a limited extent.
AS SOON AS THE MOTIVATION of EU membership for adopting supranational regulations has faded away, partly because good but unsustainable economic outcomes upon the first stage of reforms has ignited the misconception that no further reforms are required, and partly because membership will never materialize for reasons other than economic ones, the Turkish reform

process has come to a standstill. However, the weakening in the motivation for making reforms raises concerns as the Turkish economy is still in transition and has structural weaknesses with the potential to stagnate productivity growth which is the driving force behind Turkey's remarkable economic growth performance during the last decade. Thus, further reforms, including education, innovation and formalization of the economy need to be implemented for sustainable economic growth. This experience may show other countries that reforms are for their own benefit, i.e., to create a wealthier economy with more equal income distribution and that supranational regulations play a role in the making of reforms only to a limited extent.

Reforms to establish quality standards and to export high quality products cannot be separated from the reforms to institute macroeconomic stability.
THE INSTITUTION OF macroeconomic stability in Turkey within the directives of the economic recovery program launched in the aftermath of the economic crisis of 2001 coincides with improved economic performance and boom in exports. Financial markets restructuring, CB independence and fiscal discipline and transparency are indispensable reforms in establishing macroeconomic stability and improving business environment. Moreover, sound economic system and stability are important factors to attract FDI flows.

Economic and political reforms must go hand in hand.
ECONOMIC DEVELOPMENT cannot be separated from political development. Otherwise, economic growth will not be sustainable in the long run. Establishment and/or transformation of institutions guaranteeing the rule of law, democracy, property rights and human rights are of crucial importance for sustainable economic development. Turkey pursued political and economic reforms together on her bid for EU membership. However, as soon as the EU membership anchor lost its charm, anti-democratic actions of the government gained momentum, resulting in the polarization of the society. Polarization prevents pluralism and integrity and, thus, economic development and growth.

The re-establishment of the rule of law, according to international standards, strengthens transparency, fairness and integrity.
ALTHOUGH THERE is no unique rule of law for every country, inspiration by those of developed economies could save time as well as prevent political struggles in the process of making the rule of law. While establishing RAs, Turkey was inspired by the legislation of the EU. Still, it should be noted that there is no clear- cut recipe for the rule of law to inscribe to any country as each country has its own dynamics.

REFERENCES

Acemoğlu, D., Simon J., and James A. R. 2005, "Institutions as the Fundamental Cause of Long-Run Growth." In Philippe Aghion and Steve Durlauf, eds., *Handbook of Economic Growth.*

Acemoğlu, D. and James R. "*The Role of Institutions in Growth and Development*", Working Paper No.10: Commission on Growth and Development, 2008.

Adam, A. and Moutos T. 2005, "Turkısh Delight for Some, Cold Turkey For Others? The Effects Of The EU-Turkey Customs Union", *CESIFO Working Paper* No. 1550.

Airaudo, Marc, Kemal Derviş, Daniel Gros, Faik Öztrak, Fırat Bayar, and Yusuf Işık. *Stabilising Stabilisation*, EU-Turkey Working Papers No. 7: Center for European Studies, 2004.

Akman, S (2012) "Turkey in the World Trading System and the WTO: Activism under Global Challenges and the EU Process", Afro Eurosian Studies, Vol.1, Issue 1, Spring 2012, 134-172.

Akkemik, K. A. 2011, "Customs Union and Competitiveness of Turkish Exports in the EU Market : A Dynamic Global Shift-share Analysis" *Journal of Emerging Market Economies*, 3(2) 247–274.

Akkoyunlu-Wigley, A. and Mihci S. 2006, "Effects of the customs union with the European Union on the market structure and pricing behaviour of the Turkish manufacturing industry", *Applied Economics*, 38:20, 2443-2452.

Alam, A., P. Anos Casero, F. Khan and C. Udomsaph (2008), *Productivity Growth in Eastern Europe and the Former Soviet Union,*World Bank,Washington, DC.

Alper, E. and Hatipoglu, O. 2009, "The Conduct of Monetary Policy in Turkey in the Pre- and Post-crisis Period of 2001 in Comparative Perspective: a Case for Central Bank Independence" in *Turkey and the Global Economy: Neoliberal Restructuring and Integration in the Post-Crisis Era*: pp. 50-72.

Antonucci, D. and Manzocchi, S. 2005, "Does Turkey have a special trade relation with the EU? A gravity model approach." Economic Systems, 30(2), 157–169.

Atiyas I. 2012, "Economic institutions and institutional change in Turkey during the neoliberal era", *New Perspectives on Turkey*, No:47(2).

Atiyas I. and Dogan, P. 2010, "Glass half empty? Politics and institutions in the liberalization of the fixed line telecommunications industry in Turkey." In *Understanding the Process of Economic Change in Turkey*, edited by Tamer Çetin and Feridun Yilmaz, 261-284. New York: Nova Science Publishers.

Aysan, A. F. and Hacıhasanoğlu, Y. S 2007, "Investigation on the Determinants of Turkish Export-Boom in 2000s" *Boğaziçi University Research Papers*: No:19.

Aysan A.F, M. M. Karakaya and Uyanık M. 2011, "Panel stochastic frontier analysis of profitability and efficiency of Turkish banking sector in the post crisis era". *Journal of Business Economics and Management*, 12(4), 629-654

Bakir, C, and Öniş Z. 2010, "The Regulatory State and Turkish Banking Reforms in the Age of Post-Washington Consensus." *Development and Change* 41, no. 1 : 77-106.

Bekmez, S. (2002) Sectoral impacts of Turkish accession to the European Union, Eastern European Economics, 40, 57-84.

Çarkoglu, A. 2003, 'Who wants the full membership? Characteristics of public opinion support for EU membership in Turkey', *Turkish Studies*, vol. 4, no. 1, pp. 171-194.

Çetin T., Sobaci M.Z, Nargeleçekenler M., and Abdulhakimoğulları E. (2010) "The Political Economy Of Independent Regulatory Agencies In Turkey." In *Understanding the Process of Economic Change in Turkey*, edited by Tamer Çetin and Feridun Yilmaz, 261-284. New York: Nova Science Publishers

Dedeoğlu (2010) "How Does the Fiscal Rule Work? First the public financial management system shall be adapted to fiscal rule", Economic Policy Research Foundation of Turkey, Policy Note, June 2010.

Dutz, M., M. Us and K. Yilmaz, 2005, "Turkey's Foreign Direct Investment Challenges: Competition, Rule of Law and the EU Accession," in Hoekman, B. and S. Togan, eds. *Turkey: Economic Reform and Accession to the European Union*, Oxford University Press, June.

Economist Intelligence Unit (2011), Democracy Index.

Ersel, Hasan, and Fatih Özatay, 2008 "Inflation Targeting in Turkey." Paper presented at the Workshop: "Monetary Policy and Inflation Targeting," Tunis, Tunisia, October 24-25, 2008.

Ertan Özgüzer, G. and Pensiroso L. 2009, "*Worthy Transfers: A Dynamic Analysis of Turkey's Accession to the EU*," Discussion Paper 2009-29, Department of Economics, Catholic University of Louvain.

Erzan R. and Filiztekin A. (1997) "Competitiveness of Turkish SMSEs in the Customs Union" *European Economic Review*, vol.41. pp: 881-892.

Esmer, Y. 2012. "2011 Türkiye Değerler Araştırması: Özet Bulgular", July 21, 2011.

European Commission (2012) European Commission Progress report on Turkey.

Flam, H. (2003). Turkey and the EU: Politics and Economics of Accession, CESifo Working Paper no. 893, Munich.

Göksel I, 2013. "Female Labor Force Participation in Turkey: The Case of Conservatism," forthcoming, Women's Studies International Forum.

Harrison, G.W., Rutherford, T.F. & Tarr, D.G. (1997) 'Economic implications for Turkey of a Customs Union with the European Union', *European Economic Review*, vol. 41, no. 3-5, pp. 861-870.

Izmen Ü. and Yılmaz K. (2009) "Turkey's Recent Trade And Foreign Direct Investment Performance" in Ziya Öniş and Fikret Şenses, eds.,Turkey and the Global Economy. Neo-Liberal Restructuring and Integration in the Post-Crisis Era, London Routledge.

Kaminski, B., & Ng, F. (2007) 'Turkey's Evolving Trade Integration into Pan-European Markets', *The Journal of International Trade and Diplomacy*, vol. 1, no. 2, pp. 35-103.

Karaalp H. S and Yılmaz N. D (2012) "Assessment of Trends in the Comparative Advantage and Competitiveness of the Turkish Textile and Clothing Industry in the Enlarged EU Market" Fibres & Textiles in Eastern Europe; 20,3 (92): 8-11.

Kaya and Yılar (201) Fiscal transformation in Turkey over the last two decades, OECD *Journal on Budget*, Issue 1.

Lejour, A. M., and R. A. de Mooij (2005) 'Turkish delight: Does turkey's accession to the eu bring economic benefits?' Kylos 58, 87-120.

Neyapti, B., Taskin, F., & Gungor, M. (2007). Has European Union agreement really affected Turkey's trade? *Applied Economics*, 39(16), 2121-2132.

Majone, G. (1994) 'The Rise of the Regulatory State in Europe'. *West European Politics*, Vol. 17 17, no. 3, pp. 78-102.

Mercenier, J. and Yeldan, E. (1997) On Turkey's trade policy: is a customs union with Europe enough?, *European Economic Review*, 41, 871-80.

McMillan M.S. and Rodrik, D. and (2011), NBER Working Paper Series, 17143.

Mc Kinsey Global Institute (2012) Manufacturing the Future: The next era of global growth and innovation, November 2012.

Nowak-Lehmann, F., Herzer D., Martinez-Zarzoso I. and Vollmer S. 2007, "The Impact of a Customs Union between Turkey and the EU on Turkey's Exports to the EU." *JCMS: Journal of Common Market Studies*, 45: 719-743.

North D. 2005, "Understanding the Process of Economic Change", *Princeton University Press.*

North D. 1990, "Institutions, Institutional Change and Economic Performances", *Cambridge University Press*, Cambridge.

OECD (2010), Economic Surveys, Turkey.

OECD (2012),Economic Surveys, Turkey.

Öniş, Z. (2003) 'Domestic Politics, International Norms and Challenges to the State: Turkey-EU Relations in the post-Helsinki Era', *Turkish Studies*, vol. 4, no. 1, pp. 9-34.

Öniş Z and Bakır C. (2007) "Turkey's Political Economy in the Age of Globalization: The Significance of the EU Anchor", South European Society and Politics, 12:2, 147-164.

Özkan G (2005) Currency and financial crises in Turkey 2000-2001: Bad Fundamentals or Bad Luck? World Economy 28(4): 541-572.

Özler, S. and Yılmaz, K. (2009) 'Productivity Response to Reduction in Trade Barriers: Evidence from Turkish Manufacturing Plants', *Review of World Economics*, vol. 37, no. 2, pp. 479-488.

Pamuk, Ş. (2007) "Economic Change in Twentieth Century Turkey: Is the Glass More than Half Full?", Boğaziçi University Working Paper no. 41.

Pazarbaşıoğlu C. (2005), "Accession To The European Union: Potential Impacts On The Turkish Banking," in Hoekman, B. and S. Togan, eds. *Turkey: Economic Reform and Accession to the European Union*, Oxford University Press, June.

Rodrik D. 2000, "Institutions for High Quality Growth: What they are and how to acquire them?", *NBER Working Paper* no. 7540.

Rodrik D. (2010), Yapısal Dönüşüm ve Kalkınma, TEPAV, Ankara.

Sulamaa, P. and Widgren M. 2007, 'Turkish EU Membership: A Simulation Study on Economic Effects', *VATT Discussion Paper* no. 410 (Helsinki: Government Institute of Economic Research).

Taymaz, E., Voyvoda, E. & Yılmaz, K. (2010) 'Global Links and Local Bonds: The Role of Ownership and Size in Productivity Growth', mimeo, Koç University.

Taymaz, E. and Yılmaz, K. 2007, 'Productivity and Trade Orientation: Turkish Manufacturing Industry Before and After the Customs Union', *Journal of International Trade and Diplomacy*, vol. 1, no. 1, pp. 127-154.

_______ 2008, 'Integration with the Global Economy: The Case of Turkish Automobile and Consumer Electronics Industries', The World Bank, Commission on Growth and Development, Working Paper no. 37.

Togan, S. (1997) 'Opening up the Turkish Economy in the Context of the Customs Union with EU', *Journal of Economic Integration*, vol. 12, no. 2, pp. 157-179.

________ (2000) "Effects of Turkey-EU Customs Union and Prospects for the Future", *Russian & East European Finance and Trade* 36, 5-25.

________ (2005) "Economic Implications of EU Accession for Turkey" , in *Turkey: Economic Reform and Accession to the European Union* eds. Hoekman, B. & Togan, S., Oxford University Press, Oxford, pp. 311-330.

Togan, S., Nebioğlu, H. & Doğan, S. (2005), 'Integration and the Manufacturing Industry', in *Turkey: Economic Reform and Accession to the European Union* eds. Hoekman, B. & Togan, S., Oxford University Press, Oxford, pp. 87-121.

Togan, S. (2010). "Turkey: Trade Policy Review 2007", *The World Economy*, pp.1139-1389.

Uğur, M. (2000) 'Europeanisation and Convergence via Incomplete Contracts? The Case of Turkey', *South European Society and Politics*, vol. 5, no. 2, pp. 217-242.

U.S. Commission (2012), The Annual Report of United States Commission on International Religious Freedom.

World Economic Forum (2012), The Global Competitiveness Report.

World Economic Forum (2011), The Global Gender Gap Report

Yilmaz, K. (2010) : Taking stock: the customs union between Turkey and the EU fifteen years later, TÜSIAD-Koç University Economic Research Forum working paper series, no. 1023, http://hdl.handle.net/10419/45427

Yükseler, Z. and Türkan, E. (2006) 'The Transformation of Turkey's Production and Foreign Trade Structure: Global Trends and Reflections' (in Turkish) TÜSIAD-Koç University Economic Research Forum Research Report

APPENDIX 1 The list of respondents

Economic Stakeholders

- Tuğrul Kutadgobilik: The chairman of Union of Employers' Association of Turkey (TISK) and the President of Turkish Employers' Association of Metal Industries (MESS)
- Volkan Vural: The member of the board of directors of Turkish Industrialists' and Businessmen's Association (TÜSIAD) and the president of the international politics platform in the same association. He is the co-founder of Bosporus Institute and a consultant to the president of Doğan Holding.
- Murat Kalsın: The vice-president of Independent Industrialists and Businessmen's Association (MÜSIAD) and CEO of Arkon Construction Company.
- Ünal Kocaman: CEO of CMS Company.
- Erdoğan Göğen: CEO of ITC Invest Trading & Consulting AG.

Regulators

- Ahmet Yücel : Deputy Undersecretary of Ministry for EU affairs
- Ekrem Kalkan: Director of Economic Analysis and Research Union of Turkish Competition Authority.
- Ramazan Yıldırım: Deputy Undersecretary of Ministry of Science, Industry and Technology

Economists

- Sübiday Togan: Professor of Economics at Bilkent University.
- Nilgün Arısan Eralp: Director of EU Institution of Economic Research Foundation of Turkey (TEPAV).
- Izak Atiyas: Professor of Economics at Sabancı University and the director of TUSIAD-Sabanci University Competition Forum.

APPENDIX 2 The list of questions

- Alignment with the acquis was relatively successful in the chapters of free movement of goods, customs union, economic and monetary policy, enterprise and industrial policy, external relations, and statistics. Was success in these areas reflected into productivity increases in Turkey/your company? Did significant progress in these chapters improve competitiveness of Turkey/your company? Which chapters and which reforms were most effective?

- Are there regulations that are very effective in improving the competitiveness and productivity of the country/your company which are not included in the chapters that helped Turkey achieve the significant progress mentioned above? What are they?

- Is there a shift in employment and value added across sectors that has lead to productivity increases? Can you attribute this to the alignment with the acquis? Can you name specific reforms that have led to this transformation?

- Do you think that Turkey's exports to the EU have been reoriented to higher value added and more technological products? If yes, which reforms have enabled this? If not, would further alignment with the acquis achieve this?

- As a consequence of the alignment with the acquis, do you think that there was trade creation or trade diversion? If yes in which areas, markets?

- Did you observe fall in the prices of exports of Turkey/your company? Was it because of productivity boost in Turkey? Did implementation of specific reforms accelerate this? Alternatively, was it due to high levels of competition in internal EU market? If you did not observe fall in the prices of exports, what could be done to increase the competitiveness of Turkish products?

- Do you think that Turkish economy is close to catching-up with that of the EU? If yes, would this have been possible without conditional process of adoption of the acquis?

- How important are the institutional developments for the achieved growth of the Turkish economy/or your company?

- Did alignment with the acquis help Turkish companies/your company to open up to new markets? If yes, can you be specific about the reforms and the markets?

- Do you think that some of the reforms done in Turkey could also be implemented in other Mediterranean countries? If so, which ones?

IPEMED
- Institut de Prospective Économique du monde Méditerranéen -