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Research Report

Turkey's globalizing economy

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Hamburg Institute
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Turkey's Globalizing Economy

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HWWI Policy
Paper 3-13

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Turkey's Globalizing Economy

Secil Pacaci Elitok and Thomas Straubhaar

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For almost fifty years between the end of World War II and the end of the Cold War, Turkey was a border state between West and East, between communist and capitalist economic systems. Turkey was an economically isolated country with no strong relationships with its neighbors. In the Black Sea Area, there were almost hermetically sealed political borders with the Soviet Union and its satellites. In the East, geographical impediments of the Caucasus Mountains restricted cross-border movements of goods and factors. In the nearby Western neighborhood, longstanding animosities prevented strong trade and migration flows with Greek or Cyprus.

The end of the Cold War changed the political landscape of the Black Sea area and the Middle East completely. In the North-East, the collapse of the Soviet Union was followed by the nascence of new sovereign nation states – with all the problems of nation building and all the costs of going through a fundamental economic and social transformation from communist systems to market oriented economies.

In the West, the European Union (EU) widened geographically and deepened structurally, increasing the number of full members from 12 to 15 (1995) to 25 (2004) and finally to 27 (2007). Furthermore a European Monetary Union with a common currency for 16 members (and even 17 members after the accession of Estonia by the year 2011) was established. Finally, the South-East – disturbed by political crisis and wars – has become more important as a supplier of energy (i.e. gas and oil) not only for the area itself but even more for Europe and other regions of the world.

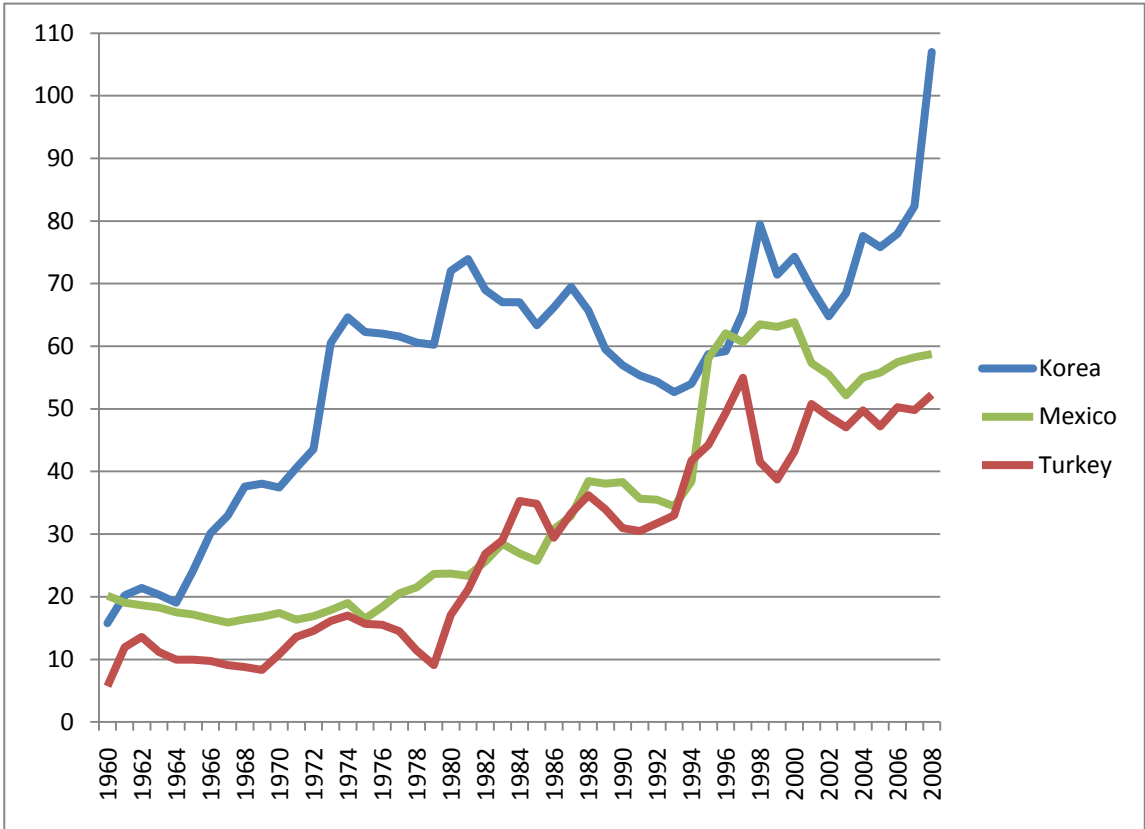
The end of the Cold War has been a catalyst for Turkish economic relations with its neighbors. Turkey moved from the periphery to the center of a region that is transforming politically, socially and economically very fast. It is now surrounded by 13 sovereign nation states, which are more or less open to international trade and factor movements.¹ All these new nation states have become potential partners for all kinds of economic activities. Due to their proximity, they are easily accessible markets for Turkish exports of goods or for imports of energy. Furthermore, they could provide the Turkish economy with cheap labor force – either as migrants to Turkey or as workers for Turkish plants to be established in the neighborhood.

¹ In this paper, all countries having either a direct common border with Turkey or having a sea border with the Black Sea are called Turkish neighbors. Thus, Turkish neighborhood consists of the following 13 countries: Armenia, Azerbaijan, Bulgaria, Cyprus, Georgia, Greece, Iran, Iraq, Moldova, Romania, Russia, Syria and Ukraine.

1. The opening up of the Turkish Economy

Turkey has taken up the opportunities and risks that have occurred as a consequence of the end of the Cold War. It has changed from a rather closed (import-substitution) economy to a much more open (export-oriented) economy with a still very strong share of state owned and state run enterprises. As figure 1 shows, the openness indicator (defined as sum of imports and exports of all goods and services divided by GDP) for Turkey was about 10% in the 1960s. It has risen by about 40 percent in the period between 1980 and 2000 and has remained since on a level of about 50%. Compared to one of the fastest growing economies of the last decades, Korea, and compared to a country with similar preconditions than Turkey, Mexico, the Turkish economy is still characterized by a low level of openness for goods and services.

Figure 1: Degree of Openness of the Turkish Economy Compared to Korea and Mexico, 1960 to 2008 in %



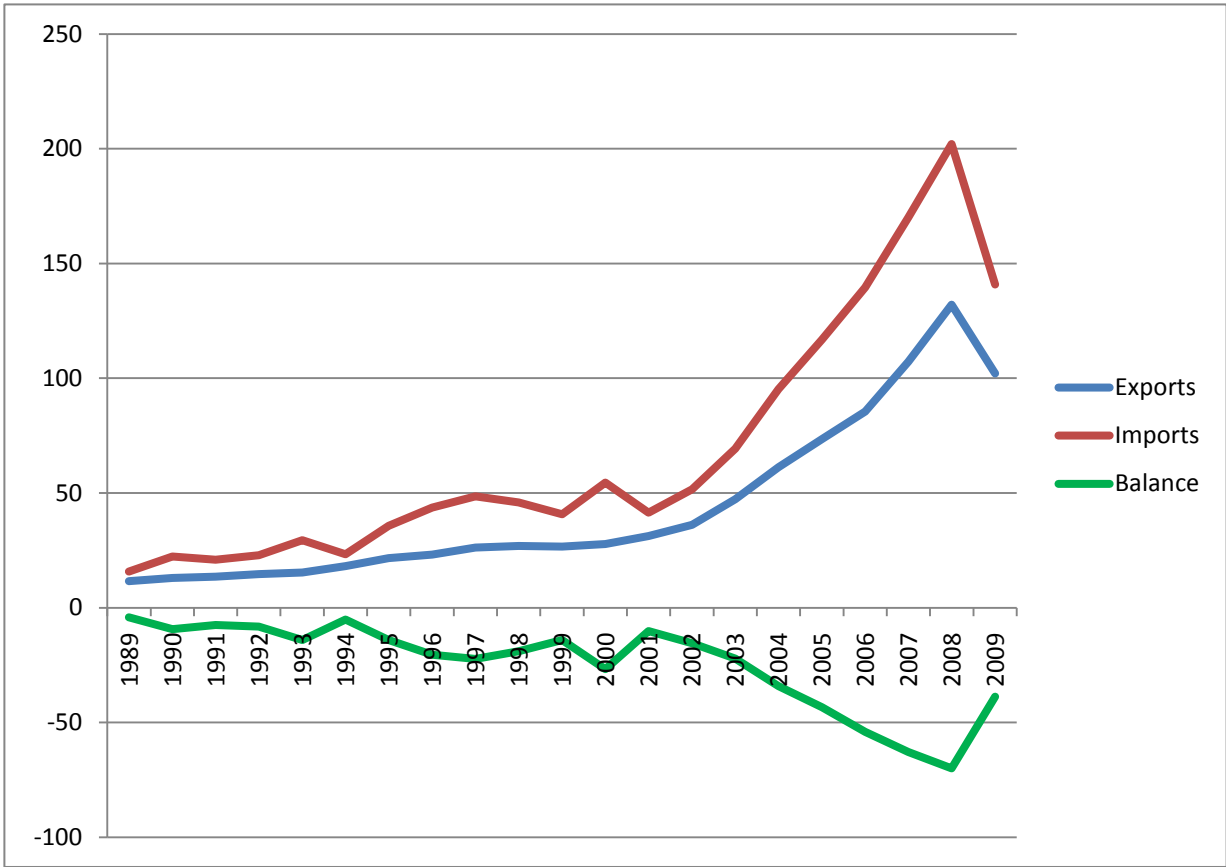
Data Source: World Bank: World Development Indicators.

2. The Turkish Balance of Trade

Turkish trade relations are characterized by a large trade of about 70 billion US-\$ in 2008 (figure 2). Due to the world recession it has decreased to less than 40 billion US-\$ in 2009.

Turkish export and imports of goods have increased substantially in the last decades, especially since the year 2001. Starting from a level of about 16 billion US-\$ for the imports and 12 billion US-\$ for the exports in 1989, imports have risen to about 200 billion US-\$ and exports to about 130 billion US-\$ in 2008. After the deep recession of 2008/2009, Turkey exported goods in the value of about 100 billion US-\$, and it imported goods of about 140 billion US-\$ value in 2009. This is a decline versus the year before of 23% for the exports and even 30% for the imports.

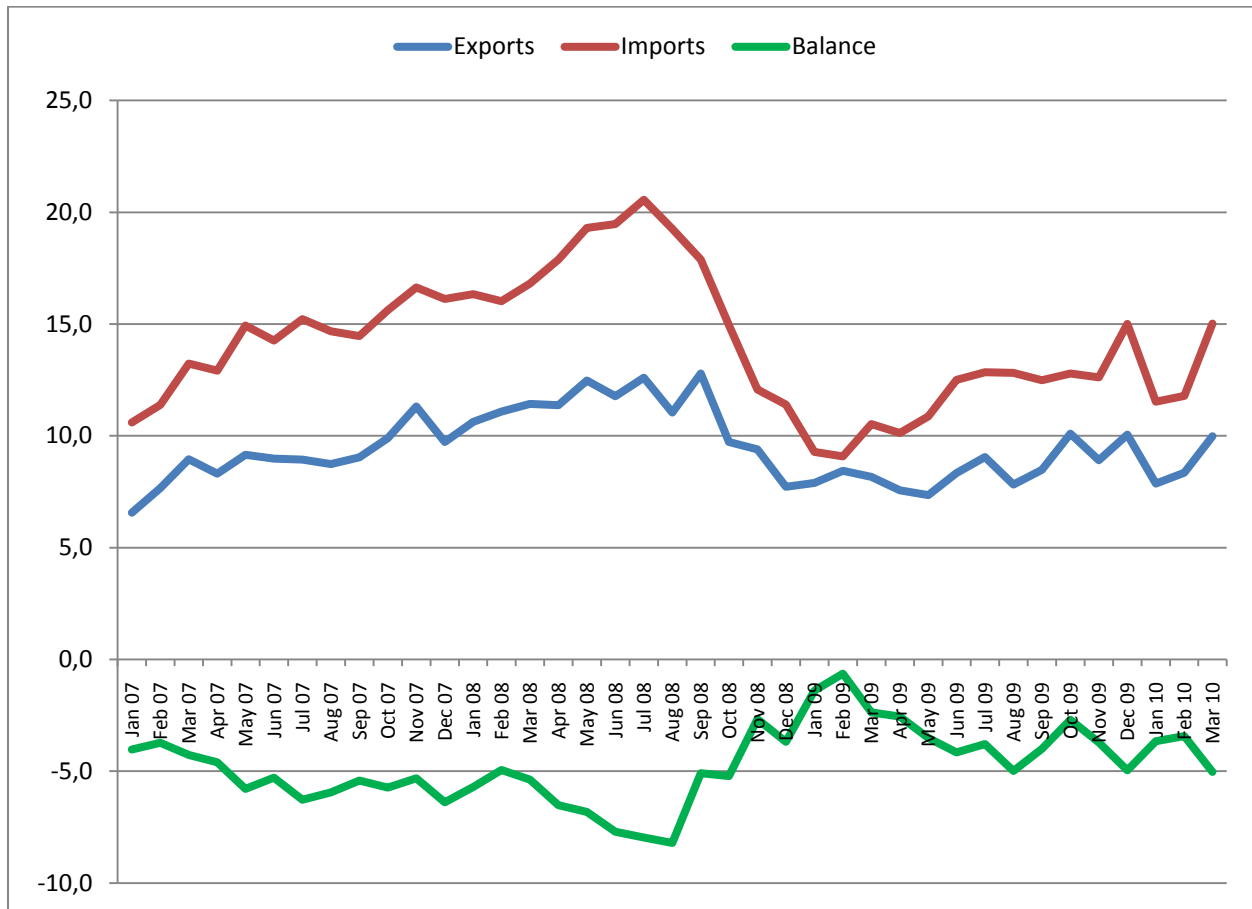
Figure 2: Trade Flows from and to Turkey 1989 – 2009
(Annual Exports, Imports and Balance in Billion current US-\$)



Data Source: Central Bank of Turkey: <http://evds.tcmb.gov.tr/yeni/cbt-uk.html>.

First data for 2010 show that the Turkish trade flows have almost reached the pre-crisis level already (see Figure 3).

Figure 3: Monthly Trade Flows from and to Turkey January 2007 to March 2010 (Exports, Imports and Balance in Billion current US-\$)



Data Source: Central Bank of Turkey: <http://evds.tcmb.gov.tr/yeni/cbt-uk.html>.

3. The Turkish Trading Partners

With regard to trade partners, Table 1 shows for Turkey that the EU 27 has played and still plays the central role by far, with Germany being the most important EU trade partner. However, the EU has lost a part of its dominant trade position to Turkey's close neighborhood. The EU accounted for almost half of all trade flows in 1991. This share has declined by more than 8% to slightly more than 40% in 2008.

On the other hand, the neighborhood has significantly increased its share on Turkish trade flows. About one quarter of all Turkish trade now goes or comes from the close neighborhood. That is 13.4% more than twenty years ago. However, most of this increase stems from the intensified exchange with Russia and it is mostly the consequence of Russian energy flows to Turkey. Thus, energy was the key that has opened up Turkey to its neighbors, and the import of energy and the rise of the oil and gas prices are the main causes of the shift of the shares of trade volumes from Europe to the neighborhood.

Nevertheless, Russia has become an important export market for Turkey with a share of 4.9% of all exports in 2008.

Turkish trade with the US has almost halved in relative terms between 1991 and 2008. In 1991, the US has been the most important market for Turkish exports outside the EU with a size of 6.7% of all Turkish exports. In 2008, Turkish exports to the US reached about 3.3% of all Turkish exports only, not much more than Turkey exports to Romania or to Iraq.

Finally, China has come into the Turkish orbit, mainly as a source for intermediate goods, parts and resources that are further improved in Turkey to be exported into other markets (mostly in Europe).

Table 1: Foreign trade relations between Turkey and its neighbors, 1991 and 2008

a) 1991

	Export		Import		Total	Trade	Balance
	mio US\$	in %	mio US\$	in %	mio US\$	in %	mio US\$
Russia	611	4.5	1,097	5.2	1,708	4.9	-486
Iran	487	3.6	91	0.4	578	1.7	396
Iraq	122	0.9	492	2.3	614	1.8	-370
Syria	264	1.9	67	0.3	331	1.0	197
Greece	144	1.1	77	0.4	221	0.6	67
Bulgaria	76	0.6	140	0.7	216	0.6	-64
Romania	105	0.8	199	0.9	304	0.9	-94
Neighborhood	1,809	13.4	2,163	10.2	3,972	11.5	-354
EU 27	7,348	54.1	9,896	47.0	17,244	49.8	-2,548
US	913	6.7	2,255	10.7	3,168	9.1	-1,342
Total	13,593	100	21,047	100	34,640	100	-7,454

b) 2008

	Export		Import		total	Trade	Balance
	mio US\$	in %	mio US\$	in %	mio US\$	in %	mio US\$
Russia	6,483	4.9	31,364	15.5	37,847	11.3	-24,881
Moldova	198	0.1	70	0.0	268	0.1	128
Ukraine	2,188	1.7	6,106	3.0	8,294	2.5	-3,918
Georgia	998	0.8	525	0.3	1,523	0.5	473
Azerbaijan	1,667	1.3	928	0.5	2,595	0.8	739
Iran	2,030	1.5	8,200	4.1	10,230	3.1	-6,170
Iraq	3,917	3.0	1,321	0.7	5,238	1.6	2,596
Syria	1,115	0.8	639	0.3	1,754	0.5	476
Greece	2,430	1.8	1,151	0.6	3,581	1.1	1,279
Bulgaria	2,152	1.6	1,840	0.9	3,992	1.2	312

Romania	3,987	3.0	3,548	1.8	7,535	2.3	439
Neighborhood	27,165	20.5	55,692	27.7	82,857	25.0	-28,527
EU 27	63,390	48.0	74,802	37.0	138,192	41.4	-11,412
US	4,300	3.3	11,976	5.9	16,276	4.9	-7,676
Total	132,027	100	201,964	100	333,991	100	-69,937

c) *Difference 2008 to 1991*

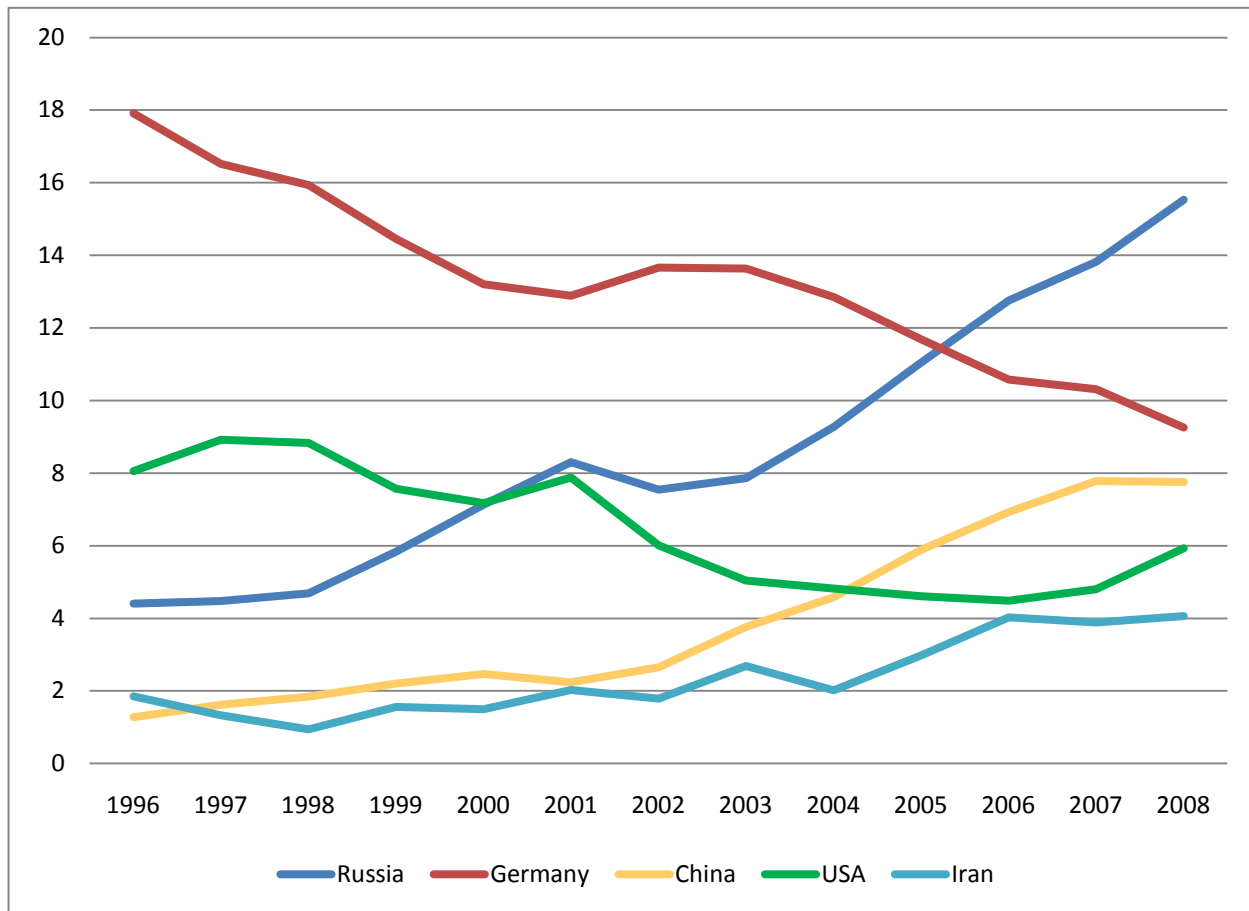
	Export	Import	Trade total
	in %	in %	in %
Ex Soviet Union	4.2	14.1	10.2
Iran	-2.0	3.6	1.4
Iraq	2.1	-1.7	-0.2
Syria	-1.1	0.0	-0.5
Greece	0.8	0.2	0.5
Bulgaria	1.1	0.2	0.6
Romania	2.2	0.8	1.4
Neighborhood	7.3	17.2	13.4
EU 27	-6.0	-10.0	-8.4
US	-3.5	-4.8	-4.2

For 1991, the values for Russia are values for USSR. Therefore, separate data do not exist for Moldova, Ukraine, Georgia, and Azerbaijan for 1991. For 2000, no data exist for Iraq.

Data Source: Turkish Statistical Institute, *Foreign Trade by Countries Report*, www.tuik.gov.tr.

Figure 4 demonstrates that Russia has become the most important Turkish import partner. Germany's share on total Turkish imports has fallen from about 18% in the mid 1990s to less than 10% in 2008. This share is only slightly higher than the Chinese.

Figure 4: Most Important Turkish Import Partners 2008
(Bilateral Imports to Turkey as a Percentage of Total Turkish Imports in %)



Data Source: Turkish Statistical Institute, *Foreign Trade by Countries Report*, www.tuik.gov.tr

Table 1 shows that with regard to the trade balance Turkey has the largest deficit with Russia. It reflects the strongly growing Turkish import of Russian gas and oil. Turkey also has a negative trade balance of 11.4 billion US-\$ vis-à-vis the EU 27 and of 7.7 billion US-\$ vis-à-vis the US. This makes clear that the “West” has strong economic interests in securing good political relationships to Turkey, in order to keep easy access to the Turkish market and to preserve the trade surplus with Turkey.

Turkey also has a trade deficit with Iran. It imports energy but is unable to export manufactured goods to Iran. One reason is the political struggles in the area. Another reason is the high level of protectionism of Iranian markets for Turkish economic activities (including barriers for Turkish personnel selling Turkish products in Iran).

However, there were some countries in the nearby neighborhood, where Turkey has generated an export surplus. To this group belong all of the bordering EU neighbors (i.e. Greece, Romania, and Bulgaria) but also the smaller ex-Soviet Union countries and Syria.

Turkey has extensive trade relations with all of its neighbors except Armenia. In addition to the intra-trade potential of the region there exists other potentials for other sectors of the Turkish economy and investments as well. For instance, with the end of the political conflict in Northern Iraq, Turkey will be an important actor who is investing in the region and taking significant role in the restructuring. Infrastructure requirements of countries like Russia, Libya, Qatar or Turkic Republics will keep its importance in the near future and this requirement will be mostly met by Turkey. In terms tourism activities, Turkey will be even more attractive for Middle Eastern countries.

Syria is of special interest for Turkey. After the Turkey-Syria free trade agreement came into effect in 2004, trade flows between the two countries have picked up and it is the expectation that Turkey might become Syria's economic gateway to Europe, and Syria Turkey's gateway to Arab markets.² The two sides signed far reaching protocols on trade, development and cultural exchanges in March 2010.³ But even if the Turkish-Syrian trade flows have more than quintupled in the last twenty years, from 331 million US-\$ in 1991 to 1,754 million US-\$ in 2008, they made up only 0.5% of the total Turkish trade in 2008 – actually a smaller share than in 1991. Much more than on the country level, neighborhood markets have become important on the regional level for Turkish border areas. This is especially true in areas along the Syrian border and in the southeast. Here, a rapidly growing exchange just over the border has taken place in the last years.

In addition to this transformation in the trade partners of Turkey lately, one aspect remained unchanged: dependency of exports to the imports. On average, each of the 100-unit export products exported, 68 percent of imported inputs are used.

Commodity composition of Turkey's trade shows that Turkey mostly exports labor intensive and primary goods. There is a need to break the dependency of exports on imported inputs and change in the commodity composition of exports from labor intensive goods to the capital intensive commodities.

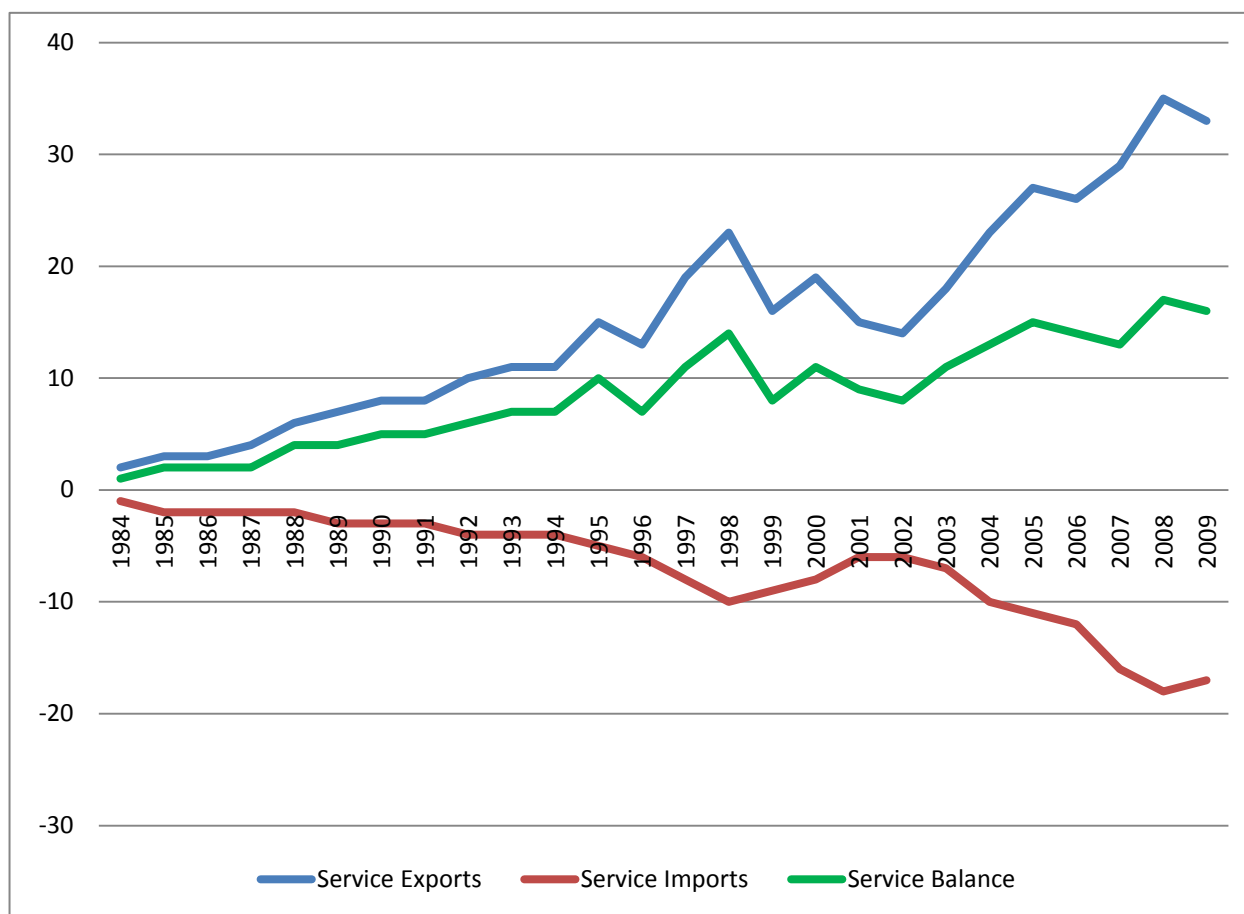
4. The Service Trade

Service trade plays an important role for Turkey. As figure 5 shows, there was a service trade surplus of about 16 billion US-\$ in 2009. At least partly, it helped to finance the deficit of trade in goods. About 60% of the service imports comes from "travel" what includes most of the tourism business.

² See Kirisci, Kemal, Nathalie Tocci, and Joshua Walker. *A Neighborhood Rediscovered (Turkey's Transatlantic Value in the Middle East)*. Washington DC: German Marshall Fund of the United States (Brussels Forum Paper Series), 2010, esp. page 21

³ See International Crisis Group. *Turkey and the Middle East: Ambitions and Constraints*. Europe Report no 203. Brussels: International Crisis Group, 7 April 2010, esp. page 10.

Figure 5: Service Trade from and to Turkey 1984 – 2009
(Annual Exports, Imports and Balance in Billion current US-\$)*



* In 2003, the Central Bank of Turkey made a change in its balance of payments statistics and decided to count the last two subitems of workers' remittances (Turkish lira conversion from foreign exchange accounts of Turkish citizens living abroad and money they spent during their visit in Turkey) under the subitem "tourism". In a long run comparison, this has led to an artificial increase in the tourism revenues after 2003.

Data Source: Central Bank of Turkey: <http://evds.tcmb.gov.tr/yeni/cbt-uk.html>.

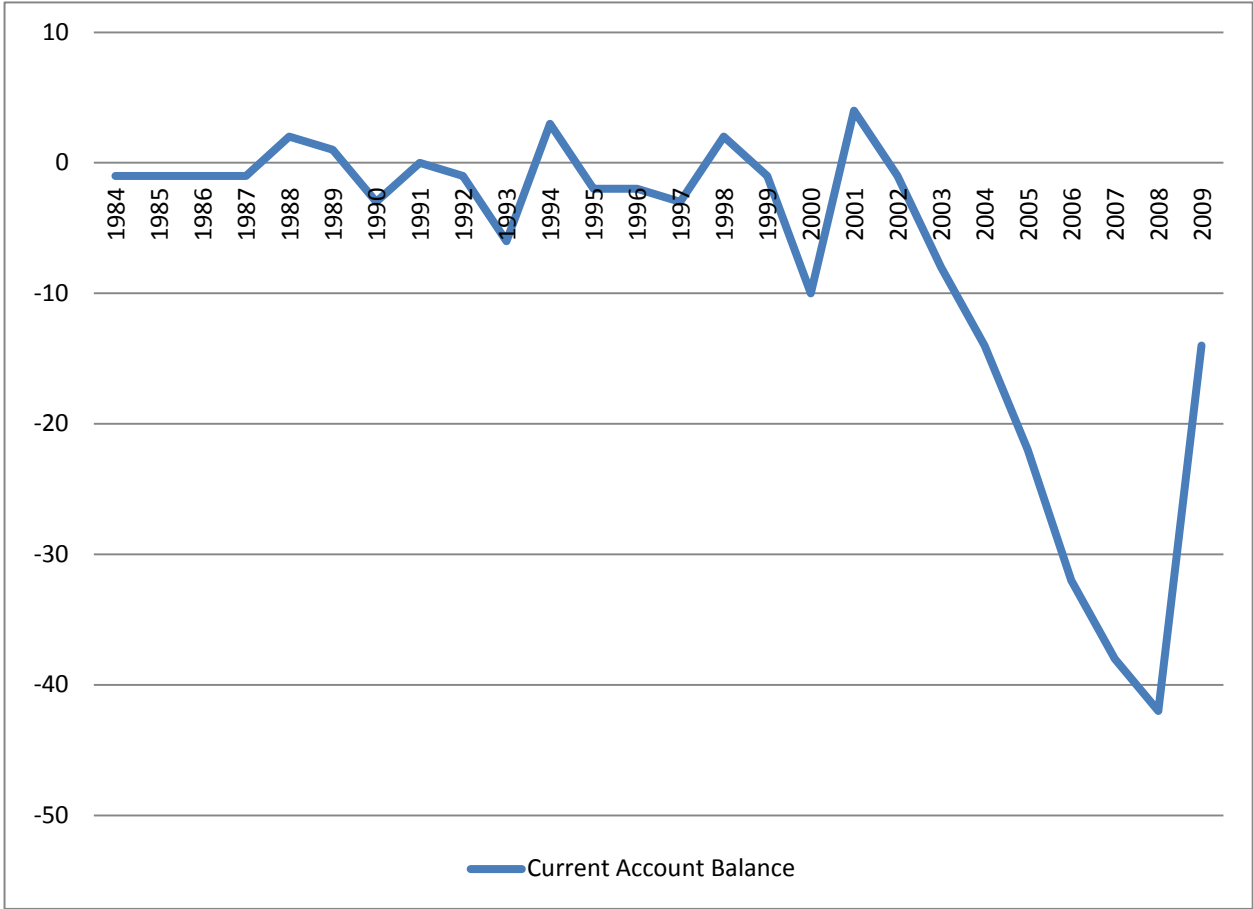
5. Conclusion: The Turkish Current Account Deficit as a Problem

As it is presented in Figure 6, from 1984 to 2009, the current account was negative with the exception of 1988, 1989, 1991 (barely), 1994, 1998 and 2001. The worsening of the current account deficit after the 2000/1 crisis is quite obvious and visible. After reaching to 22.8 billion US-\$ in 2005, the current account deficit hit the bottom point in final global crisis of 2008/9 and then followed a recovery pattern.

Current account deficit dropped from 42 billion US-\$ in 2008 to 14 billion US-\$ in 2009. In 2008 and 2009, current account deficit was financed by two items: direct investments and net errors and omissions (undocumented capital flows in the case of Turkish economy). Direct investments brought 6.1 billion US-\$ foreign exchange to the Turkish

economy in 2009. The sources of direct investments were usually the joint ventures, privatizations and sale of land. Hence, contribution of direct investments were not originated form the investments fostering the real economy-production but mostly the financial sector.

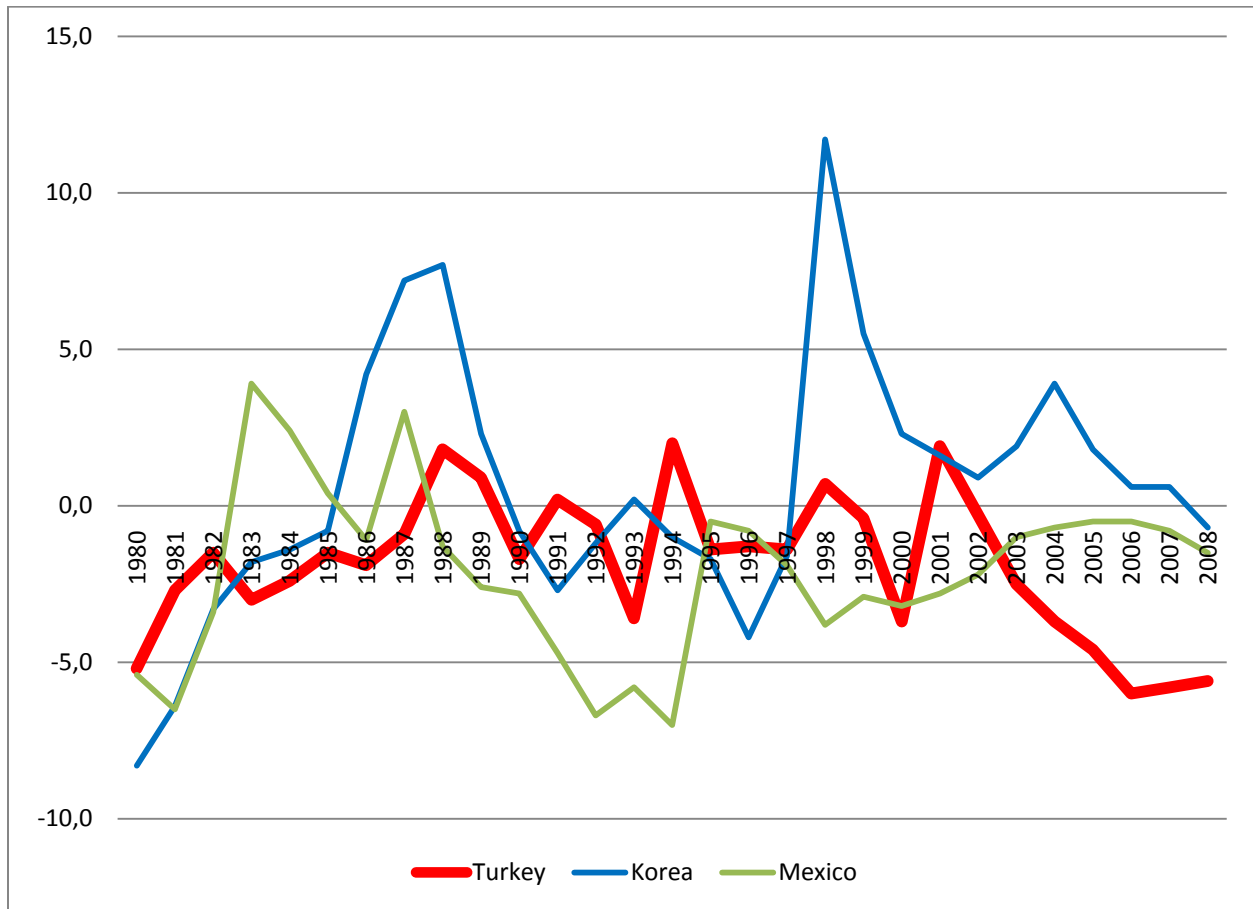
Figure 6: Turkish Current Account 1984 – 2009
(Annual Balance in Billion current US-\$)



Data Source: Central Bank of Turkey: <http://evds.tcmb.gov.tr/yeni/cbt-uk.html>.

The share of current account deficit in % of the GDP is considered to be a more important indicator than the current account deficit itself. A value for this share of 5% or more might be a critical indicator of a severe macroeconomic problem. Values far above might be a sign of a financial crises. The current account deficit in % of GDP for the Turkish economy was almost 6% in the second half of this decade. Compared to Korea and Mexico the relatively strong current account deficit indicates the fragile stability of the Turkish economy.

Figure 7: Current Account Balance in % of GDP for Turkey Compared to Korea and Mexico, 1980 – 2009



Data Source: World Bank: World Development Indicators.

In the third quarter of 2009, total external debt stock of Turkey was 273 billion US-\$. Due to debt dependency characteristics, sustainability of growth is under discussion in the case of Turkey. Significant role of external sources in financing the trade deficit increased the concerns about the stability of Turkish economy and its future as well. The link between real sectors and financial sector might be missing.

Annex Table A1: Geographical Distribution of Trade Flows from and to Turkey 1982 – 2009

a) Exports, Imports in Billions current US-Dollar and Shares of Different Regions in %

Period	Turkey (total)			EU 27			BSA 13			BSA 12 (without Russia)		
	Exp	Imp	Sum	Exp	Imp	Sum	Exp	Imp	Sum	Exp	Imp	Sum
Average	billion	billion	billion	Total	Total	Total	Total	Total	Total	Total	Total	Total
per year	US-\$	US-\$	US-\$	= 100	= 100	= 100	= 100	= 100	= 100	= 100	= 100	= 100
1982-1989	8,4	11,9	20,4	46	42	44	14	3	8			
1990-1999	19,9	33,3	53,3	56	51	53	12	8	9	9	4	6
2000-2009	70,6	108,4	179,0	55	44	48	14	17	16	11	6	8

b) Shares of Different Countries in %

Total = 100	Germany			Russia			Italy			USA			France			China		
Period	Exp	Imp	Sum	Exp	Imp	Sum	Exp	Imp	Sum	Exp	Imp	Sum	Exp	Imp	Sum	Exp	Imp	Sum
Avg per year																		
1982-1989	18	13	15				7	6	6	6	10	8	4	4	4	1	1	1
1990-1999	23	16	19	4	4	4	6	9	8	7	10	9	5	6	6	1	1	1
2000-2009	14	12	13	3	11	8	7	7	7	7	6	6	6	5	5	1	5	3

Source: Own calculations with data from: Central Bank of the Republic of Turkey, Electronic Data Delivery System (EDDS) available under: <http://evds.tcmb.gov.tr/yeni/cbt-uk.html>.

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