JOURNAL
OF EUROPEAN ECONOMY
Vol. 7 (№ 3). September 2008
Publication of Ternopil National Economic University

Economy of the European Union

Matthias FIFKA

THE LONG AND WINDING ROAD – BENCHMARKING TURKISH ACCESSION TO THE EUROPEAN UNION

Abstract

In 2005, Turkey was officially welcomed as a member candidate for the European Union. The accession process, however, is the most difficult in the history of the EU. Aside from political and social controversies, the readiness of the Turkish economy is frequently doubted. The purpose of this paper is to examine the state of the Turkish economy and to compare it to the economies of Bulgaria and Romania at the time of their accession. The core analysis is based on the question whether the Turkish economy currently has a standard that is comparable to the economies of Bulgaria and Romania when their accession to the EU was agreed upon. If that was the case, the EU theoretically could not deny Turkish accession based on economic grounds.

Key words:

Integration, socio-economic conditions, labor distribution, convergention criteria, balance of payments.

JEL: F15.

Fifka, Matthias, Dr., Visiting Professor, Department for International Studies, University of Erlangen-Nuernberg, Nance College of Business Administration, Cleveland State University, Germany.

1. Introduction

Turkey was officially recognized as a candidate for full European Union (EU) membership at the Helsinki summit on December 12, 1999. However, in the following years, the Turkish membership process received relatively little attention as the EU focused on the accession and integration of ten Central and Eastern European countries. After this eastern enlargement had been completed in May 2004, accession negotiations with Turkey were finally started in October 2005. The country on the Bosporus, which had regarded the non-inclusion in the previous round of enlargement as a serious setback, welcomed the beginning of the talks amid much fanfare. In several EU member countries, however, enthusiasm over a potential Turkish membership was limited. Especially in Austria, Germany, and France – countries which have had problems with the integration of Muslim minorities for decades – citizens and politicians have relentlessly articulated concerns.

Most of their objections revolve around socio-political issues: the unsatisfactory state of women's rights, discrimination of the Kurdish minority, persecution of political dissidents, and a seemingly blurred separation of church and state. Religion overall plays a central, if not decisive role in the controversy on Turkey's accession to the EU, as Turkey would be its only non-Christian member. This dispute certainly has been fueled by the perceived antagonism between Islam and Christianity throughout the world.

Therefore, it is to no surprise that in the academic and public discussion of Turkish EU membership the economic perspective has recently been neglected, although economic integration has always been the driver of overall European integration. One must not forget that the roots of today's EU lie in the foundation of the European Economic Community in 1957 with the single market at its core.

The purpose of this paper is to examine whether under economic criteria Turkey is ready for EU membership; political and social criteria will only be considered when relevant for economic issues. The EU itself does not predominantly provide or apply hard quantitative criteria when it comes to accession. This guarantees the necessary latitude in the process, but also leaves room for interpretation and guesswork to what degree the candidate country's economy is actually suited for membership. The approach taken in this paper is to benchmark specific indicators on the Turkish economy against the respective data on the economies of Romania and Bulgaria from 2005, the year when the treaties on Romanian and Bulgarian accession were signed, which eventually took place in 2007.[1] The underlying assumption is that these two newest members of the EU must have met the economic criteria taken into account by the responsible

[1] Using current data on Bulgaria and Romania would lead to a misrepresentation as both countries have considerably benefited from EU membership.

EU Commission in that year; otherwise they would have been denied membership. Before this comparative analysis is made and conclusions can be drawn, it is necessary to sketch a brief profile of the Turkish economy and to take a short look at the technical nature of the accession process and the criteria set forth by the EU.

2. A Profile of the Turkish Economy

The Turkish economy is a highly diverse mix of a traditional and partly inefficient agricultural sector with modern industry and commerce. In 2006, Turkey ranked 8th in agricultural output worldwide and its agricultural sector contributed close to 10% of the country's GDP, a number that only ranges in between 0.5% and 3% in most Western economies. It is even more striking that the agricultural sector in Turkey accounts for over 35% of total employment, which indicates the significant inefficiency of production methods. While Turkey's industrial sector contributes roughly 30% to GDP – a number that is in line with the EU average of 27% – its service sector is very weak compared to other European economies. It contributes less than 60% to GDP, while the EU average is 71%, and in the U.S. the share of the service sector is as high as 78%.

The industrial sector also gives reason for concern as the clothing and textile industry – making up one third of industrial output – has to face stiff competition from East Asia. Nevertheless, Turkey has been able to reduce its dependence on the textile industry by establishing internationally competitive automotive and electronics industries that already account for 18% i.e. 17% of all exports. Turkey is now the largest manufacturer of television sets in Europe and more than half of all TV sets sold on the continent come from the country at its south-eastern end (Kuser, 2006).

In the service sector, tourism is of prime importance. Over 25 million tourists visit the country annually, which creates revenues of almost $20 billion or 5% of GDP. The banking industry has undergone healthy consolidation in recent years, after it had experienced a vast crisis in 2000 and 2001 that was caused by a weak Turkish lira paired with a growing trade and account deficit. Its recovery was aided by a tighter fiscal policy, a currency reform in 2005 (1,000,000 old Turkish liras were converted into 1 new Turkish lira), and increasing privatization. This stabilization has fostered foreign direct investment (FDI), which was below $1 billion on annual average before 2004, but increased to $20.1 billion in 2006 (*Turkish Statistical Institute*, 2007).

The Turkish economy has experienced significant liberalization and privatization since the Justice and Reform Party of Prime Minister Recep Erdogan has come to power in 2002. It was able to reduce inflation from almost 65% in 1999 to 7% in 2007. During the same time, annual GDP growth was consistently over 5% and the government was able to present a balanced budget in 2006. Despite this progress, the governmental debt remains high at 60.7% of GDP, with a foreign debt of $206.5 billion or 51% of GDP, which makes the country vulnerable to macro-economic instabilities. The official employment rate has ranged in between 8% and 10% in recent years, but this neglects the significant under-employment in the inefficient agricultural sector. The employment rate remains low at about 46% with a particularly low participation of females of only 24% (*European Commission on Enlargement*, 2007).

Overall, the performance record and the perspectives of the Turkish economy are mixed. That gives critics of Turkish accession the possibility to point to a number of significant weaknesses, which are considered by the EU throughout the accession process where Turkey's readiness for membership is regularly assessed.

3. The Nature of the Accession Process to the European Union

Traditionally, a country was regarded as suitable for EU i.e. EC membership if it was European, had a stable democratic system and a functioning market economy. In the light of eastern enlargement, the EU revised and specified the conditions because of the large number of candidates and their recent transition from communism and central planning economies to democracy and free market. The revised membership criteria were formulated at the Copenhagen Summit in June 1993 and require that candidates have achieved

- «stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and, protection of minorities»;
- «the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union»;
- «the ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union».

As significant objections were raised over the question whether the EU was actually able to cope with the political, social and economic implications of integrating ten new members, the Council added a fourth condition which allowed the EU not to accept additional members, even if they met the accession criteria: «The Union's capacity to absorb new members, while maintaining the momentum of European integration, is also an important consideration in the general interest of both the Union and the candidate countries». Although this possibility for the EU to opt out was secured in the context of eastern enlargement, it must be assumed that many of the proponents of this provision were already considering using it against potential Turkish membership.

The rather vague criteria formulated in Copenhagen have been specified over the years by laws and regulations established by the European Commission and the European Parliament as well as decisions made by the European Court of Human Rights and the European Court of Justice. Nevertheless, when the candidates implement EU legislation and regulation («the obligations of membership») there is still substantial room for interpretation. All potential members are required to adopt the complete body of existent EU legislation, which is commonly referred to as «acquis communautaire» and amounts to over 80,000 pages.

In order to make a candidate's progress during the accession process more transparent, the «acquis» is usually divided into different chapters concerned with specific policy areas. In the case of Turkey, 35 of such chapters have been established. They cover very diverse topics such as the free movement of goods, education and culture, or foreign security and defense policy. It is remarkable, however, that 21 of the 35 chapters are directly related to economic issues. During the accession process, individual chapters are opened by the European Commission and once it determines that the candidate has fully complied with the respective requirements, the chapter is closed. As soon as all chapters are closed, the candidate is technically eligible for membership, provided that the Union feels able to integrate a new member.

At this point of time, two years after negotiations with Turkey were initiated, only eight chapters have been opened and solely one – concerned with science and research – has been closed. For most of them, the Commission determined in its most recent progress report that «considerable effort» on Turkey's side is necessary or that it will even be «very hard» for the country to comply with the requirements for accession. For only three of the 21 chapters related to economic issues, the Commission expects «no major difficulties.»

This rather bleak perspective must lead to the question whether the Turkish economy is indeed in such a seemingly desolate state. Many proponents of Turkish membership argue that the country's economy is as developed as the economies of Bulgaria and Romania had been at the time of their acceptance to the Union, and that Turkey would already be a member if it was not for the religious controversy. In order to shed some light onto this dispute, economic indicators describing the current state of the Turkish economy will now be compared to the respective data of 2005 on Bulgaria and Romania.

4. Benchmarking Turkey against Romania's and Bulgaria's economies in 2005

Since calculations and estimates of economic indicators vary significantly from the providing institutions, such as the World Bank, the IMF, the WTO etc., all data used here was provided by the *European Statistical Office* (Eurostat), unless otherwise noted. This not only allows a valid comparison, it is also the data used by the EU institutions concerned with accession. For Turkey, 2007 year-end estimates were used when available, because they can be regarded as reliable due to the point of writing in November 2007. For the comparison, the following categories of indicators were chosen: key economic data centered on economic output, composition and growth; labor distribution, participation and productivity; finance and budgetary conditions; balance of payments, and the administrative and legal environment encountered by businesses.

Economic Output, Composition and Growth

The first step of the analysis consists of a comparison of key economic data such as GDP, GDP per capita and economic growth. For further information, the 2005 average of the EU 25 is also mentioned, where possible. It includes the 25 member countries of the EU in 2005.

A comparison of total GDP adjusted to purchasing power standards (PPS) does not allow any meaningful conclusions since the countries differ substantially in population size. Bulgaria's population is 7.7 million, while Romania's is 22 million, and Turkey has more than 72 million inhabitants. Nevertheless, total GDP indicates that Turkey is a significant economic force and, according to IMF calculations, the world's 18th largest economy.

The comparison of GDP per capita (PPS) is more significant with respect to accession. As Table 1 shows, Turkey has not reached the level which Bulgaria and Romania had in 2005, but the difference is not large. Moreover, Bulgaria and Romania also were far behind the EU average, when their accession treaties were signed. In terms of GDP growth, Turkey is on an even level with the one of Bulgaria and Romania two years ago.

In the next step, the structure of the three economies according to sectors is analyzed, as it is a widely used objection by opponents of Turkish membership that Turkey's economic structure is backward with an over-proportionally large and inefficient primary sector. As mentioned above, this is true when compared to most Western economies, but can it also be said when compared to Bulgaria and Romania?

Table1.

Economic output, composition and growth

	EU 25 (05)	Bulgaria (05)	Romania (05)	Turkey (07)
GDP (PPS) in bn EUR	10,763.5	60.8	166.2	544.8
GDP per capita (PPS) in EUR	23,300	7,900	7,700	7,400
GDP growth	1.8%	6.2%	4.1%	5.1%
Primary sector share of GDP	2.1%	8.9%	10.1%	9.3%
Secondary sector share of GDP	27.3%	30.1%	34.7%	31.0%
Tertiary sector share of GDP	70.7%	61.0%	55.2%	59.7%

Source: Eurostat. Data for Turkey are year-end estimates.

The structures of the three economies show striking similarities (Table 1). If the share of the tertiary or service sector is taken as an indicator for economic advancement, Turkey cannot be considered to have a less advanced economy and even surpasses Romania. One might object that the mere share of sectors in GDP does not allow any conclusion on the productivity of the sectors and the productivity of the workforce in general. As it was mentioned in the profile of the Turkish economy, a large share of the Turkish workforce is employed or «underemployed» in the primary sector and that this sector is highly inefficient. Therefore, it is necessary to look at the sectoral distribution of the labor force and labor productivity.

Labor Distribution, Participation and Productivity

Analyzing the share of the sectors in GDP and workforce distribution between them produces interesting results. As indicated in Table 2, the primary sector in Turkey accounts for more than one third of total employment, but contributes less than 10% of GDP. In Bulgaria, roughly the same agricultural share in GDP was produced by only one tenth of the workforce. Romania's agriculture in 2005, however, was very similar to the one in Turkey and also characterized by absorbing a large portion of the workforce but only contributing relatively little to GDP – though it was slightly more efficient.

Table 2.

Labor distribution, participation and productivity

	EU 25 (05)	Bulgaria (05)	Romania (05)	Turkey (06)
Primary	4.5	11.0	31.6	35.9
Secondary	27.4	32.7	30.7	22.8
Tertiary	66.9	56.3	37.7	41.3
Labor productivity*	100	32.9	39.2	42.1**
Employment Rate***	63.8	55.8	57.6	45.9
male	71.3	60.0	63.7	68.1
female	56.3	51.7	51.5	23.9
Unemployment	8.8	10.1	7.7	8.4

Sources: Eurostat, ILO.

* Per person employed; EU 25=100

** Adjusted to the 2007 EU average.

*** Employment rates are calculated by dividing the number of persons/males/females by the total (male/female) population of the same age group.

Looking at the secondary sector leads to a different picture. Although only slightly more then one fifth of the Turkish workforce is employed in industry, it accounts for 31% of GDP (Table 2). In Bulgaria and Romania, the share of manufacturing in GDP is similar, but one third of the workforce is necessary to produce it. This underlines the competitiveness of several branches of Turkish industry mentioned in the economic profile.

Finally, while the service sector is less developed in Romania, it contributes roughly the same to GDP in Bulgaria and Turkey. Nevertheless, Bulgaria needs almost 6 out of 10 people in the workforce to accomplish that, while in Turkey only 4 out of 10 people are necessary to do so. This fact can mostly be attributed to Turkey's extensive tourism industry, which generates high revenues per person employed.

On the whole, labor productivity in Romania, Bulgaria and Turkey was and is significantly below the EU average, but Turkey's productivity is higher than it was in Romania and Bulgaria in 2005, despite Turkey's highly inefficient agriculture. However, the labor productivity index must be regarded with caution. It expresses the ratio between GDP and persons employed, which leads to a high number in Turkey, as workforce participation is low. While the employment rate among males is only slightly below the EU average, workforce participation among women is minimal, which leads to a low total employment rate. A widespread adherence to traditional gender roles is the reason for the small number of women active in the labor force.

Finally, unemployment in Turkey does not seem to pose a serious problem for accession when compared to Bulgaria and Romania or even the EU average. Nevertheless, it must be assumed that unemployment in Turkey is higher than 8.4%, a number which is kept artificially low by suppressing significant underemployment in the agricultural sector. Unofficial estimates of unemployment range in between 16% and 20% (Bonner, 2005; *Morgan Stanley*, 2006), but it must be noted that Romania and Bulgaria «polished up» their statistics as well when their EU membership was discussed (Cindrea, 2007).

Finance and Budgetary Conditions («Convergence Criteria»)

Aside from key economic indicators, the EU Commission for Enlargement places a major emphasis on fiscal stability with regard to the fact that every member country automatically becomes a member of the Economic and Monetary Union and is obliged to take the respective steps to meet the criteria for adopting the Euro, which, however, is not automatic. Under the rules set forth by the EU Stability and Growth pact in 1997, member states are to avoid excessive government deficits: Actual government deficit (public balance) should not exceed 3% of GDP, while total government debt should be no more than 60% of GDP. The deficit and debt criteria taken together are one of the four so called «convergence» or «Maastricht criteria», which have to be met for introducing the Euro. The second criterion provides that inflation may be no more than 1.5 percentage points higher than in the three best-performing member states of the EU. The third criterion is similar and sets forth that the long term interest rate must not exceed the level of two points above the three member states which perform best.[2] Finally, countries must be part of the Exchange Rate Mechanism II (ERM), which forces all members to keep their currency within a ±15% exchange rate range against the Euro. It is important to note that these criteria are relevant for adopting the Euro, not for joining the EU itself. Nevertheless, the EU Commission for Enlargement also monitors them closely. «Financial and Budgetary Provisions» constitute one of the 35 chapters.

As Table 3 indicates, Turkey would currently not meet the «convergence criterion» for inflation, but neither did Bulgaria or Romania in 2005. Turkey's inflation rate, which is fairly high because of rapid economic growth, falls in between the one of Bulgaria and Romania. More problematic for Turkey are long term interest rates of 10%; a level that is far too high, indicating low interest in Turkish government bonds because of the financial risk associated with them.

[2] The relevant data for the Maastricht criterion bond yields – defined by the EU as «central government bond yields on the secondary market, gross of tax, with around 10 years' residual maturity» – is not available, since it is only calculated for EU member countries, but not prior to accession.

The decisive long term interest rate that the EU looks at is the one for «central government bond yields on the secondary market, gross of tax, with around 10 years' residual maturity». The EU calculates this rate only for the EU members trying to adopt the Euro. Therefore, no data is available for Bulgaria and Romania in 2005 or Turkey in 2007. A valid comparison is not possible, but meeting interest rate criteria will pose a major problem for Turkey in the future.

Table 3.

Finance and budgetary conditions («Convergence Criteria»)

	EU 25 (05)	Bulgaria (05)	Romania (05)	Turkey (07)
Inflation rate	2.2	6.0	9.1	7.1
Long term interest rates	4.6 (2007)	3.8 (2007)	8.0 (2007)	10.0
Currency fluctuation against the euro (%)	–	0.34% (03–05)	3.57 (03–05)	6.49 (05–07)
Public Balance (% of GDP)	–2.3	3.1	–0.4	–0.8
Public Debt (% of GDP)	63.4	29.9	15.2	59.2
Public External Debt (% of GDP)*	n/a	24.3	14.3	13.7

Sources: Eurostat, IMF.

* Data according to the national banks of each country.

For determining the exchange rate stability, the average fluctuation of the respective national currency was looked at for a period of two years prior to the reference dates selected for this analysis (2005 for Bulgaria and Romania, 2007 for Turkey). Turkey's performance is the weakest in comparison, but gives no reason for concern as it would still easily fall into the percentage range of 15% set forth by the ERM.

Concerning public balance, Turkey currently meets the EU criteria easily, just as Bulgaria and Romania did in 2005. Turkey's public debt, however, barely is within the limit set forth by the Union, while that was not a problem for Bulgaria and Romania at the time of their accession. Turkey cannot «compete» with the two benchmark countries, but it still is below the high EU average, which mainly results from significant public debt in Germany, France, and Italy. The fact that three of the four largest EU economies frequently violate the stability criteria shatters the credibility of the Union as a whole. With regard to external public debt, Turkey is faring better than Bulgaria and Romania did in 2005. In recent years, the government has not only been able to reduce public external debt from 31.6% in 2001 to currently 13.7% of GDP, but also to cut back overall public debt from over 100% of GDP to 59.2% in the same period of time.

While Turkey has been able to reduce its public external debt significantly, total external debt – including the private sector – has maintained a level of over 50% of GDP. This is nothing unusual, however. In Bulgaria the total of public and private external debt amounted to 62.2% of GDP, but it was considerably lower in Romania with only 41.4%. Large foreign debt of developing or transition countries very often is a consequence of importing foreign goods for which external credit is needed. Therefore, it is necessary to look at specific data in the balance of payments of the three countries (Table 4).

Balance of Payments

The balance of payments consists of three major parts: the current account balance, the capital balance, and the financial account. The current account is the most important element and covers all transactions occurring between domestic and foreign entities. Four main transactions can be identified: the transfer of goods, the transfer of services, income receipts from work or investment, and unilateral transfers such as workers' remittances or insurance premiums. The transfer of goods and services, commonly referred to as the «trade balance,» contributes the largest share to the current account, which is negative for Bulgaria, Romania, and Turkey.

Table 4.

Balance of payments data

	EU 25 (05)	Bulgaria (05)	Romania (05)	Turkey (06)
Current Account (% of GDP)	–0.1	–11.9	–8.7	–6.3
Merchandise Exports (million US$)	1,334,827	12,766	27,403	85,479
Merchandise Imports (million US$)	1,476,352	18,362	41,215	138,290
Service Exports (million US$)	500,395	4,583	4,860	23,521
Service Imports (million US$)	436,767	3,908	4,768	10,475
Total Export-Import Ratio	0.96	0.78	0.70	0.73
FDI stock inward (in % of GDP)	31.7	51.3%	26.3%	19.6%

Source: Eurostat, WTO, UNCTAD.

This usually indicates that imports are larger than exports, which also holds true for the three countries, as the value of their exports amounts to roughly three quarters of import value. It is striking that Turkey is a net exporter of services, which can be attributed to its extensive tourism industry. Although services provided for tourists are technically not exported, they are counted as exports, because they are consumed by foreigners. On the whole, with regard to the export-import ratio, Turkey ranks in between Romania and Bulgaria, which exports most goods in relation to imports.

Finally, FDIs, which are recorded in the financial account of the balance of payments, are a major indicator for the performance, stability and future prospects of an economy, as investors generally tend to avoid unstable or ailing economies with low growth opportunities. FDI inflows into Turkey were minimal in between 1990 and 2001 averaging only $791 million annually, because investors avoided the country due to constant political turmoil, strong government regulation of key industries, legal insecurity, and high inflation. In 2003, after the Justice and Reform Party had come to power and started to enact a liberal reform policy, FDI inflows increased to $1.75 billion. Nevertheless, despite being much smaller economies, Bulgaria and Romania were clearly ahead of Turkey in FDIs at that point of time, recording FDIs of $2.1 and $2.2 billions respectively. Although Turkey has conducted a liberal reform policy and passed Bulgaria and Romania in absolute FDI in 2005, it is still a long distance away from the relative level of FDIs that Bulgaria and Romania had prior to their accession.

Administrative and Legal Environment

Obviously, investment conditions in Turkey were highly problematic before 2002, but have recently been improved. It must now be examined if the immediate business environment in Turkey has reached a level that was found in Bulgaria and Romania in 2005. For that purpose, several indicators provided by the World Bank in its *Doing Business Reports* for the respective years will be compared. The World Bank examines on an annual basis how friendly the conditions for businesses are in each of its member countries.

The reforms which have been enacted in Turkey in recent years have created an immediate business environment that is characterized by lowered bureaucratic barriers and fairly expedient administrative procedures. It takes less time to receive the necessary documentation for opening a business or obtaining a license for the construction of an average size warehouse than it did in Bulgaria and Romania in 2005[3]. The rigidity of employment index, which

[3] In its reports, the World Bank usually applies example cases in order to determine the individual indicators, e. g. the start-up of an average sized manufacturing businesses or the license procedures for the construction of an average-sized warehouse with 14,000 sq ft.

includes the difficulty of hiring and firing workers as well as contractual issues, is also lower in Turkey, expressing more freedom for employers in employment issues.

Table 5.

Immediate business environment

	EU 25 (05)	Bulgaria (05)	Romania (05)	Turkey (07)
Days to open a business	n/a	11	32	6
Days to obtain a license	n/a	212	282	188
Rigidity of Employment Index	n/a	44	59	42
Legal Rights Index	n/a	6	4	3
Good Governance Index	n/a	5.4	5.7	5.3
Time to enforce a contract	n/a	440	335	420
Time to import (days)	n/a	24	28	15
Time to export (days)	n/a	26	27	14
Total tax rate (% of gross profits)	n/a	38.6	51.1	45.1
Recovery rate in case of insolvency	n/a	33.5	17.5	20.3

Source: The World Bank.

Nevertheless, legal protection as a crucial issue for investors remains problematic. The «Legal Rights Index» calculated by the World Bank consists of ten powers of borrowers and creditors in collateral and bankruptcy laws[4]. These powers are crucial for a functioning capital market, which in turn is a major prerequisite for a high degree of entrepreneurship and the attraction of FDI. Even if bureaucratic barriers are low, investors will be hesitant to become involved if the legal framework provides only little security. This aspect is also reflected in the «Good Governance Index», which takes into account three sub-indices all concerned with investor protection[5]. Turkey again fares worst on this

[4] Among the ten powers are: general rather than specific descriptions of assets and debt are permitted in collateral agreements; any legal or natural person may grant or take security over business credits; a unified registry including charges over movable property operates; security provides priority both in and outside bankruptcy; parties may agree on enforcement procedures by contract; creditors may both seize and sell collateral out of court; no automatic stay or «asset freeze» applies upon bankruptcy; and the bankrupt debtor does not retain control of the firm.

[5] The indices include 1) the ability of investors to hold executives or board members reliable, 2) the extent to which the management has to disclose important transactions to

indicator, although not significantly worse than Bulgaria and Romania. It is to no surprise that Romania, which offers best protection for investors, also has the most efficient court system, measured in the time that it takes to enforce a contract.

Turkey, as a major exporting and importing nation, has made significant efforts to remove bureaucratic barriers which are a burden for international trade. Even worldwide, Turkey is among the leading nations, when it comes to expedient import and export, and clearly outpaces Romania and Bulgaria.

Concerning the total tax rate, which includes the sum of all the different taxes payable after accounting for various deductions and exemptions, Bulgaria offers the best conditions, followed by Turkey and Romania. The same ranking can be observed for the recovery rate in case of insolvency. The recovery rate expresses «how much of the insolvency estate is recovered by stakeholders, taking into account the time, cost, depreciation of assets and the outcome of the insolvency proceeding" (*World Bank*, 2008).

In general, in 6 out of 10 indicators, Turkey is faring better than Bulgaria; in comparison to Romania it is even 7 out of 10. The reforms for improving the business environment are clearly showing their effects. In 2006, Turkey was ranked 16th globally in the attraction of FDI with inflows of $20.1 billion. Investors also remain optimistic for the future. A survey among 192 multinational corporations suggested that FDI in Turkey will be rising at least until the end of 2009 (*The Journal of Turkish Weekly*, 2007). In its effort to attract investment from abroad, Turkey would profit enormously if accession to the EU would be at least visible on the horizon.

5. Conclusions and Implications

Regarding Turkish accession to the European Union, two questions have to be asked. First, is Turkey ready for membership in the EU, and second, is the EU ready for Turkish membership? To come to a comprehensive conclusion, these questions would have to be looked at from a political, social and economic perspective. However, this essay was limited to the latter. It made the assumption that the Turkish economy could be regarded as ready for the Common European Market, if it demonstrated the same or better conditions – expressed in various indicators – than Bulgaria and Romania did upon the time of their accession agreements.

---

the shareholders or the public, 3) access of shareholders to documents and other information in case of lawsuits.

Of the statistical data presented here, 24 indicators can be used for direct comparison[6]. Turkey only fares better than Bulgaria in 10 out of the 24 indicators; against Romania the number increases to 13. Therefore, we have a mixed result, and it cannot be clearly determined if Turkey's economy is suited for EU membership. However, we have to take into consideration that for this first – rather unsatisfying – conclusion all factors were weighted equally, which is a doubtful assumption by any means. A criterion like «days to obtain a license» cannot be given the same importance as public balance or legal security. It is not the aim of this paper to develop an elaborate weighting system, but it will be attempted to create central indicators that can be considered equally important, although any weighting of indicators will always be subject to personal opinion. For that purpose, major indicators shall be isolated and minor indicators shall be combined. Using this method, the following indicators can be determined: GDP per capita, overall employment rate, unemployment, labor productivity, inflation, public balance, public debt, exchange rate fluctuations, current account balance, export-import ratio, FDI stock, legal rights and investor protection[7], taxation, and administrative conditions[8]. The number of indicators has thereby been reduced to 13 and they are largely comparable in importance.

Turkey only fares better than Bulgaria did in 2005 in three out of these 13 key indicators (current account, administrative conditions) and surpasses Romania in six (unemployment, inflation, current account, export-import ratio, taxation, administrative conditions). This result sheds a rather negative light on the readiness of the Turkish economy for the European Union and leads to the following conclusion. Turkey's immediate administrative and bureaucratic environment for businesses has improved significantly, but broader economic and legal conditions need further stabilization and reform. Two major areas that Turkey has to work on can be identified.

Government Finances and Institutional Reform

Turkey has to maintain the fiscal discipline that it has demonstrated in recent years. Resolute fiscal consolidation has been the key to Turkey's strong economic performance and the reduction of inflation. Prime Minister Erdogan's

[6] These indicators are: GDP per capita; GDP growth; labor productivity; employment rate (overall – male – female); unemployment rate; inflation rate; currency fluctuation; public balance; public debt; public external debt; current account balance; export-import ratio; FDI stock inward; days to open a business; days to obtain a license; rigidity of employment index; legal rights index; good governance index; time to enforce a contract; time to im- and export; total tax rate; recovery rate in case of insolvency.

[7] Based on an average of the following indicators: legal rights index; good governance index; time to enforce a contract; recovery rate in case of insolvency.

[8] Based on an average of the following indicators: days to open a business; days to obtain a license; rigidity of employment index; time to import and export.

party has been able to present balanced budgets. Public debt as well as foreign debt could be reduced significantly, but are still at a level which makes Turkey vulnerable to external shocks and global market volatility. This situation creates a dilemma. On the one hand, Turkey faces strong expenditure pressures to overhaul the agricultural sector, reform the health care as well as the pension system, and improve infrastructure and especially education. The transformation of the backward educational system, which «produces» a comparatively small share of university educated or high-skilled workers, is vital for future economic development as the advantages in the area of low-cost labor, which Turkey has enjoyed so far, become increasingly eroded by global competitors who can offer labor at a much lower cost. This will be felt especially in the Turkish textile industry, which still is the largest industry in the country with 16.3% of total industrial capacity, but will have to face increasing competition from Asia. However, on the other hand, there is only little room for Turkey to increase government spending in order to avoid the fragile fiscal situation that the country was in at the beginning of this decade. Whether Turkey will be able to solve this dilemma remains to be seen, but chances for a positive outcome are given. Relatively high expenditures in the health care and pension system combined with poor outcomes indicate that there is room for reform through increased efficiency. To achieve this, the over-proportionally large bureaucratic apparatus has to be reduced.

Moreover, overall employment has to be raised to relieve the pension system, which suffers from low employment rate, especially among women, and relatively early retirement. The normal retirement age of 60 for men and 58 for women causes a financial burden that cannot be financed in the long run. Due to high social security contributions and obligatory severance payments, which are among the highest worldwide, employers in Turkey are reluctant to hire new workers. Naturally, many individuals are pushed into the informal sector, where working conditions are poor, the productivity is low, and no contributions to the social system are being made. Thus, cuts in pension contribution rates must be made and more flexible employment protection adopted. If these goals can be achieved, more public funds will be available for improvement of the educational sector in order to give a broader basis of the young population access to high quality education, which is currently only accessible for the most able or affluent.

Legal and Administrative Environment

The second area where Turkey has to enact considerable reform is improvement of the legal and regulatory framework through stable and independent institutions. Steps in the right direction have already been taken. The Turkish central bank has gained formal independence from government in 2001. That in turn has led to a more responsible monetary policy – reflected in the notable record in decreasing inflation – and increased the bank’s credibility at home and abroad. The confidence of foreign observers and investors was also fostered by the Foreign Investment Law of 2003, which guarantees the safe transfer of profits, royalties and fees, as well as the repatriation of foreign capital. The reforms to provide an easy and expedient process to set up a new business and to obtain necessary documentation have already been mentioned in the comparison. Although these streamlining efforts have been fruitful, an intransparent body of laws and regulations, which is one of the most detailed of all OECD countries, still remains (OECD, 2006). The complexity results in significant cost for the government and investors, and more importantly, gives room to discretionary decisions made by the bureaucracy. This creates significant uncertainty about the outcome of pending procedures; something that also applies to decisions made by the courts. Corruption in the administrative and legal areas remains a widespread problem. In the 2007 «Corruption Perceptions Index» published by *Transparency International*, Turkey was ranked 64^{th} with a meager 4.1 out of 10 possible points, which puts it in line with the countries like Columbia or El Salvador, but far behind most European countries that score in between 8 and 9. In consequence, «further simplification of the legal and regulatory rules governing the conduct of business is needed, and the commercial justice system should be reformed to provide a streamlined and predictable framework for enforcement" (OECD, 2006).

Assessment and Outlook

The first overall question – whether Turkey's economy is ready for EU membership – must at this point of time be answered with «no». However, if Turkey is able to continue its course of economic and legal reforms paired with economic stabilization, then the economic aspect will – compared to political and social issues – most likely pose the smallest barrier to accession in the future. In this context, it could be argued that the EU membership would actually help to accelerate the necessary reform process owing to competitive economic pressures from the other EU countries. However, it might also be stated that the desire to reform would decline after accession – a trend that is observable in several of the 2004 accession countries – because the ultimate goal of EU membership has been achieved and can hardly be reversed.

Similarly, the second key question – whether the EU economy is ready for Turkish membership – can be discussed most controversially. Proponents can point to a consumer market that would be the second largest in the EU after Germany, creating significant opportunities for all EU producers. The EU is already the Turkey's largest trade partner and its inclusion would therefore only be a natural enlargement. Moreover, the internationally competitive Turkish automotive and electronics industries could be seen as a valuable asset to the EU economy. The more significant asset, however, might be Turkey's young labor force that could help to reduce the Union's demographic problems, which will eventually lead to labor shortages.

Nevertheless, outward migration – aside from the political and social controversies connected to it – could also become a tremendous financial burden for destination countries, if the Turkish immigrants, who are often only poorly educated and unskilled, cannot find work and will have to be supported by the governments. According to Wolfgang Quaisser of the *Institute for Eastern European Studies* in Munich, approximately four million Turks would emigrate to other European countries once Turkey became a member (as quoted in *Die Welt*, 2004). While the costs resulting from immigration for individual member countries cannot be determined, the EU Commission has calculated that Turkish membership – assuming the country joined in 2015 – would cost the Union itself between 16.5 and 27.9 million Euros annually; money that naturally falls back on its members. These transfer payments would have to be made to Turkey within the framework of the Union's agricultural and structural policies aiming at economic development. Considering that these costs are roughly equal to the costs resulting from the accession of all ten countries in 2004, Turkish membership is highly problematic.

Although the EU, i.e. its member countries, could probably sustain Turkish accession economically, their willingness to do so remains in doubt, as the burdens clearly outweigh the benefits at this point of time. Consequently, the EU will continue its «wait and see position» to monitor the progress that its potential new member makes. With each year that Turkey is able to improve its economic condition and environment for business, it becomes a more attractive and financially less burdensome candidate. In view of these considerations, Turkish accession cannot be expected to take place before 2020.

Bibliography

1. Anastasakis, Othon. 2007. «Power and Interdependence». *Harvard International Review*. Vol. 28, No. 4: 14–17.
2. Bonner, Arthur. 2005. «Turkey, The European Union and Paradigm Shifts». *Middle East Policy*, Vol. 12, No. 1: 44–72.
3. Cindrea, Ioan. 2007. «The Crisis on the Labor Market in Romania». *Theoretical and Applied Economics*. Vol. 4 (April 2007): 25–28.
4. *Die Welt*. 2004. «Vier Millionen Zuwanderer». Interview with Wolfgang Quaisser. Dec. 15. http://www.welt.de/print-welt/article358663/Vier_Millionen_Zuwanderer.html.
5. *European Commission*. 2005. «Enlargement». http://ec.europa.eu/enlargement/key_documents/reports_nov_2007_en.htm.

6. *European Commission.* 2006. «Turkey 2006 Progress Report». http://ec.europa.eu/enlargement/pdf/key_documents/2006/Nov/tr_sec_1390_en.pdf
7. *European Commission.* 2007. «Turkey – Economic Profile». http://ec.europa.eu/cgi-bin/etal.pl.
8. «Gul Presidency Puts Turkey at Crossroads». 2007. *Defense & Foreign Affairs Strategic Policy*. Vol. 9, No. 35: 20-22.
9. Kuser, Michael. 2006. «The Unknown TV Giant». *Business Week*. http://www.businessweek.com/globalbiz/content/jun2006/gb20060609_371863.htm.
10. «Mountains Still to Climb – Turkey and the European Union». *The Economist*. Vol. 375, No. 8426. May 14: 39.
11. *Morgan Stanley – Global Economic Forum*. 2006. «Jobs for Votes». http://www.morganstanley.com/views/gef/archive/2006/20061115-Wed.html.
12. *OECD*. 2006. «Policy Brief – Economic Survey of Turkey». http://www.oecd.org/dataoecd/50/53/37529636.pdf.
13. Oguzlu, Tarik. 2004. «Changing Dynamics of Turkey's U. S. and EU Relations». *Middle East Policy*. Vol. 11, No. 1: 98-105.
14. Quaisser, Wolfgang. 2004. «Die Tuerkei in der Europaeischen Union?». *Institute for Eastern European Studies*. http://www.oei-muenchen.de/info11.pdf.
15. *The Journal of Turkish Weekly*. 2007. «Turkey: 16th in FDI Flow». Oct. 18. http://www.turkishweekly.net/news.php?id=49594.
16. *Transparency International*. 2007. «Corruption Perception Index». http://www.transparency.org/news_room/in_focus/2007/cpi2007/cpi_2007_table.
17. *Turkish Statistical Institute*. 2007. http://www.turkstat.gov.tr.
18. *World Bank*. 2006. «Doing Business in 2006 – Europe and Central Asia Region». Available by request at the World Bank.
19. *World Bank*. 2008. «Doing Business 2008 – Central Asia». http://www.doingbusiness.org/documents/RegionalReports/DB2008_RP_Central_Asia.pdf.

The article was received on June 12, 2008.