

An Overview of Turkish Economy: Outlook and Current Perspectives

Dr. Yılmaz ARGÜDEN ¹

Türkiye is at the center of an economic and political area known as "Eurasia", where three regions of the world, Europe, the former Soviet Union and the Middle East intersect. The proximity to the Balkans and the rest of Europe as well as to the growing emerging markets in Central Asia, the Middle East, and North Africa creates unique business opportunities. The experience of numerous global firms confirms Türkiye as a predominant investment location and export platform. Companies like Coca-Cola, GE, Procter & Gamble and Phillip Morris, as well as international investment institutions like the World Bank Group's International Finance Corporation already have selected Türkiye as a regional base. Türkiye is fast becoming a production center for Europe in diverse industries, but in particular in automotives.

Türkiye is the leading investor in Caucasian and Central Asian Turkic Republics. Due to her strong cultural and historic ties, Türkiye provides privileged access and a perfect base to develop business with these countries.

The international image of Türkiye in terms of a destination for investment is generally shaped by the diverse market opportunities, both domestic and export-oriented, that Türkiye offers. The potential of these markets covers over 1 billion consumers, including:

- A huge and growing domestic market (approx. 72 million),
- High-income European markets (approx. 600 million),
- Emerging Russia, Caucasia and Central Asian markets (approx. 250 million),
- Diverse and expanding Middle East and North Africa markets (approx. 160 million).

Türkiye's potential has long been recognised by the international community, but its star has not been easy to rise due to a number of reasons. Political conflicts and instability created a sense of immobility, limiting the potential of the economy. Structural problems such as high inflation and real interest rates, high unemployment, unstable exchange rates, and income inequality that needed urgent attention were not adequately attended, delaying long awaited economic and political reforms.

Turkish history is marked with great successes that follow important crises. For example, the decimation of the Ottoman Empire after World War I was followed by the formation of the secular, democratic republic of Türkiye by the one of the greatest leaders in history, Atatürk. The serious economic crises at the second half of the 70's was followed by economic reforms of Turgut Özal that liberalized the Turkish economy. Similarly, the 2001 financial crisis turned out to be a blessing in disguise, despite the fact Türkiye had to pay the cost of such a shock for many years to come. In fact, the aftershock of the crisis was so strong that political choices were radically reviewed and politicians were forced to address a number of politically difficult structural reforms.

Such hardship eventually paid off. After more than 40 years of struggle towards integration with the EU and 25 years with the rest of the world, Türkiye has now embarked on a new level of development. Not only the aftershocks of the economic crisis

¹ Dr. Yılmaz Argüden, is the Chairman of ARGE Consulting (www.arge.com), a columnist, and an Adj. Prof. of strategy at the Bosphorus University and the Koç University. He is also the Chairman of the Turkish - US Business Council and a Founding Board Member of TESEV, a leading Turkish think tank. He has led the Turkish Privatisation Program at its initial years and acted as the Chief Economic Advisor to the Prime Minister. He is a graduate of The RAND Graduate School and was selected as a "Global Leader for Tomorrow" by the World Economic Forum. (www.arguden.net)

that hit the country hard in 2001 are fading away, but also the country’s full potential has been brought to the attention of foreign investors, mainly thanks to the commencement of full membership negotiations with the EU and success of an economic programme that has so far been yielding positive results.

Such a blessing in disguise also triggered a serious change in the mentality of politicians and businessmen alike. Although the former had no other alternative but to address politically difficult choices, the latter had to improvise in the face of an increasingly open and competitive economy. Producing cheaply was no longer sufficient. Business community also had to improve quality and create world brands and in such tasks, they are proving to be successful. Recently, Türkiye has become one of the top countries to host European Quality Award winners, and Turkish brands are becoming household names in a wide range of countries.

Other lessons were also learned. Until 2001, Turkish business community generally preferred to maintain their interests within Türkiye. After the crisis, they have learned the hard way that diversifying their interest outside Türkiye would not only be acceptable, but also was a necessity if they really preferred to integrate with the global economy. Many Turkish companies are gaining ground against global companies in high growth markets such as Russia.

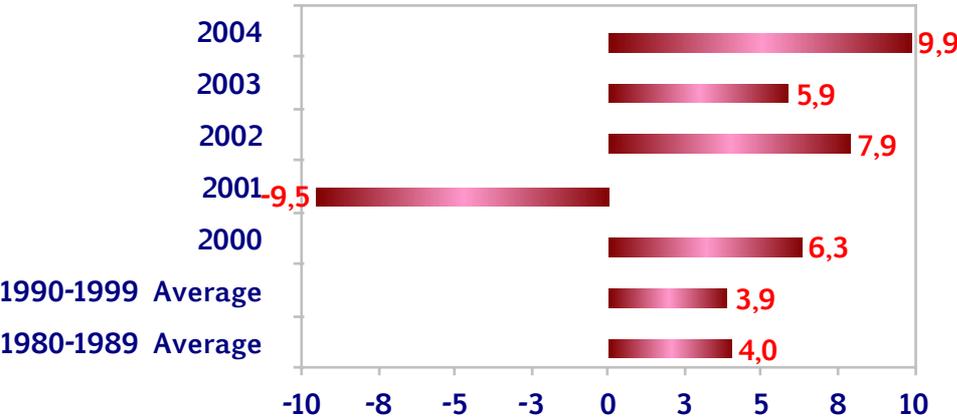
In this setting, an important question still remains to be answered: has Türkiye done enough to ensure that growth and stability are here to stay? To address such matters is almost always tricky. However, when one considers the current economic climate as well as the potential Türkiye has to offer for investors, it is fairly safe to argue that the usual concerns of the past does not fit into the picture of the future.

To substantiate our arguments, it may be useful to begin our analysis by addressing the general economic situation in Türkiye from a historical perspective.

ECONOMIC GROWTH

Türkiye witnessed three major crises since 1994 and the 2001 financial crisis was one of the worst economic downturns Türkiye has ever experienced. Although the average historical growth rates have been more than satisfactory, political instability, problems in the foreign affairs, populist domestic policies and a major earthquake at an industrial centre have all contributed to these crises.

Graph 1: ECONOMIC GROWTH, %



Source: State Planning Organisation (SPO)

Growth rates since 2001 on the other hand have been the highest in the OECD area. What is different from the past is the fact that in the period since 2001, Türkiye has carried out some of the most impressive and long-awaited structural reforms, which were recognised by the international community: The EU has agreed to open full membership negotiations with Türkiye and IMF declared Türkiye as a success story. It would not be an exaggeration to suggest that in the absence of a force majeure, Türkiye is set on the right track for economic growth of satisfactory levels.

Table 1: GDP

	GDP Growth (%)	GDP Nominal (billion \$)
1980-89	4,0	----
1990-99	3,9	----
2000	6,3	202
2001	-9,5	145
2002	7,9	183
2003	5,8	238
2004	8,9	302
2005(E)	5,1	340
2006(E)	4,7	360
2007(E)	5,3	385

Source: SPO, Treasury

According to the economic programme, it is expected that Turkish economy will continue to grow at an average of 5 % annually for the next two years.

Furthermore, the long-term perspectives look even more promising. With Türkiye's population growth rate having fallen from over 2% to roughly 1.5%, it is on the verge of entering a 'golden demographic period' similar to what East Asia experienced in the 1980s, where the productive working population is largest relative to children and retirees, providing the potential for even more rapid income growth.

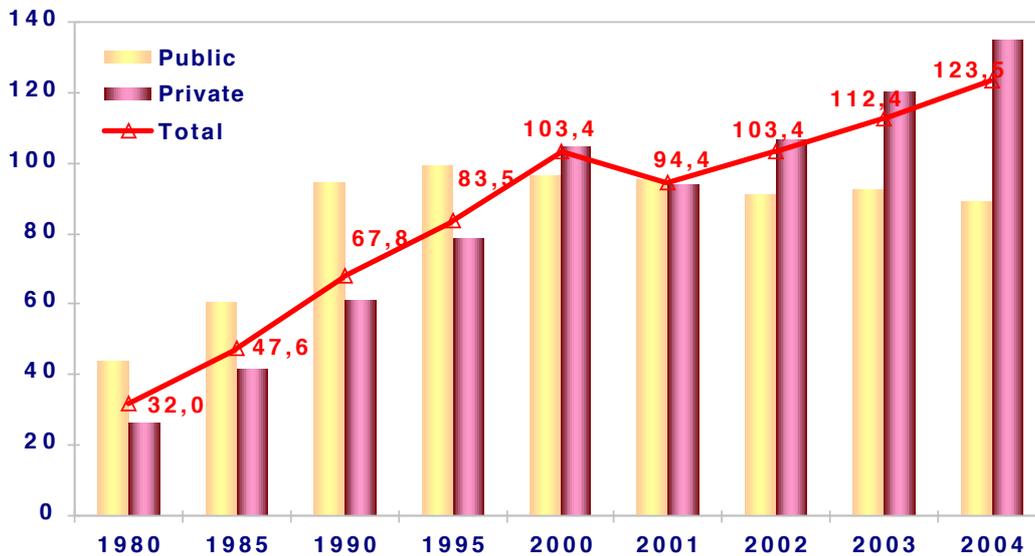
This situation is likely to be a panacea for improving European competitiveness as well as Turkish competitiveness. The continuation of reforms to bring Türkiye into full EU membership will not only increase the confidence in the Turkish potential and investments in Türkiye, but also is likely to make Türkiye indispensable for the EU. For example, with her renowned hospitality, quality of medical care, pleasant climate, Türkiye is likely to become the Florida of EU, in terms of caring for the old.

Only a few emerging markets in the world have the potential of attracting investment both for export as well as for their domestic market. Türkiye is in such a privileged position to create a 'virtuous investment cycle', with a more competitive domestic business environment further strengthening Türkiye as a platform for exports, and exports in turn stimulating firms to upgrade and better serve the domestic market. This is true not only for the products, but also for the young managers. Young Turks are being employed by the global firms throughout the world with their professionalism and flexibility to deal with a wide range of circumstances.

INDUSTRIAL PRODUCTION AND CAPACITY UTILISATION

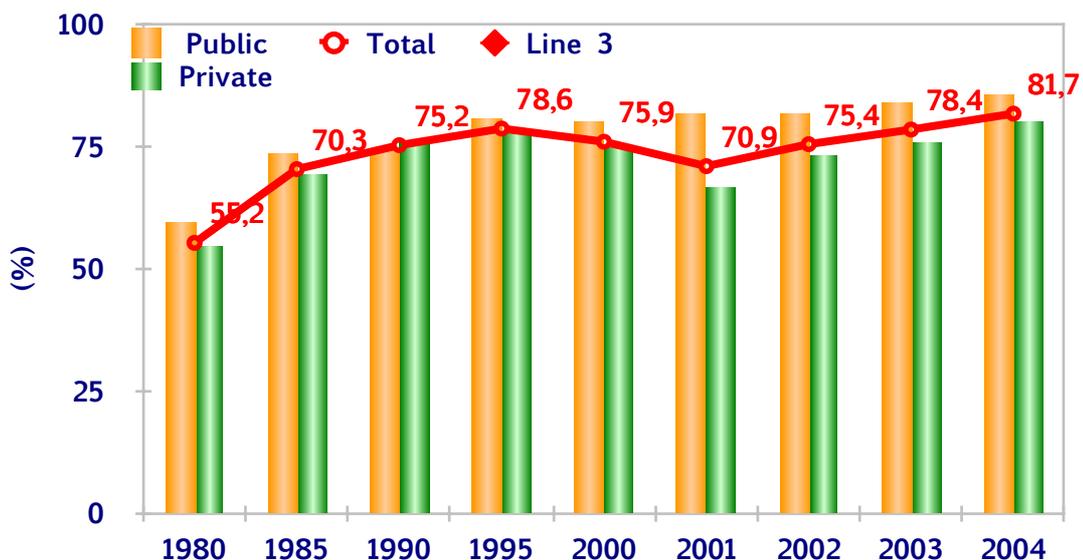
Industrial production has shown a steady increase since 2001 and reached its highest ever level of 143 in September 2005, based on the 1997 index. Capacity utilisation rates have demonstrated a similar pattern and have been hovering around the 80 per cent mark over the last year.

Graph 2: INDUSTRIAL PRODUCTION



Source: State Institute of Statistics (SIS)

Graph 3: CAPACITY UTILISATION



Source: SIS

These graphs about the levels of industrial production and capacity utilisation, demonstrate increased levels of confidence in the markets. After all, capacity utilisation rates are higher than the 1995 boom years' levels and industrial production has skyrocketed by 20 points since the end of 2000, another boom year.

FOREIGN TRADE AND CURRENT ACCOUNT DEFICIT

Turkish foreign trade has increased tremendously over the past decade, growing almost 20% annually. According to WTO figures, Türkiye ranks fifth in the world in terms of exports growth. In fact, Türkiye's exports have more than doubled in the last three years, reaching an estimated \$ 72 billion for 2005. Its imports have also been growing at an impressive rate. The structure of imports remains concentrated in raw materials and other industrial inputs, suggesting that however high they may be at this stage, imports are merely supporting the export base.

Table 2: FOREIGN TRADE

(Billion \$)	1980	1990	2000	2003	2004	2005(E)	2006(E)
Exports	3	13	28	47	63	72	80
Imports	8	22	55	69	97	115	128

Source: SIS, SPO

The only serious concern in major economic indicators relate to the current account deficit, which is high by any standards at its annual current level of \$ 21,5 billion as of end of September 2005. Historical data suggest that although the current account deficit is higher compared to last year, the rate in which it is growing is slowing down and the possibility of financing it is definitely improving.

Any correction to such a high figure carries its risks. The general attitude of the government towards financing the deficit is to keep calm, carry on with IMF programme and EU integration process and continue to improve the quality of financing over time.

EXCHANGE RATES AND INTRODUCTION OF NEW TL

After a very strong devaluation in 2001, Turkish Lira has been left to float freely – with minor interventions – and has become overvalued against major currencies by some 45%, according to the exchange rate index. Needless to say, such an overvaluation has its consequences in the exporting ability of the country. However, despite numerous outcries from the business community, the government insisted on freely floating the TL.

In order to create a psychological impact and to facilitate accounting, the present government has introduced the new TL by getting rid off six zeros of the currency. Such a change gave a boost to the positive expectations about the economy.

INFLATION

The level inflation has reached in recent years is another success story in the economic programme. Despite numerous domestic and international pressures such as high oil prices, the steady decrease in inflation levels has not only boosted confidence in the domestic market, but also allowed all actors of the economy to be able to plan ahead, perhaps for the first time in the last 30 years.

Table 3: INFLATION

(%)	2001	2002	2003	2004	2005(E)	2006(E)
CPI	68	30	18	9	8	5
WPI	89	31	14	14	6	5

Source: SIS

Turkish business people are very happy to have the high inflation nightmare out of their sight. However, working in an unstable economic environment for such a long time has definitely built their financial skills and sensitivity. For example, many global businesses chose to utilize their Turkish managers' skills to deal with the Asian crises.

INTERETS RATES

Having suffered from substantial real interest rates and having to deal with the financial crises under such unfavourable conditions, Turkish economy is now getting accustomed to the idea of relatively lower interest rates, another manifestation of confidence in the markets.

Despite scepticism regarding its current level, as some experts argue that they are very high compared to the inflation level, the risk elements are slowly disappearing, simply suggesting that in time, real interest rates too will reach a more comfortable level, reflecting the true potential and risk of the country.

Table 4: INTEREST RATES

	2003	2004	2005(E)	2006(E)
Govt. Bonds	28	20	14	13
O/N borrowing	30	20	14	13

Source: Treasury

BUDGETARY DATA

For the first in its modern history, Turkish government has prepared and declared a three year budget in line with the IMF targets. Such a development has definitely contributed to the positive expectations in the market.

Table 5: CONSOLIDATED BUDGET

In billion new TL	2004	2005 (E)	2006 (E)
Expenditure	141	145	157
Interest Payments	56	46	46
Exc. Interest Pay.	85	99	111
Revenues	111	131	144
Taxes	90	113	125
Deficit	30	15	13

Source: Treasury

It is important to underline a few facts about the fiscal discipline. Since the beginning of the economic programme, budgetary discipline has been kept vigorously. Governments were committed to the fiscal discipline and did not seek solutions in populist policies, which turned Türkiye's budget in the past into a black hole. Secondly, and again in line with the discipline issue, targets have always been set at acceptable levels.

It can be argued that expenditures are kept under control with interest payments stabilising for the next year at the very least. The tax collection is increasing and stabilising at around 85 % of the total revenues. Most importantly, the deficit is narrowing thanks to the positive economic outlook, reducing interest rates and thus risks.

RECENT DEVELOPMENTS AND TARGETS FOR THE FUTURE

As part of the economic reform programme, Turkish government began a series of privatisations, some of which are in strategic industries. Of all the privatisation programme, three transactions including Türk Telekom's sale to Saudi Oger, Tüpras' (petroleum refinery) sale to the Koç and Shell Consortium, and Erdemir's (steel) sale to OYAK group of Türkiye attracted a great deal of attention from international investors and has been a milestone for growing confidence in the Government's economic programme. The privatisation programme raised USD 13,5 billion in 2005.

It seems that the government's persistent attempts in the privatisation programme will continue in the future, creating further and profitable opportunities in the energy, telecom, agribusiness, transport and real estate industries.

As for the relations with the IMF and other major financing institutions, Türkiye implemented most of the important structural reforms, giving the impression to the outside world that economic and monetary discipline are very important in order to maintain credibility and that a stable economy and political system free of unnecessary turbulences are key to success.

A similar portrait was depicted in the relations with the EU. To the surprise of many supporters and sceptics alike, Türkiye has successfully completed a series of political reforms and secured a new beginning with the EU in the form of initiating full membership negotiations. Such a prospect placed Türkiye in a highly desirable position in the eyes of foreign investors.

CONCLUDING REMARKS

In short with her high growth potential, qualified worker force and managers, and entrepreneurship spirit, Türkiye provides an important potential for global businesses. Furthermore, regional political stability can only be established on a sustainable basis if the economic development spreads throughout the region. The engine for growth in the Balkans, Caucuses, Central Asia, and the Middle East is likely to be Türkiye. Perhaps most importantly, as an observer of Turkish economy has put it "Türkiye will be the 'viagra' for Europe" by becoming the key agent to help improve European competitiveness.