

Turkey

Status Index (Democracy: 7.05 / Market economy: 6.79) 6.92		Management Index 6.49	
HDI	0.750	Population	71.3 mn
GDP per capita (\$, PPP)	6,772	Population growth¹	2.0 %
Unemployment rate	10.3 %	Women in Parliament	4.4 %
UN Education Index	0.82	Poverty²	10.3 %
		Gini Index	40.0 (2000)
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003. ² Population living below \$2 a day (1990- 2003).			

A. Executive summary

At the European Council meeting in Brussels in December 2004, “the European Council welcomed the decisive progress made by Turkey in its far reaching reform process, and expressed its confidence that Turkey will sustain that process of reform. The EU will continue to monitor closely the progress of political reforms on the basis of an Accession Partnership setting out priorities for the reform process” (Article 18, European Council Presidency Conclusion). In addition, “the European Council decided that, in the light of resolution of the European Parliament and of the Commission report and recommendation, Turkey sufficiently fulfills the Copenhagen political criteria to open accession negotiations... [and] invited the Commission to the Council a proposal for a framework for negotiations with Turkey. It requested the Council to agree on that framework with a view to opening negotiations on 3 October 2005” (Article 22).

Turkey’s serious political and economic difficulties seem to be the main impediments to full membership in the European Union. Turkey’s recent macroeconomic problems were primarily domestic in origin, stemming largely from excess aggregate demand generated in the public sector, which forced the economy to grow faster than private savings, would allow. In other words, political imperatives generally dominate economic imperatives, which has been a fundamental dilemma facing both the former and present governments of Turkey.

Determining the right policy is not enough; the political will and the power to implement this policy is also necessary. The economy is slowly recovering. Turkey needs to maintain its “impressive progress” in reforming banks, whose loan policies and lack of reserves were primary causes of the economic crises in 2000 and 2001. The leadership has reacted quickly to try to reassure both domestic markets and the IMF that it will keep the commitments it has made to the IMF. However, inconsistent and populist policies pursued since 1989 have resulted in a “two steps forward and one step backward” sequence, while the outward-looking development strategy established in 1980 was subsequently interrupted by significant mistakes

made by Turkish decision-makers at the end of the 1980s. The Turkish economy has returned repeatedly to conditions of major macroeconomic instability. High inflation and unemployment rates remain major concerns once again.

The new IMF-guided stabilization program, which is still underway, seems to offer the Turkish economy a chance to exit this state of permanent crisis. With uninterrupted, determined implementation of the latest IMF-guided stabilization program, the present government has the chance to break these deep-rooted vicious cycles and to reduce economic imbalances that remain serious. Economic stability would certainly contribute to the internal resolution of the country's political stability issues, and it is therefore crucial. In addition, improving economic conditions and establishing economic stability would provide the government with the self-confidence needed to make necessary political reforms. This would in turn create a politically stable environment for the completion of political liberalization in order to satisfy the 1993 Copenhagen Criteria, which would certainly help Turkey's cooperation with the European Union, leading to positive outcomes in accession negotiations with the European Union.

Apart from these economic problems which remain unresolved, other issues – such as widespread nepotism in state-owned enterprises, ongoing corruption, abuse of power by many politicians, and bribery – have hit the headlines, and top domestic policy agendas. There is a growing call for “cleaner society” and the elimination of political corruption. It has become clear that incoherent and sometimes nationalistic statements issued by certain politicians do not provide a suitable framework for solving these problems, which have only increased over the years. A political “changing of the guard” and a generational shift – not only within the party-political landscape and the state itself, but also in all private and state-owned enterprises and institutions – is therefore absolutely essential. Party leaders and governing elite who came of age and began their service in cold war conditions have been shocked by the unexpected radical political and economic changes taking place around the world. It has been quite difficult for established politicians and institutions to interpret these new circumstances, and to adjust themselves adequately and correctly by reviewing and improving party politics and programs.

B. History and characteristics of transformation

The Ottoman Empire was a multicultural state, which stretched from the Adriatic Sea to Egypt, with vassals throughout the empire belonging to different religions, such as Islam, Christianity, and Judaism. The philosophy of state, however, was based on the Islamic principles of Shariah (the Quranic legal system) originated from the Quran, and on the powerful political representation of the class of priests (ulema) who later became civil servants of the state. Ottoman Sultans since 1774 actively exercised a dual function, serving as head of the Empire and the leader of all Muslims as "Caliphate" at the same time.

In 1924, shortly after the establishment of the modern Turkish Republic, the institution of the Caliphate was abolished by Atatürk and his companions, who wanted to establish a secularist world outlook, with strict separation of state and religious affairs. A series of secular measures were implemented, such as shifting the weekend holiday from the Islamic holy day to the Christian Sunday, and replacing the lunar calendar of Islam with the Gregorian calendar.

The young Republic had a dual objective: to deal with religion, but to relegate it from the public to the personal domain. These reform measures, initiated by the leadership as part of a Westernization process that lasted for over 150 years, were aimed at overcoming the economic and technical backwardness of the country. It was a common belief that secularism would also contribute to establishing the fundamental principles of a Western-type democratic system in Turkey. Atatürk and his friends believed that with the separation of state and religion, the westernization process could be implemented and modified, and Western standards of living could be reached. He believed, as Philip Robins put it, that “Islam was repugnant as a manifestation of oriental mysticism which offended the rigor of European rationalism.” The leadership also hoped secularism would diminish the influence of religion on politics, and prevent the return of former “religiously-tainted” leadership to power. In addition, the potential for conflict and controversy between the two major religious groups, the Alevis and Sunnis, would be hindered within a secular society.

With the establishment of the Turkish republic in 1923, Turkey's development strategy was built upon the broad objectives of rapid economic growth, self-reliance and employment creation, and equitable income distribution and social justice. After an initial period of relatively free trade policy and very low overall growth in the 1920s, the government decided to introduce a policy of "Etatism" in the 1930s. Within the framework of this new development philosophy and policy, the government started to intervene heavily in the economy, helping to launch and sustain an inward-looking development strategy.

This inward-looking strategy and protectionism aimed to achieve industrialization behind the protective walls of tariffs and import quotas, saving foreign exchange for debt payments and import expenditures. This was justified by the widely held view that rapid industrialization could only be realized with help of the import substitution policy. In addition, Turkey was favorably impressed and influenced, as were many other developing countries, by the perceived success of the Soviet Union in its rapid economic development without any significant external assistance. Indeed, in the 1930s, Turkey faced huge structural and institutional problems, such as low savings and investment and structural unemployment in agriculture. Furthermore, there was a shortage of entrepreneurs and managers to undertake activities in the private sectors, which had no experience in either domestic or foreign markets, and were therefore unprepared to take high risks by selling abroad.

This strategy assigned a leading role to the state in economic development, especially in key industries such as manufactured foods, textiles, railways, and the energy sector. Under this new state-led, inward-looking development strategy, a number of State Economic Enterprises (SEEs) were founded in Turkey, which primarily produced and marketed agricultural, mineral and manufactured commodities for the domestic market. Protectionist measures were put in place to protect these infant industries from international competition. Over the years, the importance of these SEEs, in terms of both total production and total employment, grew steadily.

Prior to 1980, this inward-looking development strategy played a major role, and it was pursued vigorously by all Turkish governments for more than half a century. Nevertheless, Turkey succeeded in building a well-diversified industrial structure. The country also succeeded in eliminating poverty, and improving the education, health, and nutrition of its population. However, it should be underlined that these achievements were obtained at a high cost. The industrial structure, while diversified, is not internationally competitive in most if not all cases in terms of cost and quality of output. Most of the industries in the public sector have yielded negligible returns and have been exceptionally over-employed. Although it was obvious that this inward-orientation was creating a highly protected domestic industry and encouraging inefficient use of resources, inflexible labor markets dominated by the state, and price distortions in the economy, it was not seriously questioned by the Turkish private sector or by policy-makers until 1980.

By implementing policies of import substitution and pursuing industrialization behind high protectionist barriers and isolated from international competition, Turkey failed to adopt policies that would foster rapid economic growth. Instead, the government has pursued monetary and fiscal policies to satisfy its overriding goals related to populist demands.

As a result, the government accrued increasing budget deficits and it was forced to borrow from abroad or from the Central Bank and the public. This led to financial instability, accelerating inflation, bitter industrial conflicts, and a cyclical balance of payments crisis that returns to cause political instability almost every ten years. This vicious circle was only interrupted by a military takeover, and the implementation of an Economic Stabilization Program imposed by the IMF and the World Bank.

During the 1990s, three main issues topped Turkey's political agenda. Of primary concern was the erosion of secularism, the spread of an Islamic movement in the country and the advance of Islamists within state power structures. Second, the "Southeast question" or the Kurdish issue has also been a primary concern. Third, Turkey's political system has not been able to adjust itself to the rapid economic and social changes that have taken since the collapse of the Soviet Union. Instead, the country has been suffering because of the inability and unwillingness to change among shortsighted politicians of the cold war period.

Established political parties have experienced heavy defeats since 1994, in contrast to the continuing rise of Islamist parties. One of the main reasons for Turkey's Justice and Development Party's (AKP) election success was the splintering of Turkey's political landscape, with 17 parties ranging from the extreme left to the right wing represented in the general election. Only two of these parties reached the 10% threshold, and the resulting two-party system may perhaps create more political stability.

Secondly, none of the established parties—regardless of their political attitude, philosophy or programs—tried hard enough to address the country's huge economic, political and social problems, which had mounted over the decades. Governments led by parties within the existing political system were unable to demonstrate their determination to undertake necessary policies, or the political will or clarity to carry out radical reform. Their policies instead became unpredictable and confusing, putting the government's reputation at stake.

The policy uncertainty that followed led to decreases in investment, intensification of speculation and a strengthening of the underground economy, all of which contributed to the deepening economic crisis of the country. Negative economic trends caused displeasure in the working population – such as small farmers, workers, unemployed people and marginal groups living at the outskirts of the large cities – which were heavily impacted by the high rates of inflation and the worsening labor market. People within these lower-income groups and the working class subsequently began searching for a promising political party that could convince them of its ability to enhance their future prospects. Until the breakdown of the former Soviet Union, socialist and social democratic parties traditionally played this role among the working classes. Islamist parties and the AKP have since taken over this function from the leftist parties. As a result, election analysis indicates that AKP voters include not only traditional regular voters, but also ordinary people largely unaffected by the economic instability and “protest voters.” These groups of people have apparently been persuaded by the Islamists' slogan “bright future.”

Parties that have described themselves as modern and Kemalist, as far as the fundamental principles of the Republic are concerned, have frequently pursued populist policies that have been relaxed in tolerating anti-secularist manifestations and Islamist demonstrations.

Former governments failed not only to address economic problems, but also in fighting corruption and the underground economy. According to the press, the size and scope of the underground economy and the Mafia's connection with political circles reached a disquieting point, at which point the demand for “peace and order” and a “clean society” began increasing; these growing public fears should be cause for serious consideration in the future.

C. Assessment

1. Democracy

Turkish voters went to the polls on November 3, 2002 in an election widely regarded as the most important one for many years. It was clear the incumbent would be replaced, but it was unclear who would govern this strategically important country and in which direction they would lead it. A party with deep Islamic roots, the Justice and Development Party (AKP) headed by Recep Tayyip Erdoğan, won a landslide victory in the general election and acquired a massive parliamentary majority, receiving more than one-third of all votes cast and 363 of 550 parliamentary seats. The Republican People's Party (CHP) will be the new opposition party in parliament.

1.1. Stateness

The end of the Cold War triggered changes both outside and inside Turkey. Former political taboos began to be broken, and internal political problems that had been suppressed for decades could no longer be ignored. The long-deferred need for comprehensive reform measures surfaced with increasing intensity. Changes in political attitude and rethinking processes seemed to be prerequisites for an adjustment process to the new international order subsequent to the collapse of the bipolar system that had existed since 1945. Challenges emerged both domestically and internationally and increased the pressure on Turkey. Issues around human rights, enforcement of democratization processes, adjustment difficulties between political classes and systems, political Islam, stateness and ethnic affiliation were addressed by the media and the subject of heated public discussion. The need for change made initiation of radical reform measures imperative in all fields of political and economic life.

The state's monopoly on the use of force has been established nationwide in principle, but the state does not seem to be able to fully control organized criminal activities and terrorist activities initiated from outside the country.

Under the 1923 Treaty of Lausanne, non-Muslim communities (Jews, Armenians, and Greeks) are regarded as minorities in Turkey. Other de facto minorities, such as the Kurds, are not granted minority status. Turkey has not signed the Council of Europe's Framework Convention for the Protection of National Minorities or the European Charter for Regional or Minority Languages (ECRML). It also has not ratified the Additional Protocol No. 12 to the European Court of Human Rights (ECHR) on the general prohibition of discrimination by public authorities. On the other hand, the Constitution has been amended regarding the protection of cultural rights to lift the ban on the use of languages other than Turkish. The electoral system

remains unchanged, and the 10% threshold that political parties are required to achieve makes minority representation in parliament difficult.

The founders of the Turkish state were aware that the influence of religion in society could not be eliminated overnight. Thus, the Directorate for Religious Affairs (Diyanet İşleri Başkanlığı) was founded with the aim of overseeing religious institutions and providing prayer and preaching. Actions were taken against the discrimination of women in public life and institutions, and the former Islamic legal system was replaced with the Swiss civil code. The Islamic education system was abolished and public religious schools closed, relegating religious education to the sphere of clergy and theological schools. The activities of many religious institutions, heterodox organizations (tekkeler) and sects (tarikats) were suppressed or forbidden by the state. For a long time, leaders regarded secularism as the most important pillar and a key element of the "Kemalist Revolution." This move toward secularism over the past decades has meant Turkey is now the only Islamic country practicing secularism irrespective of its various political fluctuations and tensions. This move toward secularism has therefore upgraded Turkey's perceived status in the West and amongst pro-Western elites in Islamic countries.

Turkey's fundamental administrative structure was adopted by the founder of the Republic from the Ottoman Empire. The state is centralized and it is governed by a powerful state bureaucracy whose representation and influence extends throughout the entire territory of the country. However, considerable deficiencies in organizational structure, administration of justice, health services and education exist.

1.2. Political participation

Free local and general elections have been taking place since 1950. Turkey is making great effort to implement the political reforms outlined in two major constitutional reforms and eight legislative packages, which include the freedom of expression and assembly, freedom of association, and minority rights.

Elected rulers possess the power to govern the country in principle, but various Islamic groups and regional feudal rulers, particularly in eastern and southeastern Turkey, can greatly affect the results of local and general elections. Civil-military relations are moving toward European standards.

Since 1999, Turkey has made radical changes in political life, and civil society has grown remarkably. Progress has been achieved in freedom of demonstration and peaceful assembly, and some of the restrictions concerning freedom of association have been eased. The law on political parties has been amended to make closure of these parties more difficult.

Regarding freedom of the press, the new press law adopted in June 2004 represents an important step toward increasing press freedom, by strengthening the right of journalists not to disclose their sources and reinforcing response and correction protocol and replacing prison sentences with fines. Additionally, foreigners will now be permitted to edit or own Turkish publications.

1.3. Rule of law

Judiciary independence and efficiency have largely been achieved. State Security Courts were abolished and some of their competencies shifted to the newly created Serious Felony Courts.

According to the annual report prepared by the EU Commission in 2004, “the principle of the independence of the judiciary is enshrined in the Turkish Constitution, which provides that judges and prosecutors shall be attached to the Ministry of Justice insofar as their administrative functions are concerned. Moreover, appointment, promotion, discipline and the careers of all judges and prosecutors are determined by the High Council of Judges and Prosecutors, which is chaired by the Minister of Justice and of which the Undersecretary of the Ministry of Justice is also a member.” The constitution underlines that the High Court of Justice must be an independent institution.

President Ahmet Sezer has identified corruption as one of the most serious problems affecting Turkey, and has given his support to the fight against corruption. The government has taken serious steps in the fight against corruption aimed at ensuring the transparency and accountability of resource allocation in the public sector, preventing politically motivated interventions in the management of the economy, and strengthening good governance. Turkey ratified the Civil Law Convention on Corruption, and on January 1, 2004 became a member of the Council of Europe’s Group of States against corruption (GRECO). In December 2003 parliament adopted proposals to open investigations into allegations of corruption against a former prime minister and several other ministers, and the Parliamentary Investigation Committee decided to bring charges against the former state ministers. The current privilege of parliamentary immunity has been identified as one of the main reasons for corruption.

Turkey has ratified major international covenants on civil, political, social and economic rights and protocols of the European Convention on Human Rights. The fight against torture and ill-treatment has been strengthened, and the Turkish legal system has come closer to European standards in this respect.

1.4. Stability of democratic institutions

Democratic institutions are improving under monitoring by the EU Commission. All reform measures introduced in past years have aimed at restructuring the country's centralized, hierarchical and secretive system into a decentralized, participatory, transparent, responsive and credible model. They are also focused on closing the gap between the European Union and Turkey.

With the exception of some marginal, nationalist, and leftist groups, all relevant political, economic and social interest groups agree on the legitimacy and desirability of a well-functioning democratic system. A great majority of the Turkish population supports Turkey's full membership in the European Union.

1.5. Political and social integration

A splintering of the political landscape has occurred in Turkey, and the general election included 17 parties representing views from extreme left to right. This indicates a stable, moderate, socially rooted party system cannot be established. However, because only two of these parties garnered more than the 10% threshold, perhaps the two-party system can now create more political stability in the country.

Freedom of association has been extended and improved in a new law, and interest groups have established a number of associations to represent their political, economic and other interests. Social self-organization in Turkey refers to voluntary associations created by people who are in need, and seems to be heavily affected by political and economic affairs.

2. Market economy

The coalition government formed after April 1999 elections made fighting inflation its first priority. The government signed a "stand-by agreement," or new stabilization policy, with the IMF on December 22, 1999. Despite some initial success, this program collapsed in February 2001 for three basic reasons: the lack of coordination of economic policies, unwillingness to implement structural reforms and privatization of the deeply mismanaged state-owned enterprises, and distrust of the banking system, particularly state banks exploited by politicians.

In its 1989 opinion on Turkey's application for EU membership, the EU Commission stated, "Turkey's economic and political situation... does not convince [the Commission] that the adjustment problems which could confront Turkey if it were to accede to the Community could be overcome in the medium term."

In its 2004 regular report on Turkey's progress toward accession, the Commission concluded, "economic stability and predictability has improved with the sustained

recovery since 1999.... Turkey has made further considerable progress toward being a functioning market economy, in particular by reducing its macroeconomic imbalances. Turkey should also be able to cope with competitive pressure and market forces within the Union, provided that it firmly maintains its stabilization policy and takes further decisive steps toward structural reforms.”

2.1. Level of socioeconomic development

One of the basic problems in Turkey is rapid population growth. The natural growth rate has slowed to 1.4% annually in past years, but remains very high in comparison to the EU average. One of the main challenges for Turkey is its high level of unemployment, and particularly youth unemployment. The total population of Turkey is currently around 70 million; 50 million are older than 15 years and represent almost 70% of the total labor force in Turkey.

It is interesting to note that 29 million people are excluded from workforce statistics (elderly people, pupils, students and disabled people). This means that the employed population is 21 million, of which approximately 4 million people are employed in unpaid labor within the family. Figures indicate that 17 million workers receive regular wages or are self-employed. Therefore, the burden of 53 million people's cost of living rests on this working population. The Turkish labor market is characterized by low participation of women, a high tax burden (40% in 2001), and a large percentage of unskilled labor. The high social security contribution required of employers is one of main drivers of a widespread informal sector in Turkey.

Turkey is considered one of the new emerging and promising countries of the world economy. Per capita income is relatively low in comparison to other EU countries. GDP per capita in terms of purchasing power was 28.5% of the EU-25 average in 2003, level with Bulgaria and Romania. Measured in current prices, the share of Turkish GDP in the GDP of the EU-25 was around 2% in 2003, or just half of the ten new member states.

The total population of Turkey is approximately 70 million, which is equal to that of the 10 new EU member states combined, or 15.5% of the EU-25 population. Additionally, the population growth rate is approximately 1.8% annually, compared to 0.2% in the EU-25. Another key economic indicator is the distribution of income among persons or classes; it is very important how the wealth created within a country is distributed personally, sectorally and regionally. Various empirical studies indicate that income distribution in Turkey has been worsening at the expense of the working population, and the income gap between rich and poor has been widening. Huge differences exist regionally, in a west-east pattern, and between urban and rural areas.

Two-thirds of the total Turkish population resides in large cities and in the most developed regions of the country. Cities like Ankara, Istanbul and Izmir create over

80% of total economic value added, and are attracting people from rural areas. The industrial centre Kocaeli is the wealthiest region in Turkey, with a GDP per capita more than 90% higher than the national average (and 46% of the EU-25 average). In contrast, the poorest regions Ağrı and Van only have one-third of the national GDP per capita (or 8% of the EU-25 average).

These regional disparities have affected the economic structure of the regions remarkably. The western part of Turkey is relatively concentrated on manufacturing production and services, which have become major sources of income and employment. In most other regions agricultural activities determine levels of income, value added and productive employment. As a result, Turkey has been facing not only a serious internal migration problem, but also high levels of emigration since the early 1950s and 1960s. Since the 1980s, net emigration from Turkey has been estimated to be approximately 50,000 people per year, which is about 0.2% of the current labor force. The number of Turkish citizens residing and officially registered in the EU-15 totaled approximately 3 million in 2004.

2.2. Organization of the market and competition

In March 1995, Turkey signed a customs union agreement with the European Union, a significant milestone in longstanding relations that can be regarded as the final stage of the Association Agreement. The European Parliament approved the decision of the Association Council for Turkey's membership in a customs union, to begin on January 1, 1996. Turkey is already strongly integrated into the EU region, although it is not a full member of the European Union.

The customs union covers only the free trade of manufactured goods between Turkey and the European Union. In accordance with the customs union framework, Turkey has eliminated all customs duties, quantitative restrictions, all charges having equivalent effect to customs duties, and all measures having equivalent effect to quantitative restrictions in its trade with the European Union as of January 1, 1996. Under this union Turkey is committed to align with the EU internal market *acquis communautaire*, including free movement of industrial goods, intellectual and industrial property rights, competition policy (state aid control and antitrust), and the adoption of the common external tariff. In order to comply, Turkey must completely open its economy to international competition. It adopted the Common Customs Tariff (CET) against third country imports in January 1996 and all of the preferential agreements the European Union has established with third countries by the year 2001. According to Article 19.2 of the Additional Protocol, Turkey is permitted to impose higher tariff rates than those specified in the CET on particular products for another five years.

Implementation and the comprehensive functioning of a customs union does not only require trade-related measures; equally important are regulatory framework activities around production, such as anti-trust policies, state subsidies to enterprises,

competition policies, and industrial and intellectual property rights. Turkey would conform to EU standards in all these spheres. In order to harmonize its commercial policy with the European Union, Turkey should align itself progressively with the preferential customs regime of the Community within five years of the date of its entry. This means Turkey will lose its international sovereignty concerning foreign trade policy, without any form of active participation in the decision-making process in Brussels.

Establishment of the internal market has been one of the most important achievements of the European Union, and EC competition policy makes an essential contribution to smooth single market functions and uniform implementation of competition rules within the European Market. It is therefore clear that if Turkey wants to be fully integrated into this wider economic region, first priority should be given to adaptation and implementation of the EU competition regime (i.e. establishing a legal framework and administrative capacity). State intervention in the economy has declined following deregulation of important markets such as agriculture, energy and telecommunications. According the Progress Report on Turkey 2004, Turkey's antitrust legislation has been established, largely based on the main principles of the EU antitrust rules. As required by the Customs Union Protocol signed in 1995, Turkey established a functionally independent body with the administrative capacity to ensure implementation of these rules.

To date, Turkey has not established the administrative capacity or legal framework for monitoring state aid and subsidies.

According to the Customs Union Agreement between Turkey and the European Union, Turkey is allowed to maintain protective tariffs on specific sensitive goods, such as motor vehicles, footwear, leather products and furniture originating from EU countries. In 2001, Turkey adopted a new import regime that brought tariff rates on all industrial products to Common Customs Tariff levels. In addition, further changes were made regarding Turkey's obligations and commitments to the WTO and its free trade agreements with third countries.

It does not appear that participation in the customs union has worked to Turkey's advantage in the short-run. Since 1996, the Turkish economy has put under pressure by heavy competition from EU economies. However, the Turkish economy appears to have the capacity to cope with competitive pressures and market forces within the European Union, particularly in the areas of labor and raw material intensive goods.

Turkey's trade with the European Union has increased remarkably following its high degree of trade liberalization. In 2004 merchandise trade with the EU-25 accounted for more than half of total Turkish trade; 55% of Turkish exports were to EU-25 countries, and 47% of its imports came from the European Union. Exports to the European Union have been diversified from traditional to higher value-added products and research-oriented goods more difficult to imitate. In addition, Turkey has signed free trade agreements with EFTA, Hungary, Israel, Romania, Latvia, Lithuania, Estonia, Slovakia, Slovenia, Bulgaria, Poland and Macedonia.

2.3. Stability of currency and prices

The Istanbul Stock Exchange (ISE) was established in early 1986. The ISE is the only securities exchange in Turkey established to provide trading in equities, bonds and bills, revenue-sharing certificates, private sector bonds, foreign securities and real estate certificates as well as international securities. The ISE is governed by an Executive Council composed of five members elected by the General Assembly. On October 25, 1997, the government appointed the chair and chief executive officer of the ISE. Four other members of the Council represent the three categories of Exchange members: development banks, commercial banks and brokerage houses. The ISE trades the stocks of around 300 companies. Its market capitalization has been above 30% of the GDP in recent years, but declined to 19% in 2002. Since the beginning of 2003, it has been trending upward, reaching 22% in January 2004. The stock exchange is very sensitive to internal and especially international political affairs, it has been showing unexpected fluctuations.

Turkey's economic crises and poor economic performance have been closely connected with its legacy of banking sector distortions, manifested in both public and private banks. The government has introduced reform measures in both sides of the banking sector. State-controlled banks have been recapitalized and their short-term exposure has been substantially reduced. Private banks have been required to improve their capital adequacy ratios to adhere to international reporting and prudential standards. In order to realize the restructuring process in the banking sector two institutions have been established. Non-viable private banks have been put under the administration of the Public Savings and Deposit Insurance Fund (SDIF) and dissolved, and the independent Banking Regulatory and Surveillance Agency (BRSA) was established in autumn 2000 to strengthen banking sector surveillance.

Turkish banking sector assets amounted to slightly more than 70% of the GDP. Bank lending to the private sector comprised 42.5% of total deposits, while the share of securities reached 68.5% by the end of 2003. Approximately 90% of the security portfolio consists of government securities. The banking sector currently includes some 50 banks, but it is dominated de facto by two state banks that comprise approximately one-third of total sector assets and a few private banks. The main source of banking income is interest earnings from government securities, which account for about 50% of total income. Because of this highly profitable, low risk-bearing public sector borrowing, credit provision to the private sector has been particularly low. The elimination of non-viable banks and restructuring of support in the form of the "Istanbul Approach" has helped to improve the sector's capitalization.

On the other hand, the role of the non-banking financial sector remains very limited. The sector consists of 70 insurance companies with assets amounting to approximately 4% of the GDP. The non-banking financial sector is under the supervision of the Treasury, and specialized agencies such as the Capital Market Board or the SDIF.

The new IMF stabilization program, put into force in April 2001, included the following ambitious aims: structural policies aimed at correcting the distortions directly underlying the recent crisis (including those in banking); enhancing the transparency of economic management; implementing fiscal and monetary policies geared toward restoring financial stability; and encouraging an enhanced social dialogue aimed at price and wage policies consistent with macroeconomic stability. The economic regime is focused on inflation and a relatively flexible exchange rate. It soon became clear that the new program could not succeed without additional funding to boost confidence and allow the government to roll over its debt.

In 2003, average consumer price inflation was 18.9%, compared to 29.7% the year before. During the first six months of 2004, the average was only 8.9%, reaching a historic low. Price distortions can be remarkably reduced. The main factors that contributed to the rapid decline of the inflation rate included tight monetary and fiscal policy, decreasing domestic demand for commodities, and limitations on wage and salary increases in the public sector. Since 2001 the Turkish Central Bank, which is an independent institution responsible for monetary policy, has followed a broadly flexible exchange rate system, with exchange rates determined by supply and demand factors. Since then, the Turkish lira has appreciated against the U.S. dollar, and the credibility of Turkish currency has increased in international foreign exchange markets.

The government must follow this stricter stabilization program, which credibly curtails the public sector, privatizes large sectors, and increases efficiency of remaining segments. Priority should be given to reducing inflationary pressures and fiscal deficits in order to reduce real interest rates and high public sector borrowing requirement (PSBR), which negatively affects the level of private investment. If the government fails to limit significant public sector retrenchment, it risks the budget deficit spiraling upwards.

Consensus across all parts of society on the new economic package is indispensable. Without so-called social peace, it seems impossible to realize a stabilization program oriented toward long-term goals. In order to re-establish macroeconomic balance, fiscal discipline and stability-oriented economic policy must be continued. Privatization of state-owned enterprises and banks, as well as market deregulation, must be implemented. The inflow of foreign direct investments must be encouraged by removal of the remaining obstacles.

In order to maintain macroeconomic stability, the Turkish government committed itself to realizing all of these targets (tax administration reform, social security

reforms, a Public Expenditure Review and financial sector reform) in its letter of intention submitted to the IMF on April 2, 2004.

2.4. Private property

Turkey has been a signatory to many protocols and agreements in the recent years concerning intellectual property rights, and established the Turkish Patent Institute in 1994. Since then, Turkey has made substantial efforts to adjust its legislation to the *Acquis communautaire* in the area of intellectual property rights. In 1995, before the customs union came into force, Turkey aligned its legislation on patents, copyright and related rights, designs and models, trademarks, and geographical indications. In 2000, Turkey ratified the European Patent Convention, established specialized courts in Istanbul to deal with intellectual property matters, and intends to increase the number of these courts. In 2003, Turkey adopted the Bern Convention for the Protection of Literary and Artistic Works and the WIPO Performances and Phonograms Agreement, and stepped up efforts to fight counterfeiting and piracy. In 2004, Turkey approved the WIPO Copyrights Agreement. The Parliamentary Commission on Foreign Affairs has recommended that Turkey also approve the Geneva Text of the Hague Agreement on the Industrial Designs and WIPO Trademark Law Treaty. All these steps indicate Turkey has made a strong effort to harmonize its legislation with the *Acquis communautaire*. However, it is clear that a lot of work remains to do during the accession period to the European Union.

The Turkish legal structure is characterized by many problematic aspects, which may negatively affect investors, such as the slow progress of judgment processes, low levels of protection for minority shareholders, uncertainty regarding certain business laws, disallowance of international sharing for large projects involving government concessions, etc. In addition, international investors are misled by dependency on an owner-manager, inadequate efficiency and improper institutional management, and accounting standards and information systems that discourage the penetration of foreign direct investment (FDI) in Turkey.

Another obstacle to FDI is the restriction on ownership. For example, German companies have strong preference for 100% ownership, on similar grounds as a preference for direct investment over licensing. Ownership eases the decision-making process within a company and allows for better control over intangible assets such as technology, product quality and credibility. The most important single factor for German investors is the difficulty in dealing with state authorities and bureaucracy in developing countries. Turkey's civil service tends to be highly bureaucratic. Personal acquaintance is the traditional way to accelerate these processes, and local partners or agents are invariably in a better position to handle bureaucratic procedures than foreign investors acting alone. Other factors preventing FDI inflows into Turkey include a complex tax system and insufficient collection of taxes, subjective application of law and regulations, discrimination against equality principles established in the Turkish constitution, and a minimal level of

privatization-related investment. Turkey's image has been marred by scandals, corruption, bribery, misuse of authority and mistrust. This is compounded by other deterrents to FDI, including a lack of transparency, political interference, negative government attitudes toward foreign investment and internal social tensions.

In order to create a more efficient market economy, Turkey has made significant improvements in the field of company law through an amendment to the Turkish Commercial Code aimed at simplifying the procedures required to set up a company, in connection with the provisions of the new Foreign Direct Investment Law put into force in 2003. In fact, the number of steps required to establish a company has been reduced from 19 to three. Privatization of state-owned enterprises is sluggish. The total amount of revenues generated from privatization is approximately 3.6 billion euros, or 1.7% of the GDP in 2003. During the last five years, the state has fully withdrawn from industries such as petrol distribution and certain food processing activities, and reduced its activities in textiles, iron and steel, wood and paper production, and tourism.

2.5. Welfare regime

Since the foundation of the Republic, Turkey has made immense progress in social policy and employment, especially in the area of health and safety at work. Labor Law adopted in May 2003 included several regulations concerning working conditions and hours; overtime work and special procedures for shift workers came into force in April 2004. Regulations on occupational health and safety in temporary or fixed-term employment were published in May 2004. Regulation on the employment of children and young workers was put into practice in April 2004. Regarding equal treatment of women and men, the constitutional amendments adopted by parliament in May 2004 stressed, "Men and women shall have equal rights. The state has the duty to ensure that this equality is put into practice." In the area of workplace health, new regulations were put in place in December 2003, in the field of public health, Turkey has signed the global Framework Convention on Tobacco Control (FCTC), and additional resources were allocated to the health sector. With regard to social inclusion, a circular issued in July 2004 requires public institutions with more than 50 employees to employ at least three disabled persons or ex-convicts.

Typically, as an economy develops the growth rate of the population diminishes and the share of the agricultural sector in terms of both GDP and total employment declines. Indeed, rapid industrialization in Turkey has changed the composition of employment among the three main sectors of the economy. It is widely assumed that continuous and sustainable economic growth requires that the size of the labor force grow more rapidly than the size of the population as a whole. The Turkish labor market has not been able to satisfy this condition; since the early 1960s, except for few years in the 1960s, the growth rate of the population has exceeded the employment growth rate in Turkey. Moreover, the gap between the two growth rates

has widened throughout the years, so that the Turkish economy has not been able to diminish its structural unemployment rate. Based on official figures, the structure of unemployment in Turkey resembles that of some developing countries.

Rapid economic growth has not resulted in enough demand for labor to reduce the level of unemployment, which rose from 6.6% in 2000 to 12.4% by the first half of 2004. Employment growth could not absorb the overall growth of the labor force, leading to continued increases in unemployment. Unemployment is particularly high in the 15-24 age group, who represent 23.7% of total unemployment. Female unemployment was 7.3% in 2003, whereas male unemployment was 9.5%. The female employment rate is particularly low at 26%, however, with the male employment rate at 66% in 2002.

2.6. Economic performance

Recent figures clearly indicate the Turkish economy was heavily impacted by the economic crises. Growth rates have exhibited considerable annual variation, fluctuating remarkably from one year to another, and the real economy has experienced sharp turnarounds between economic boom and recession within an eight-year period.

The real rate of annual growth of the Turkish economy has been 3.5% between 1987 and 1995, with a growth spurt of 6.3% from 1996 to 1998. However, real economic growth rates slowed considerably starting in the second half of 1998, with overall GDP growth in 1998 of only 3.2% and continuing decline throughout 1999. Growth became negative in 1999, significantly below the level of previous years. However, real GDP grew by 7.8% in 2002 and 5.9% in 2003. In the first half of 2004, output growth was 12.4%. The main sources of growth have been exports and restocking. The negative impact of the Iraq War on the Turkish economy has remained limited. All these indicators point to strong confidence in the market economy and improved shock resistance in the Turkish economy.

GDP per capita is 5,800 euros, and absolute poverty is rare in Turkey. Traditionally strong family ties and the existence of the informal sector check the growth of poverty in the country. However, the number of people in danger of falling below the poverty threshold has increased, reaching a risk-of-poverty rate of 30.3%. The growth of poverty and the high unemployment rate might be key reasons for the increasing incidence of criminal activities, especially in the large cities, and could perhaps cause social unrest in the future.

2.7. Sustainability

Some limited steps have been taken in the areas of air quality, nature protection, chemicals, noise and nuclear safety and radiation protection to adopt legislation and

to improve the government's administrative capacity.

Turkey has introduced measures to improve its administrative capacity. A new law was adopted in May 2003 to establish the Ministry of the Environment and Forestry. Limited progress has been made in the field of horizontal legislation. Public consultation mechanisms related to environmental impact assessments now appear to be largely in line with EC requirements, but further efforts are needed concerning trans-boundary issues. Regarding waste management, a law was adopted to ratify changes made to the Basel Convention in controlling trans-boundary movement of hazardous wastes and their dispersal in June 2003. Turkey has not yet ratified the Kyoto Protocol. In terms of air quality, Turkey passed legislation in January 2003 relating to emissions from non-road mobile machinery. As far as the protection of nature is concerned, the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES Convention) on the import and export of endangered species was adopted in February 2003, and the European Landscape Agreement was ratified in June 2003. There has been no sign of improvement in the transportation sector regarding the acquis on industrial pollution and risk management. In June 2003, Turkey adopted the Cartagena Protocol in the field of genetically modified organisms, and the Montreal Protocol in the field of chemicals. As far as written agreements are concerned, Turkey has signed and adopted most international laws, regulations and protocols concerning environmental protection in order to improve environmental conditions in Turkey and bring them in line with the acquis.

One determining factor of rapid economic development is the availability of well-educated human resources. Unfortunately, Turkey does not demonstrate adequate performance in the field of education. The schooling rate in Turkey has reached 11.4% in pre-school education (vs. the EU level of 85%), 96% in primary education (vs. the EU level of 106%), 81% in secondary education (vs. the EU level of 102%) and 35.8% in higher education (vs. an EU level of 55%). The share of education in total public expenditures was 11.5% in EU countries in 2000, but remained at 9.2% in Turkey in 2003, while the ratio of public expenditures for education was 3.9% in 2001. The literacy rate of the population aged 15 and over is 87.5% overall, with a rate of 95.3% for males and 79.9% for females. Literacy has not reached desired levels, particularly for the female population.

In 1998, Turkey increased the length of compulsory education from five to eight years. This radical change in compulsory education succeeded in enrolling 1.1 million children, and required the immediate construction of 3,900 new primary schools and 15,300 additional new classrooms within existing schools.

3. Management

3.1. Level of difficulty

From the 1970s until November 2002, coalition governments dominated the political arena, sometimes with life spans as short as three months. Instable governments during this period were not able to solve the primary crucial political and economic problems of the country. Since November 2002 Turkey has returned to a two-party system, with both represented in the parliament. The ruling party AKP holds an absolute majority in the national assembly and is able to change the political and economic structure of the country, including its constitution, without any political support from other parties. Therefore, it was possible to pass all of the laws, regulations and reform packages necessary for fulfillment of Copenhagen criteria through parliament without any difficulties.

A one-party ruling system can maintain political stability or it can conversely cause political instability, as could occur if the present government should try to replace the still-extant secularist regime with a religious-based political system. Furthermore, the governance capacity of political leadership also depends on the role of the state, its civil-military relations, economic reform, and secular versus religious politics. If Turkey continues to demonstrate the basic principles of secularism within a Moslem society, perhaps it can serve as a good example for other countries in the region.

However, structural constraints on governance are very high. The present government faces major economic and political problems. Economic constraints include a high level of unemployment, the accumulation of an unqualified labor force, serious inequities in income distribution, and infrastructural deficiencies (in schools, housing, hospitals) resulting from rapid population growth.

Regarding the primary indicators of civil society, since 1999, several legislative reforms have been undertaken in order to establish freedom of association. A recently adopted law on associations is aimed at reducing the opportunities for state interference in the activities of associations, and allows associations to open branches abroad, join foreign bodies or hold meetings with foreigners. The law also removes all restrictions on student associations and allows for the establishment of temporary and informal platforms or networks for all civil society organizations.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	5
System of government:	<i>Parliamentary</i>	Electoral system disproportionality:	24,7
		Latest parliamentary election:	03.11.2002
		Effective number of parties:	1.8
1. Head of State:	<i>Ahmet Necdet Sezer</i>	Cabinet duration:	11/02-03/03
Head of Government:	<i>Abdullah Gül</i>	Parties in government:	1
2. Head of Government:	<i>Recep Tayyip Erdoğan</i>	Cabinet duration:	03/03-present
Type of government:	<i>single party majority</i>	Parties in government:	1
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. Effective number of parties denotes the number of parties represented in the legislature, taking into consideration their relative weight (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i.</p>			

A party with deep Islamic roots won a landslide victory in Turkey, which is causing great concern in the European Union, which seems to be strongly influenced by the “crash of civilizations” thesis presented by Huntington. Cultural differences exist between Turkey and Europe based on their respective differences in historical background and religion. This posits that European culture is a unique culture based on its Greco-Roman heritage and Christianity.

Freedom of religion and religious belief are guaranteed by the constitution, and freedom to worship is exercised largely without any restrictions. Turkey has two types of religious groups: non-Muslim minorities (mainly Greek, Jewish, Armenian, etc.) and a Muslim majority (Sunni and Alevis). The protection of cultural rights has made progress since 1999. The constitution has been amended to lift the ban on the use of languages other than Turkish, including Kurdish. Society and the political elite are partially polarized along ethnic, religious or social divides.

3.2. Steering capability

In its regular report on Turkey in 2004, the EU Commission came to the conclusion that, “over the past year the Turkish government has shown great determination in accelerating the pace of reforms, which have brought far-reaching changes to the political and legal system. It has also taken important steps to ensure their effective implementation in order to allow Turkish citizens to enjoy fundamental freedoms and human rights in line with European standards.” This statement confirms that the government is committed to democracy and a market economy, but it remains to be seen how successful the government will be in implementing its new reform measures.

The government must follow a stricter stabilization program, which credibly curtails the public sector, privatizes large sectors, and increases efficiency of remaining

segments. Priority should be given to reducing inflationary pressures and fiscal deficits in order to reduce real interest rates and high PSBR, which negatively affects the level of private investment. Key macroeconomic objectives for 2003 and 2004 were targeted. With lower real interest rates and increasing confidence, private consumption and investment are expected to be the determining factors of growth. Building on the impressive inflation performance, continued prudent macroeconomic policy could bring Turkey closer to achieving single digit inflation by meeting the government's 12% inflation target by the end of 2004.

With regard to European Union relations and external pressures, the political leadership gives the impression that it is able to demonstrate complex learning, act flexibility, and replace failed policies with innovative ones. However, with regard to internal reform policies, such as the restriction of political immunity, the political leadership shows little willingness and ability to learn, and the routines of policymaking do not enable introduction of innovative approaches.

3.3. Resource efficiency

A new IMF stabilization program was enacted in April 2001, aimed at correcting the distortions directly underlying the recent crisis (including those in banking), enhancing the transparency of economic management, and implementing fiscal and monetary policies geared toward restoring financial stability. The economic regime is focused on inflation and a relatively flexible exchange rate. It soon became clear that the new program could not succeed without additional funding to boost confidence and allow the government to roll over its debt.

Under pressure from IMF recommendations, the Turkish government has been improving its resource allocation and efficiency. The present government, as with previous governments, continues to employ its own supporters within the state apparatus. Turkey adopted the Public Financial Management and Control Law (PFMCL) in December 2003, but implementation cannot be ensured before 2008. The PFMCL aims at eliminating extra-budgetary funds and the consolidation of income, expenditures, assets and liabilities of all public-spending institutions under a single budget. It also creates common ground for relevant actors and provides a framework of responsibility and accountability within public finance management.

The Turkish government frequently has difficulty in coordinating conflicting objectives or interests. Coordination among various government bodies requires further improvement, and more effort is needed to reform and restructure state organizations and privatize state-owned enterprises. The current government expends great effort in establishing a uniform organizational structure for all independent regulatory authorities.

The underground economy or informal sector is very common in Turkey. Research on this topic indicates that the unrecorded economy has varied from 3.0% to 22.9%

of GNP over the period examined, and increased sharply after 1995. Primary reasons for the expansion of the informal economy are high direct taxes and high social security costs. President Ahmet Sezer stated that corruption is one of the most serious problems affecting Turkey, and has given his support to the fight against corruption. The Turkish government has taken serious steps in this area, aimed at ensuring transparency and accountability in public sector resource allocation, preventing politically motivated interventions in the management of the economy, and strengthening good governance and the fight against corruption.

In its Progress Report 2003, the Commission addresses this fight against fraud and corruption, reporting that in January 2003 Turkey adopted new legislation aimed at implementing the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions ratified in 2000. Accordingly, the Turkish Penal Code, the Public Procurement Law, the Law on Preventing Money Laundering, the Law on Control of Narcotics, the Law on the Organization and Tasks of the Ministry of Finance and the Law on Public Officials were all revised. These amendments introduced two new offences into Turkish legislation. First, the offence of bribing a foreign public official was inserted into Article 211 of the Penal Code. Second, the laundering of property and proceeds obtained or derived from bribery, including bribing a foreign public official, has been added to Article 2 of the Law on Prevention of Money Laundering. Turkey has notified the OECD Working Group on Bribery in International Business Transactions that legislation implementing the 1997 Convention was fully in place and that Turkey was ready to receive OECD examiners.

3.4. Consensus-building

On March 20, 2001, the new Turkish government presented its “National Program.” The priorities of the program were identical to the priorities of partnership with the European Union. The Turkish government endorsed the eighth and last bundle of laws for political reform before last year’s summer break. The project was presented after an unprecedented tour de force. In a step that can be regarded as historical, it aims at two important problems. First, it is meant to match the Copenhagen Criteria and to bring Turkey closer to the European Union. Second, this project may drastically change the immobile political landscape of the republic. The reform package includes abolishment of the death penalty, granting of cultural and minority rights for Kurds and other minorities in Turkey, improvements to the right of free expression and opinion, and a liberalization of association laws.

As far as improvement of the market economy and establishment of democracy are concerned, great consensus exists among different interest groups. A small group of opposition parties have little impact on decision-making processes. Reformers cannot control all veto actors, but can significantly limit the use of their powers. Long-term unemployment is an important and serious challenge to the Turkish economy; more than 40% of the unemployed have been jobless for more than one

year. The high level of unemployment compared to OECD countries seems to be one of the main causes of increased political and social violence in Turkey in recent years.

Parties describing themselves as modern and pro-Western have nevertheless pursued a populist agenda and tolerated anti-secular sentiments and demonstrations by Islamists.

The present government, headed by Erdoğan, declares itself a conservative party, but is a pro-Islamic party that intends to reflect Islamic principles in the political and economic life of Turkey. Discussions about prohibition of “illegitimated sexual relations” and the headscarf demonstrate this. While the political leadership sometimes puts issues related to religion on the agenda, if they face any reaction from the public they tend to drop them. Interestingly, these same issues are often reintroduced later under a different name or title.

To large extent, the political leadership takes into account and tries to satisfy the political and economic interests of civil society actors.

Former governments failed not only in economic terms, but also in fighting against corruption and mediating the underground economy and its relations with politics. According to the press, the size and reach of the underground economy, as well as the Mafia’s connection with political circles, has reached an alarming level. Longing for “peace and order” and a “clean society” is increasing. Very recently, a series of affairs that were heavily covered by the media caused fear in the public and prompted serious frustration with the established political class. In December 2003, parliament adopted proposals to open investigations into corruption allegations against a former prime minister as well as several other ministers.

3.5. International cooperation

One of the main virtues of the European Union is to encourage applicants to reform, modernize themselves, respect the rights of minorities, and break with hegemonic temptations. According to many Europeans, the same should be true of Turkey. If Turkey meets the conditions set by the European Union, it will become a full member in 10 or 15 years. It is now up to Turkey to seize this opportunity. A common point of view, both in Turkey and in the European Union, maintains that if the European Union had not put pressure on the political leadership to adopt new laws and regulations, the state would not have been able to introduce radical reform measures within two years. The government has also been following IMF-led reform measures in order to re-establish macroeconomic equilibrium.

Turkey is member of international organizations such as the United Nations, OSCE, the Council of Europe, NATO, OECD, the Stability Pact for Southeast Europe, the Economic Cooperation Organization (ECO), the Black Sea Economic Cooperation

(BSEC) and the Islamic Conference Organization. Turkey holds observer status in the Arab League. Turkey is a candidate country for full membership in the European Union with strong economic and political links with the United States. The government has longstanding historical relations with, and economic interests in, the Arab world and it has developed economic and political relations with Israel.

The collapse of the Soviet Union, the destruction of Iraq's military and economic potential, and the exhaustion of Iran following eight years of war have all contributed to Turkey's elevation to the level of a pre-eminent regional power. Even after the dissolution of the former Soviet Union, the approach of NATO member states and the European Union to relations with Turkey remains dominated by strategic considerations. It is expected that Turkey will be able to carry out three main functions within the Western security context.

During the Gulf War and after its cessation, Turkey cooperated very closely with Western allies, demonstrated not only through its loyalty to NATO but also underlined by the importance of its strategic position in potential regional conflicts. The Turkish government also subsequently stated its intention to send Turkish soldiers into conflict regions such as Somalia and Bosnia-Herzegovina under U.N. command. Turkey should assume the function of bridging economic and political relations between Central Asia and the Middle East, now that many believe the disintegration of the Soviet Union has left a political vacuum in Central Asia and Transcaucasia.

The EU Commission and EU leaders are now persuaded that Turkey has made sufficient progress on fulfilling the Copenhagen Political criteria regarding democracy, human rights and legal reforms. On December 15, 2004, the European Parliament adopted a resolution opening negotiations with Turkey. The European Union has also finally decided to hold membership negotiations with Turkey, scheduled to start on October 3, 2005. Since then, the credibility and reliability of the government has increased significantly. In terms of the European Union's role in international affairs, Turkey's full membership would bring both advantages and challenges, and would increase Turkey's importance in regional and world affairs. Many believe that if Turkey can establish a strong democratic regime combined with a Muslim social and cultural environment, it could act as a good example for other countries in the region.

Turkey is located at a regional crossroads – between the Balkans, the Caucasus, Central Asia, the Middle East and the eastern Mediterranean – of strategic importance to Europe. After the collapse of the Soviet Union, tensions in the bilateral relations between Turkey and Russia have increased due to overlapping interests focused on the Caucasus and Central Asia. These tensions could have been reduced by strong economic relations between the two countries, with 15% to 20% annual growth in foreign trade. Turkey has improved its relations with Greece in the past years, and cooperation has not been affected by lack of progress on the Cyprus issue, which has not yet been solved. A conflict of interest between Turkey and the

United States arose over Iraq. The Turkish government has an economic and political interest in maintaining Iraq's territorial integrity. Relations with Syria essentially improved, primarily due to the Iraq War and challenges in the region. Despite Iran's nuclear program and differing opinions in religious affairs and the implementation of democracy in both countries, economic relations with Iran are improving and both countries have been interested in maintaining Iraq's territorial integrity and containing Kurdish separatism.

Over the last ten years (1995-2005), Turkey has made important contributions to peacekeeping and stabilization operations as a member of the Stability Pact. Turkey's location is important in securing energy supplies, and is becoming an increasingly key transit country between Europe, Caspian producers, and the Middle East. Turkey shares partial borders with the most energy-rich regions in the world. In the southern Caucasus, Turkey has intensified its economic and political relations with Georgia and Azerbaijan, and relations with Armenia are expected to improve with economic relations.

4. Trend of development

4.1. Democratic development

The Presidency Conclusion of December 17, 2004 states, "The European Council welcomed the decisive efforts made by Turkey in its far-reaching reform process and expressed its confidence that Turkey will sustain that process of reform.... To ensure the irreversibility of the political reform process and its full, effective and comprehensive implementation, notably with regard to fundamental freedoms and full respect of human rights, that process will continue to be closely monitored by the Commission." This statement indicates that Turkey has already met the minimum requirements for European democracy and is on the proper course for deepening this tradition under monitoring by the European Commission. The close relationship between Turkey and the European Union will positively impact the consolidation of democracy within the country.

4.2. Market economy development

Remarkable progress has been made in establishment of a well-functioning market economy. The government has also committed to a comprehensive structural reform program to support sustained improvement in Turkey's fiscal performance. Many of these reforms are designed to control expenditures, broaden the tax base, and shrink the informal economy over the medium term.

The economic stability of Turkey will depend on four basic and interconnected factors in coming years: a positive decision by the European Council to establish a date to begin negotiations between Turkey and the European Union; the level of

determination in the present government to follow IMF policies in the coming years; uninterrupted continuation of structural reform measures; and political stability. These factors are fundamental to the success of the economic stabilization program. Economic stability and predictability have improved during the sustained recovery following the economic crises in 1999 and 2001. The reduction in inflation from 65% in 1999 to 9% by December 2004 was one of the most important achievements.

Economists usually follow three main indicators to determine whether policymakers have effectively established stable macroeconomic policies, which in turn underpin the political and social stability of the country. These include real economic growth rates, rates of unemployment and underemployment, and the balance of payments, in particular the current account balance.

Regarding growth rates, the Turkish economy was heavily affected by the economic crises. Growth rates have also demonstrated considerable annual variation, fluctuating remarkably from one year to another. The real economy has experienced sharp turnarounds between boom and recession within an eight-year period. The real rate of annual growth of the Turkish economy has been 3.5% between 1987 and 1995, with a growth spurt of 6.3% from 1996 to 1998. However, real economic growth rates slowed considerably starting in the second half of 1998, with overall GDP growth in 1998 of only 3.2% and continuing decline throughout 1999. Growth became negative in 1999, significantly below the level of previous years. However, real GDP grew by 7.8% in 2002 and 5.9% in 2003. In the first half of 2004, output growth was 12.4%. The main sources of growth have been exports and restocking. The negative impact of the Iraq War on the Turkish economy has remained limited. All these indicators point to strong confidence in the market economy and improved shock resistance in the Turkish economy.

Unemployment rates typically follow a trend: where an economy develops, the growth rate of the population typically diminishes and the share of the agricultural sector in terms of both GDP and total employment declines. Indeed, rapid industrialization in Turkey has changed the composition of employment among the three main sectors of the economy. It is widely assumed that continuous and sustainable economic growth requires that the size of the labor force grow more rapidly than the size of the population as a whole. The Turkish labor market has not been able to satisfy this condition; since the early 1960s, except for few years in the 1960s, the growth rate of the population has exceeded the employment growth rate in Turkey. Moreover, the gap between the two growth rates has widened throughout the years, so that the Turkish economy has not been able to diminish its structural unemployment rate. Based on official figures, the structure of unemployment in Turkey resembles that of some developing countries.

Rapid economic growth has not resulted in enough demand for labor to reduce the level of unemployment, which rose from 6.6% in 2000 to 12.4% by the first half of 2004. Employment growth could not absorb the overall growth of the labor force, leading to continued increases in unemployment. Unemployment is particularly high

in the 15-24 age group, who represent 23.7% of total unemployment. It is estimated that the unofficial rate of unemployment in Turkey exceeds 20%. The unemployed labor force has no social security and receives no unemployment benefits from the state; this worsens the living conditions of unemployed people and makes them greatly dependent on the income of other family members. The heavy concentration of unemployment in younger age groups may not simply be a reflection of the rapid growth of the labor force, but also indicate a high degree of job security amongst the employed in Turkey.

Achievements in trade liberalization and the move toward an outward-oriented trade regime have been remarkable by any standard. Exports are a major engine of growth; measured in U.S. dollars exports grew at an average annual rate of 34.6% from April 2003 to 2004. On the other hand, expenditures on imports increased from 52.5% during the same period, so the current account deficit has been growing since 2003. The main factors driving rapid increases in imports were continued restocking, overvaluation of the Turkish currency against other currencies, and a higher oil bill.

D. Strategic perspective

Some potential sources of political instability exist within Turkey. First, from the 1970s until November 2002, coalition governments dominated the political arena, sometimes holding power for a little as three months. These unstable governments were not able to solve crucial political and economic problems. Since November 2002, Turkey has returned to a two-party system, with both parties represented in the parliament. The ruling party AKP holds an absolute majority in the national assembly, and can therefore change the political and economic structure of the country, including the constitution, without any political support from other parties. This has made it possible for the AKP to pass through parliament all the laws, regulations and reform packages necessary to fulfill the Copenhagen criteria, to some extent with help of the CHP. While a one-party ruling government can maintain political stability, it can also cause political instability. Instability is likely to result if the present government should try to replace the still-secularist regime with a religious-based political system.

Second, if the present Turkish government was not in the position to establish macroeconomic stability and reduce the unemployment rate, this could also lead to political instability. Economic success will be one of the determining factors of political stability in the coming years.

Third, the present Turkish government spends a great deal of time and energy trying to influence the decisions of EU members in order to open negotiations in a positive way. If Ankara interprets the December 2004 decision of the European Council negatively, this could create serious political turbulence.

In addition, some potential sources of economic instability exist in Turkey. Despite declining inflationary pressures and rapid growth rates, the demand for labor has not increased with the economic recovery. On the contrary, Turkey's unemployment rate rose from 9.3% in 2002 to 12.4% in the first half of 2004. Increasing unemployment and the worsening of income distribution at the expense of the working population in coming years could lay the groundwork for social trouble.

The growing current account deficit could also be a negative factor affecting macroeconomic stability, which results primarily from overvaluation of the national currency against other key currencies. This has resulted in increasing demand for imported commodities from abroad. An increasing current account balance deficit could lead to the need for external financial resources, such as short-term capital inflows, in order to bridge such a deficit gap. This would return Turkey to its initial position of instability.

If the Turkish government aborts the IMF-guided stabilization policy in favor of more populist policies, it would become difficult to convince internal and external producers and investors to trust the future of the Turkish economy.

Finally, if the EU Commission and the European Council should decide to postpone the date, it will open negotiations on the full membership of Turkey in the European Union; this could also create some uncertainties in the economy, in both the short- and long-run.