TURKEY IN EU, ECONOMICALLY FEASIBLE?

AN ANALYSIS OF TURKEY’S ECONOMIC GROWTH POTENTIAL IN LIGHT OF THE EU LISBON STRATEGY

Maarten Beer
200587005

MA THESIS

Advisor: Asst. Prof. Dr. Esra LaGro, Jean Monnet Chair

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The thesis you’re about to read is the finishing product of the International Master Program for European Studies (IMPREST). This one-year program has enabled me to enhance my knowledge in European affairs after graduating as an international oriented economist by August 2005. The master program took place at two different universities, in my case the first semester at Maastricht University and the second at Dogus University in Istanbul.

The master program has completely satisfied my expectations. During the program I’ve learned a lot more about Europe, European identity, the European Union, enlargement and of course EU-Turkey relations. Next to that it was a great experience to stay for a couple of months in two completely different cities. A comparison between the small city of Maastricht and the gigantic city of Istanbul is of course impossible. They share however the fact that I enjoyed my time there very much.

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Many people have made this a year to remember. Going twice to new, unknown cities has been quite a step for me, but in both cities the people surrounding me have made me feel at home. Most gratitude however goes to those who stayed behind. Most important in this respect my girlfriend Lieke who has been very well capable of dealing with a boyfriend not being around that much, especially in the last months. Next to her of course my parents, who supported me very much in the decision to keep studying even after five years.

I hope you will benefit from reading this thesis.

Maarten Beer
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SUMMARY

The aim of this thesis is to give an insight in the feasibility of Turkish accession into the EU in light of the Lisbon Strategy. Therefore, the strategies towards growth between Turkey and the EU have been compared. Similarities are found in the prioritisation of a stable macro-economic environment, investment in R&D and the focus on SMEs. In the Lisbon strategy increasing employment is a major goal, while this is less the case for Turkey. Next, economic aspects surrounding accession have been analyzed. Gains from accession go primarily to Turkey, estimated at between 4.9 and 6.5 additional annual growth of GDP. Labour migration from Turkey to the EU is expected to be modest. Estimations for the total migration inflow by 2030 range from 960,000 to 2,200,000 in the most negative scenario.

The performance of Turkey in attaining the goals set in the Lisbon strategy is relatively poor. In comparison to the average of the CEEC8 countries, Turkey is especially lagging regarding employment and productivity, the labour force education level and the high government debt. However, this implies at the same time that under the right conditions, Turkey’s growth potential could be explored, reducing the gap within a clear timeframe. Catching up at an annual rate of at least 2.5 percent would reduce the GDP gap by 30 percent in the next 10 years. Increasing labour participation to CEEC8 average would mean an increase of 4.9 million workers. A strong institutional setting is necessary to explore Turkey’s growth potential. Most important from short run to long run are 1) a stable macro-economic framework, with government budget balance and low inflation 2) enhancing facilities for SMEs and reducing corporate tax rates 3) increasing labour market flexibility and 4) increase education level of the workforce. With these measures in place Turkey might be able to catch up fast with the Lisbon goals, making accession of Turkey more feasible on economic grounds both for herself and the EU.
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Introduction

Looking back at the economic development of the European Union (EU) in the first years of the twenty-first century, two topics are very prominent. First, by the year 2000 the EU member states have adapted a new strategy in order 'to become the most dynamic and competitive knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion and respect for the environment' (Presidency conclusions, 2000: p 1), the so called Lisbon strategy. Another major event was the enlargement of the EU with 10 new member states as of May 2004. With this enlargement the EU became an increasingly important player in the world economy. Politically this enlargement was important since this was the first enlargement process where the Copenhagen criteria played an important role. Before the acceding countries were accepted as a new EU member, they had to fulfil a large number of criteria.

However, the enlargement process has not come to an end. An interesting development is the decision of the European Council of December 2004 to start accession negotiations with Turkey as of October 2005. Turkey has been a candidate state since 1999. The main goal of this thesis is to get an insight into the economic aspects of potential Turkish accession into the EU. Although the negotiations started only recently and they will probably not be finished before 2015, it is very interesting to investigate in how far the Turkish economy would fit into EU. Central in this analysis is to what extend the Turkish economy can benefit from and can be beneficial to the EU Lisbon strategy. Therefore the aim is to investigate the growth potential of Turkey within the setting of the Lisbon agenda and the potential accession of Turkey into the EU. The main research question to be answered is:

How will Turkish economic growth opportunities fit within the European Lisbon agenda?

To answer this question a number of sub-questions will have to be answered:

1. What are the main important aspects of both Turkish and EU growth agenda's and in how far are they similar to each other?
2. How far is Turkey in reaching the Lisbon strategy goals, also in comparison to current EU members?
3. How can Turkish accession into the EU enhance growth for both Turkey and EU?

The answers to these questions will be provided in the following chapters. The first chapter will give a theoretical framework on growth. In this thesis, the Solow model and extensions on it related to the knowledge economy and international trade effects on
growth will be the central theoretical framework. The second chapter will give a comparison of Turkish and EU growth agendas. A comparison will be made between the Lisbon agenda for growth of the EU, especially the renewed strategy for 'growth and jobs' and the Turkish development plans, especially the 8th five year plan for 2001-2006 and Turkish industrial policy. This will give a good insight concerning the important bottlenecks of the respective economies and the plans to solve them in order to achieve sustainable growth. The third chapter will be about two important issues of EU accession. First, within a theoretical framework and based on recent literature a good overview will be provided on the gains from enlargement for both Turkey and EU. To give some comparative information the literature on the last enlargement will also be reviewed. The second aspects discussed, is the potential migration flow after accession. For comparison the 'migration literature' on the last EU enlargement will be taken into account as well. In the fourth chapter two aspects will be discussed. First, some important insights into the current situation of the Turkish economy will be presented. This will be followed by a variety of comparative analyses on competitiveness, quality of governance, but mainly on the progress towards meeting the Lisbon goals. The general economic situation of Turkey as well as its progress towards the specific Lisbon goals will be compared with the situation of different EU countries. As with the gains from EU accession, the comparison will be mostly with the combined situation and progress of the ten new member states. In the fifth chapter the outcomes of the previous chapters will be discussed in order to provide an answer to the main research question.
CHAPTER ONE: THEORETICAL FRAMEWORK ON GROWTH

As has been explained in the introduction, the central goal for this project is to analyze how well Turkey will economically fit within the EU. Both EU and Turkey are looking for a way to achieve sustainable economic growth. Turkish accession into the EU will be analyzed within the framework of the Lisbon strategy, which is primarily focussed on economic growth. Therefore this chapter will give a theoretical framework on growth. The theoretical framework to be presented in this context starts with the basic model as originally proposed by Solow (1956). Elaborating on this, the more recent endogenous growth model will be presented in the second section. To provide a good framework in section three, related issues to growth theory will be assessed as well. Most important in this respect is the relation between trade openness and economic growth.

1.1 Solow model on growth
The Solow model is a neoclassical growth model. The model is based on the concept of an aggregate production function and a capital accumulation equation. The most basic models predict that there can be no long term economic growth per capita because of diminishing returns on capital. The only way to achieve long run growth in these models is by exogenous change of technological capacity. Without this technological change, adding additional units of capital will only lead to diminishing returns.

The model is based on the IS-LM model (Keynesian cross), which states that in an equilibrium situation planned spending equals income. Stated in a formula:

\[(S-I) + (T-G) + (IM-EX) = 0\]

Here (S-I) is Savings minus Investment, (T-G) means Taxes minus Government spending and (IM-EX) stands for Import minus Export.

When returning to a closed economy without government this leaves S-I= 0 or S=I which means that domestic saving equals investment. The basic idea for an economy is that Output (Y) is a function of the input of Capital (K) and Labour (L):

\[Y = f(K,L)\]

Combining these functions and taking into account that the current capital stock gets smaller through depreciation we arrive at

\[\Delta K = s f(K,L) - \delta K\]
The change in capital stock is positively influenced by increased savings (S) influencing the output of K and L and is diminished by depreciation of capital (\(\partial K\)). This equation shows that the capital stock will grow if the domestic saving rate or gross investment is higher than the depreciation on the capital stock. Assuming that labour supply is fixed so can be left out, the figure below shows the basic Solow model:

**Fig. 1.1 The Solow model on growth**

In this figure, it is shown that output per worker increases as long as investment in capital is higher than depreciation. Investment is only profitable if the returns on capital are higher than the cost of depreciation. Due to the diminishing returns on capital, an equilibrium situation is reached at \(k^*\) where investment equals cost. The figure of the Solow model may differ for different countries and change over time.

Although the basic model has the unrealistic assumption that labour growth is zero, this doesn’t matter for the outcomes of the model. Increasing the number of workers has the short run effect of increasing the marginal return on capital. This is however not the solution to diminishing returns to capital. If there are more labourers, more capital is needed to maintain output per worker. The basic result is therefore the same, growth per capita ceases. The only way economic growth can be achieved is through technological development. With this the production function is extended to \(Y = f(K, A, L)\) where \(A\) includes all knowledge in production. If \(A\) and \(K\) grow at the same rate, output must grow at the same rate and can do so also in the long run (Rogers, 2003: p 14-16).
1.2 Endogenous growth model
The only problem with the basic Solow model, is that it assumes technological change to be exogenous. In the 1980s new models have come up, the so-called endogenous growth models or new growth theory. A central concept in these models was the idea of knowledge spillovers. They occur when the activities of one firm affect another firm’s stock of knowledge. The idea is that firm B can profit from technological inventions of firm A without making any additional cost. This modelling allows individual firms to deal with diminishing returns to capital while social capital remains constant. Central idea is that diffusion of knowledge has a positive effect on economic growth. The easier knowledge can be spread, the higher the spillover effect, the higher the technology accumulation and the higher economic growth will get. Societies with institutions enabling knowledge to spread far and fast are able to achieve higher growth.

The basics of ongoing endogenous growth is the idea that knowledge is gained through investments and knowledge creates further investment. With technological spillovers from one firm to another further investments may be triggered, followed by additional knowledge. This increased knowledge can lead to new investment opportunities and the process can endlessly continue. Important in this respect is to think about the fact that spillovers would be socially optimal, if there are no cost obtaining them. However, if there are costs this would decrease knowledge accumulation and therefore economic growth. To reduce cost, governments can play an important role in transferring spillovers or by investing in development of knowledge through R&D (Rogers, 2003: p 23-31).

1.3 International trade and capital flows in growth models
In an international context, growth theory is used to answer the question how countries can learn and absorb technology from the rest of the world in order to increase growth. In this respect the general idea is that countries that lag behind can catch up and decrease their technology gap. Catching up is not an automatic process. To be able to catch up it is most important that the lagging country has enough absorption capacity. This means that especially the labour force must be able to cope with new technology. When the gap between countries is too big, this absorption capacity is often too low, so technology input does not lead to strong economic growth.

There are two main ways in which knowledge spillovers can be inserted into another country, namely through Foreign Direct Investment (FDI) and export. In this context, first the relation between FDI and Total Factor Productivity (TFP = the combined production of a fixed bundle of labour and capital) will be theoretically framed. TFP can increase in two ways. First, it can receive superior technological knowledge from other firms (spillovers). Second techniques can be developed internally by investing in research and development. FDI flows usually go from high to low productivity countries.
Through FDI flows, firms with lower technological standards in poorer countries can profit from the knowledge of their counterparts from the richer countries. These FDI inflows affect TFP of those countries both directly through the import of superior capital and indirectly through technological spillovers to local firms. These technological spillovers can also be brought in through the inflow of higher qualified workers, training local workers (Ferret, 2005).

As for the relation between trade and growth a lot of debate has been on the best trading strategy, either import substitution or export oriented trade. The current empirical outcomes show that export oriented policies contribute better to a country's development. However it is good to keep in mind that the chosen strategy is not the actual problem for growth. The problem is mainly that with a import-substituting policy trade barriers are used to protect the domestic industries. It is exactly this aspect that distorts the adoption of new technologies and the provision of new types of services and capital. With lack of these inflows, economic growth is hampered.

Next to that, empirical research also shows that export oriented industries are more productive than other industries. A potential explanation of these findings is given by the 'export market self-selection hypothesis' and the 'learning by exporting hypothesis'. The first suggests that only the more productive firms start exporting. This means that only international competitive firms take an export oriented strategy, making it obvious that it seems as if this strategy is best for growth. The second hypothesis argues that exporting firms profit from productivity increase due to foreign contacts. These firms have easier access to technological spillovers through their foreign partners. Next to these potential reasons for higher productivity of exporting firms are: increased incentives to innovate, increased competition, increased incentives to upgrade product quality. These actually all come down to the point of international competition. In order to be able to stand in a more competitive international environment, it is necessary to be more inventive (Falvey and Yu, 2005).

This section provides the necessary analytical framework for growth. From the original Solow model it proceeded to the endogenous growth models, where technological progress is the key for growth. Next to that links have been laid down towards the gains from FDI and export towards growth. Following this analytical framework, the next chapter will provide insights into the growth strategies of both Turkey and the EU.
From the theoretical framework on growth, this chapter will provide insights into the strategies to achieve growth for both Turkey and the EU. Both Turkey and the EU have their own difficulties when it comes to sustainable growth. The problem for Turkey mainly lies in the high volatility of the economy, with high growth rates followed by severe crises. For the EU growth rates are stable but rather low. Both the EU and Turkey are currently confronted with some more structural problems that block them from achieving high sustainable growth. By 2000, the EU has come up with a new strategy to achieve sustainable growth, the so called Lisbon strategy. Turkey on the other hand uses multi-annual growth plans as well as industrial policy for the medium run.

In this chapter a comparison will be made on both strategies. It will give an insight into the main bottlenecks for sustainable growth, and the potential solutions to them. In this way it becomes visible whether EU and Turkish economic problems in general show some similarities or that there are big differences. The first section presents the Turkish strategy for growth, thereby mainly focusing on the 8th 5 year plan for 2001-2006 and on Turkey’s industrial policy. The second section gives an insight into the Lisbon agenda of the EU. Special attention will be paid to the updated agenda as of 2005 which came about after the presentation of a number of reports on the progress towards the Lisbon agenda. The third section will provide some remarks on the similarities and differences of the two strategies.

2.1 Turkey and its strategy for growth

Turkey uses a number of different plans to achieve future sustainable growth and with the goal of catching up with the European Union. This section will provide the main important goals mentioned in these different plans, going from long-run to short-run planning. The most long term plan is the strategy for long-term growth (2001-2023). Based on this the government uses medium term five year plans, with the 8th five year plan being the most recent, covering the period 2001-2006. In the 8th plan, the most important aspects and actions for the short and medium run are framed within the context of the country’s industrial policy as well as other government policies. The short term program presented here is the Pre-accession Economic Program 2005 (PEP).

Long-term planning: strategy for long-term growth, 2001-2023

Although long-term planning for a more than 20 year timeframe is pretty farfetched it is important to show the main goals, since the medium and short term plans are based upon this plan. The core of the economic strategy for long term growth 2001-2023 is:

- Reform of the economic and social structure through restructuring of the state;
- Raising the level of education and health care in society;
• Improving income distribution;
• Strengthening scientific and technological capacity and developing new technologies;
• Enhancing effectiveness in infrastructure services;
• To protect the environment and
• To develop the export-oriented, technology intensive production structure emphasizing on generating a high added value.

In order to achieve these goals, the main emphasis is to meet the conditions for an information society. The human capital potential of the young population should be enhanced by investment in education. The economy should be market oriented, with strong industrial policy and open for international competition. If all this works out well, policymakers expect that an annual growth of 7 percent should be possible and that by 2023 the income per capita reaches the EU average (State Planning Organization (SPO), 2000: p 21).

Medium term: 8\textsuperscript{th} 5 year plan and industrial policy
The core of the 8\textsuperscript{th} 5 year plan for the period 2001-2006 gives a clearer picture of the active measures to be taken. It is important to keep in mind that this plan has been written before the economic crisis of 2001. After this crisis some of the priorities have been adjusted. The first priority is to bring down inflation to single digits and to achieve public sector balance. Attached to this, the criteria for accession to the EU are mentioned as policy guideline. A major achievement should be attained in implementation of the acquis and to fulfil other criteria, such as the Maastricht criteria on the Stability and Growth Pact. To be able to sustain the information society, it is important to provide the labour force with the necessary tools. Therefore, more investment should be made in education to fulfil the need for qualified labour. For macro-economic stability and to cope with increased international competition the state should reduce its capacities and influence and focus only to its core goals. In this respect a number of state companies should be privatized.

The industrial policy aims for a flexible structure which will enhance technology. In this respect it is important to increase investment in R&D while taking care of health policy and the environment. To expand the use of knowledge necessary legal and institutional arrangements shall be made and information and communication technology infrastructure shall be rapidly developed. Accordingly, the Turkish government should provide a sustainable framework with strong institutions in which private companies can be internationally competitive (SPO, 2000: p 26).
This 8th year development plan is the basis for the most important and concrete document, the industrial policy (SPO, 2003). This has been written as a medium term plan for industrial policy to achieve sustainable growth. It is especially assigned to the manufacturing industry. The main goals are to:

- increase competitiveness and productivity;
- maintain sustainable growth and
- stay outward oriented in order to deal with increased globalization.

The focus of the Turkish industrial policy for achieving sustainable growth lies with: *innovations, investment* and *exports*. Special attention in this regard will be paid to small and medium enterprises (SMEs) for two reasons. First of all, SMEs have a considerable share within the industrial structure. They cover around 99.6 percent of the total number of industrial establishments, 63.8 percent of employment and 36.0 percent in value added. Secondly, SMEs are expected to be the best capable to deal with innovations. The government's general policy is to stimulate the three ways towards growth and to play a supporting role. This means that government should:

- stimulate high-technology industries;
- promote and support solid financial and administrative company structures and
- provide the industry with a good (ICT) infrastructure and good industrial property rights.

Under the heading of *innovation* a number of issues have been given priority. First of all more investments should be done in R&D. It is important that public and private institutions combine efforts in this area. University-industry cooperation should be supported. To increase innovative capacities and to make better use of inventions, the level of knowledge of the labour force should be increased by investing more in human capital.

*Investment* should be more promoted. Investments in R&D especially with respect to information and communication technologies, new product and technology generation, protection of the environment and improvement of SMEs should be supported. In this light lending facilities should be improved. The utilisation of financing facilities such as credit guarantee funds, risk capital, financing investment partnerships, asset investment partnerships shall be extended.

Next to that complexity and excessive red tapes in administrative procedures should be reduced. Attention should be paid to increasing contact with foreign partnerships to increase FDI inflows. In line with this policy, public sector investments will be intensified mainly on economic and social infrastructure.

To increase export, companies should be directed into export oriented production. Competitiveness of Turkish companies should be increased. Additional resources should
be made available to support export oriented industries. Next to that industrial policy aims at replacing consumer good and raw material industries with more knowledge and technical industries, in order to compete in a further globalizing world.

To improve the position and performance of Small and Medium Enterprises a number of facilities should be made available. As mentioned above, SMEs will be supported by more and better credit facilities and supporting institutions. In this light more industrial zones will be set up and different organizations will help SMEs by providing information and, technology access.

All these measures shall be taken with sustainable development as ultimate goal. Therefore the protection of the environment and social cohesion should not be forgotten while pursuing technology oriented growth. Next to building on the existing policies, the process of accession into the European Union plays an important role. In this light especially the alignment with the acquis is a priority (SPO, 2003: p 42-61).

**Short term: the Pre-accession Economic Program 2005 (PEP 2005)**

For short term development action most information is contained in the Pre-accession Economic Programs (PEPs). These programs show what government is planning to do in the upcoming two to three years. Although this is to a large extent an overview of the different laws that are (to be) implemented, a short overview of the main important aspects of PEP 2005 is presented here.

The main emphasis in short term government policies lies within the macro-economic policy. The central aim is to live up to the Maastricht criteria within the next three years. In order to achieve this fiscal discipline and price-stability are the most important. Keeping a primary fiscal surplus in the upcoming years should contribute to the reduction of governments borrowing requirements and of the public debt to GDP ratio. Price stability should be maintained by the independent central bank. It aims at lowering inflation, while at the same time keeping a floating exchange rate to avoid overvaluing of the Turkish lira. A good stimulant for reduction of government debt could come from further privatization. The privatization process that has started in the 1980s and has been strengthened in recent years will be continued.

Another important aspect of structural reform is the creation of a more favourable investment environment. Some adaptations to Law no. 4054 on competition policy have been made. The strengthening of the capacities of the independent Competition Authority and the Competition board is very important in this respect. Next to that government investment guarantees can create a better investment environment. Reforming the banking sector and capital market is another priority. In chapter four some further
information on the restructuring of the banking sector after the 2001 crisis will be provided. In light of the pre-accession economic program, the aim is to increase banking financial stock in order for banks to work more as intermediates. With additional capital stock banks can provide more loans for investment. Restructuring the capital market will mainly be done through the creation of a separate capital market for Small and Medium Enterprises (SMEs), which should improve the possibilities of opening new business.

It is not only government documents, but also public reports of other institutions that give insights into the Turkish agenda for growth. Most interesting for this thesis is the 2003 report of UNICE (Union for Industrial and Employers' Confederations of Europe) on the Turkish progress towards the Lisbon strategy (UNICE, 2003). TÜSAID, the Turkish participating organization in UNICE made recommendations on important aspects of the Lisbon agenda for Turkey such as public administration reform, promotion of entrepreneurship and innovation, investment in education and improvement in employment and labour markets. The most important recommendations under these headings are summarized below:

Modernizing the state: public administration reform
- End state monopolies and allow for competition in these sectors;
- Privatize state service sectors except general interest sectors;
- Restructure public institutions taking into account basic principles of reform such as: accountability, transparency and productivity and
- decentralize decision making.

Entrepreneurship and innovation
- Entrepreneurship should be a top government priority;
- Credit facilities and access to capital should be improved for SMEs
- A sound scientific infrastructure has to be established
- Technological innovation should be recognized as primary driver of economic growth and
- More innovative firms should be started up and (financially) supported.

Education
- Increase the period of compulsory education to 12 years;
- Strengthen the relation between education and employment and
- More resources should be made available to invest more in education at all levels.

Labour market and employment
- Adapt labour law to allow for more flexible working patterns;
- Reduce taxes on income and
- Diminish the gap between male and female employment rates
It is clearly visible that the advice of the employers is largely in line with the development goals of government. Public state reform as well as the strengthening of an innovative private sector are top priorities. It is interesting to see that the employer organization is geared more towards the Lisbon strategy and focuses more on education and the labour market relative compared with Turkish government.

This brief overview shows the main important strategies design to lead to the economic growth of Turkey. The priorities set by these programs can be explained to a large extent with the help of the theoretical framework presented in the first chapter. Especially for a country which is not making optimal use of its potential, capital accumulation through investment is a good start for achieving growth. The priority is set towards achieving and improving the technological capacities, which should be the major source of growth. This can be supported by being open to FDI and by export oriented industries.

2.2 EU and the Lisbon Strategy
By the year 2000, the EU formulated a coherent strategy for growth, the so called Lisbon agenda. The aim of this strategy was: 'to become the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment' (Presidency conclusions, 2000: p 1). As this quote shows, the main importance of this project is that all parts of it should be formed in a coherent manner. The search for growth should be accompanied by increasing the number of jobs and the quality of these jobs. Increasing quality of jobs and people should lead to higher productivity and in that way contribute to growth. On the other hand, the aim for growth and development should not be at cost of social cohesion or the environment. In order to achieve this, it proposes a three-point approach:

- preparing the transition to a knowledge-based economy and society by the development of improved policies in terms of the "information society" and research and development, in addition to completing the internal market and accelerating structural reform;
- modernising the "European social model", investing in people and combating social exclusion; and
- sustaining a healthy economic outlook and favourable growth prospects by applying an appropriate macrroeconomic policy mix.

Movement towards a "knowledge-based economy" will be a significant boost for European growth, competitiveness and employment. In order to become a knowledge based economy, it is important to achieve more widespread use of the internet and to adopt legislation on the legal framework governing issues such as electronic commerce
and the telecommunications regulatory framework. It should be ensured by 2002 all schools have access to the internet and that all relevant teachers are skilled in the use of the internet by the end of 2002. Special attention is devoted to the problems of new and innovative businesses, and particularly small and medium-sized enterprises (SMEs), looking in particular at ways in of lowering the costs of business and removing unnecessary "red tape" (Kok et al., 2004: p 10). Most other important goals can be find under the heading of the 'European social model' which are presented below:

**Education and training**

The Lisbon Council stated that the EU's systems need to adapt to the demands of the "knowledge society" and to the need for an improved level and quality of employment. Member States, the Council of Ministers and the Commission are therefore asked to meet a number of targets, including:

- the achievement of a substantial annual increase in human resources investment;
- the number of 18- to 24-year-olds with lower-secondary level education only who are not in further education and training should be halved by 2010;
- the development of schools and training centres into multi-purpose local learning centres;
- the drawing up of a definition of appropriate basic new skills to be acquired through lifelong learning, including information technology skills, foreign languages, entrepreneurship and social skills. A European diploma for basic information technology (IT) skills should be established in order to promote increased mobility of IT specialists in Europe;
- improvements in the mobility of students, teachers and training and research staff, by making the best use of existing Community programmes; and
- the development of a voluntary common European format for curricula vitae in order to aid general mobility within the EU.

**Employment policy**

Within the employment policy strong targets are set. The employment rate in the EU should increase from an average of 61% to 70% by 2010 the proportion of women in employment should increase from an average of 51% to 60%. At European level most attention should be paid to:

- improving employability and reducing skills gaps, through means such as creating a Europe-wide database on employment and learning opportunities and by promoting special skills attainment programmes;
• giving higher priority to lifelong learning, including the encouragement of agreements between the social partners on issues such as innovation and lifelong learning;
• increasing employment levels in service industries; and
• furthering all aspects of equal opportunities, including the reduction of occupational segregation.

Modernising social protection

The systems of social protection which make up the European social model need to be adapted in order to ensure that work pays and to secure the future of these systems in the face of an ageing population.

Promoting social inclusion

• promote a better understanding of social exclusion through continued dialogue and exchanges of information and best practice;
• "mainstream" the promotion of inclusion in Member States' employment, education and training, health and housing policies; and
• develop actions targeted at specific groups such as minority groups, children, elderly people and people with disabilities (EIRO, 2000).

By 2002 an independent Group of experts was asked by the European Commission to review the combination of the two most important agenda's for the upcoming decades, the Lisbon agenda and EU enlargement. The Group was asked to review the entire system of EU economic policies and to propose a strategy for delivering faster growth together with stability and cohesion in the enlarged Union. The final results of this report -the so called Sapir report (2003)- gives an external view on the most important challenges, resolutions and strategies for the EU to be followed in order to achieve these goals. Their assessment starts with a short analysis of recent economic development. The main identified problem is the lack of dynamism in the economy. The EU economy has shown rather mediocre growth over the past years, rather modest compared to growth figures of the US. There is a better track record when looking at stability, with low inflation and a reduction in budgetary deficits. It is suggested that between these goals of growth and sustainability there has been some economic trade-off where the aim of stability has brought a slowdown in economic growth. For the upcoming decade the main challenges are under two headings. The first is sustainability, by which they refer to the sustainability of the social security system in light of the ageing population. The second is enlargement, where it is acknowledged that entering the EU will not automatically lead to catching up and that strong policies are necessary to achieve economic convergence of the new member states.
From this review and the identified challenges, four principles in recommending new policy design are set:

1. To expand growth potential it is primarily important to change some micro-economic policies. However also macro-economic policy reforms are necessary, especially rethinking EU budget spending.
2. Well functioning markets for labour, capital, goods and services foster growth.
3. Instead of using a policy instrument for multiple goals, one instrument should be attached to only one goal.
4. New policy design should improve the functioning of an enlarged union.

Next to that 4 principles for delivering policies are:

1. Methods need better matching to tasks.
2. Effective implementation of EU policies often depends on the willingness and political agenda of national and sub-national governments. Therefore EU should be promoted as facilitator for policies at this level.
3. There should become a sense of shared ownership of the European agenda also at lower levels.
4. Variable geometry is a natural reaction in an enlarged union.

From this the Group formed a six point Agenda for Growing Europe, of which the last two are on the delivery modes:

1. A dynamic single market; an increased focus on simplifying access of new entrants and a more pro-active labour movement policy.
2. Boost investment in knowledge; increase spending on R&D, create a European Agency for Science and Research and stimulate private investment in R&D through tax-benefits.
3. Improve the macro-economic framework of EMU; improve incentives for countries to save up surpluses in good times, give the commission more space to act upon breach of criteria and allow for differentiation between countries because of their different current situation.
4. Redesign policies for convergence and restructuring; convergence policies should focus on countries, not on regions. Funds should be invested in human and physical capital.
5. Increase effectiveness of decision making and regulation; better assignment of competences between EU and (sub) national levels, more regulatory functions from the commission to independent bodies, institutional reform and increased Qualified Majority Voting (QMV) in the Council.
6. Refocus the EU budget; change the current Funds into three funds: a growth fund, a convergence fund and a restructuring fund. All funds should be completely separately divided, with clear transparent criteria.
Pelkmans and Casey (2004) made a detailed assessment of the Sapir report. Although they in general agree with the recommendations made in it, they question in how far the recommendations will indeed lead to improvement of the growth agenda. They argue that the recommendations are probably a good start, but not enough. The main reason for this is in their view that the report (as requested by the European Commission) mainly focuses on macro-economic EU policy changes and not on the real issue, the cooperation of national governments. Big problems that will probably remain, are for example the difficulties national governments have with the strengthening of the internal market and the very slow progress in reforming the (national) labour markets. Another question to be asked is why both national governments and private companies do not invest more in R&D. In addition to this, more attention should be paid to micro-economic policy issues related to improving incentives for innovative and entrepreneurial behaviour. All in all, as much as they agree with the Sapir report recommendations, further action especially at national level is necessary according to their view.

According to the mid-term review of the Lisbon strategy prepared by a high level commission chaired by Wim Kok in 2004 (Kok et al, Mid-term Review of the Lisbon strategy) the overall achievements in reaching the Lisbon targets are rather modest. The report highlights that 'for Europe to increase its living standards, it needs to accelerate employment and productivity growth through a wide range of reform policies as well as a wider macroeconomic framework for growth, demand and employment. No single action will deliver higher growth and jobs. Rather, there are a series of interconnected initiatives and structural changes that through concurrent action in the European Union will release its undoubted potential' (Kok et al., 2004: p. 6). According to the report urgent action is required in five interacting fields:

1. the knowledge society,
2. the internal market,
3. the business climate,
4. the labour market and
5. environmental sustainability.

Under the heading of knowledge society, the EU should aim at increasing Europe's attractiveness for researchers, increase investment in R&D and spread the use of ICT. The internal market should be completed, with special attention drawn to the single market for services. Services account for around 70 percent of GDP but only for 20 percent of internal trade. A lot of regulatory and/or de facto barriers still exist especially in this sector. In line with this the business climate should be improved. Regulation should be reduced or improved, special support should be given to SME's and new starting businesses. Within the labour market, special attention should be drawn to
raising the education level of the labour force as well as aiming at a trajectory of life long learning. Another important aspect is the rapid ageing of the European population and with that the reducing size of the labour force if no appropriate measures are taken. Sustaining environmental stability should be achieved through spreading eco-innovations and by pursuing policies which lead to long-term and sustained improvements in productivity through eco-efficiency (Kok et al., 2004: p 6-7).

Building on this report the Commission developed an adapted strategy under the title ‘Jobs and growth, a new strategy for the Lisbon agenda’ (2005). Within this renewed strategy the main targets are:

1. To make Europe a more attractive place to work
2. To ensure that knowledge and innovation are the beating heart of European growth
3. To shape policies to ensure that businesses are able to create more and better jobs.

To achieve these broad goals, a number of more specific goals and targets are given. It is acknowledged that the first important thing is to keep sound macroeconomic conditions, to underpin a credible effort towards growth and jobs. In this light the Stability and Growth Pact plays an important role. Next to that it is important that the new financial framework for the period 2007-2013 reflects the priorities written down and agreed upon by all member states. However, the most important is -as also acknowledged in the mid-term review- that it is especially the member states and national governments that have to pull progress. Without a more willing and productive attitude of individual member states, the strategy will not work. The next subsections briefly show the main important issues for achieving the three main goals mentioned above.

1. Europe as a more attractive place to work

First of all, it is important to extend and deepen the internal market, in order for business and consumers to feel the benefits. In order to achieve this, a number of issues should be acted upon:

- EU legislation should be quicker implemented by the member states. Next, the regulatory framework should be reformed. Most importantly is the proactive use of competition policy. For certain sectors such as energy, telecommunications and financial services, sector screenings should show the remaining barriers to competition.

- To extend the internal market, the main goal is to make sure that it functions better, especially in the field of services and movement of labour. The service sector still maintains a lot of national barriers for the provision
of services in another member state. Full freedom in these fields should be achieved.

2. Knowledge and innovation for growth
To make Europe an information and knowledge based society it is important that public authorities support innovation. A focus should be kept on information society, biotechnology and eco-innovations. This starts by increasing the levels of both public and private investment in research and development. Reforms in State aid policy should improve support for small and medium enterprises.
In order to guarantee long-term competitiveness of the EU, it is very important to maintain a high quality education system. At European level efforts will be undertaken to create an ‘European Institute for Technology’. Next to that the Commission will support regional innovative pools, where universities and industries work together to make better use of available knowledge and innovations.

3. Creating more and better Jobs
The strategy towards the creation of more and better jobs is threefold. First of all the member states should increase their efforts to boost the level of employment. In the light of an ageing population it is important to pursue active employment policies for older people to work longer and to make sure that the number of young people and females in the labour force increases. Attached to this, member states should improve their social security system to keep it sustainable.
Secondly, it is important to improve the adaptability of workers and enterprises and the flexibility of the labour markets. In the light of the shrinking workforce a good migration policy is necessary. It is also important to equip new entrants into the working population with the right tools. Therefore it is important to increase investments in education and training. Life long learning should be central in this approach. It is necessary to increase the mobility of the working force. This would very much be supported by the adoption of a common framework for recognition of qualifications. All other restrictions on the mobility of workers should be abolished. This includes the current barriers to workers from the 10 new entrants (Commission 2005, growth and jobs).

The overview shows that the Lisbon agenda has had quite some adaptations during the first 5 years of implementation. Both the Sapir report and the mid-term review have led to a more clear strategy. A choice has been made to work primarily on growth and jobs.

Many of the mentioned goals and suggested actions for growth in the ‘developing’ Lisbon strategy can be related back to growth theory. Openness of the internal market should improve knowledge building through enhanced spillover effects. The internal market for services and labour movement are the areas where the internal market is not working
properly so far. The technology base of the economy should be improved by investment, international cooperation, strengthening the relation between industry and universities and by improving the capacities of workers. A flexible but stable macro-economic environment should be maintained to improve competitiveness of the economy.

2.3 Comparative Analysis
Based on the documents analyzed in the previous sections, this section will provide the main similarities and differences found for the growth strategy of Turkey and the EU. This comparison functions as a basis for the analysis in chapters 4 and 5 when the accession of Turkey in the EU will be discussed with its progress towards the Lisbon agenda as starting point. The comparison of growth agenda's is a first step in this direction.

Although probably with a relatively different starting point (as will be analyzed in the next chapter) the strategies of the EU and Turkey show a number of similarities. First of all, they both point at the importance of a stable macro-economic structure. Both refer in this light to maintaining a tight fiscal and monetary policy. For Turkey this is important in the light of avoiding economic crises and creating a solid foundation for growth. For the EU this focus should be seen in the light of an ageing population and the sustainability of the social security system. A tight fiscal policy should prevent a further rise in government debt. In the case of Turkey and some individual EU countries this government debt is already quite high. Figures on this will be provided in chapter four. For these countries, a tight fiscal policy should create a budget surplus to reduce total government debt. Both the EU and Turkey have this target of macro-economic stability as their primary task. Without this solid foundation all other aspects for growth become vulnerable.

The second important similarity lies in the focus on investment in the 'knowledge society'. Turkey wants to increase its scientific and technological capacity in order to be able to compete in an globalizing world. In this light, more investment in R&D should be made. A good infrastructure -especially ICT infrastructure- should be constructed to support the development of new highly technological industries. The link between universities and industry should be strengthened. The EU also wants to improve its technological capacities by investing in R&D. It also aims at creating a stronger European knowledge area, in order to combine strength within different countries. Both know that their investment activities relative to their point of reference (for Turkey the EU, for EU the US and Japan) are pretty low. Increasing technology based investment should give the primary boost to the economy, to 'pick it up'.

To reach stronger growth, both EU and Turkey acknowledge the important role that Small and Medium Enterprises (SMEs) play in the economy. These companies create an
important part of employment and added value. Next, they are usually very well capable of using and implement new technologies fast. In order to support these enterprises both the EU and Turkey aim at reducing administrative barriers for the set-up and development of enterprises. For Turkey, special attention will be paid to availability of capital for these smaller enterprises. In order to profit from investment in technology both EU and Turkey also acknowledge the importance of education. More investments in education should be made in order to increase the number of people able to use technological innovations. Next, increasing the quality of employees, should give them a higher job adaptability which can increase labour movement.

Next to these main similarities, there are also some differences between the strategies. Most important is the relative low emphasis of Turkey on employment while this is a major issue in the EU. This has to do with the different structure of the (potential) labour force. The EU has to deal with an ageing population, which will reduce the labour force within a couple of years, while in Turkey the labour force will grow in the coming years. With this in mind the EU focuses on increasing the potential labour force especially aiming at keeping older people longer in the working force and by increasing the number of females in the labour force. Next, it aims at increasing the quality and level of jobs.

For Turkey the problem of a shrinking labour force is not an issue. On the contrary, the labour force will grow the upcoming years with around 1 percent annually. However Turkey still has to deal with a rather high unemployment level of around 10 percent. It is also problematic that the unemployment level of young people is almost twice as high as the average unemployment level.

Related to this different emphasis on employment is the different focus on education. In the growth agenda for Turkey the main focus lies on increasing investment in the education system, to increase the general level of education. In the EU strategy the focus lies more on the principle of Life Long Learning, meaning more on-the-job training.

An obvious difference is the attention given within EU to the internal market. By reducing remaining barriers, especially for services, the potential remaining gains from the internal market should be unlocked. However, in the light of the current Customs Union (CU) between Turkey and the EU as well as the potential Turkish accession into the EU, also Turkey can also pay more attention to the benefits of the internal market. The next chapter will provide a good insight into the theoretical and empirical potential gains from accession into the EU. The main focus here lies with the gains from trade and the gains from accession into the single market. Also further attention will be paid on potential factor movements, especially labour migration.
In the previous chapter some insights have been gained on the growth strategy of both EU and Turkey. It has been shown that there are quite some similarities despite the different starting position of both economies. However, next to the changes mentioned in the previous chapter, additional gains and growth may probably be achieved from Turkish accession into the EU. This chapter will provide the main theoretical and empirical gains from a further enlargement of EU with Turkey. For proper analysis the first section will give a theoretical framework for the main channels of gains from enlargement, which are free trade and regional integration. The second section will give an overview of the literature on the gains from enlargement. The third section will provide some insights on the potential migration flows from Turkish accession into the EU. In the fourth section a short analysis will be made on the institutional aspects that play a role in an acceding country with the potential for catching up. To give a good broad picture and to provide some reference when looking into the economic effects of Turkish accession, the main outcomes of some research projects on the last enlargement will also be provided. In this way a start will be made in comparing progress of different groups of countries, which will be continued in the next chapter.

3.1 Trade theory and regional integration theory
This section will give an insight into the main important theories which are used when analyzing the potential gains from accession into the EU. The first sub-section will briefly explain the standard trade model. Additional in the second sub-section some insights on strategic trade will be provided as well. The third sub-second section will show the basics of regional trade theory, which will give a good framework concerning the gains from the formation of an integrated free trade area.

3.1.1 The standard trade model
The standard trade model is the most recent broad theory on international trade. It combines input from the two main important models that have been used for a long time, the Ricardian model and the Heckscher-Ohlin model.

Within the Ricardian model, production possibilities are determined by the allocation of labour between sectors. This model shows that trade starts based on the concept of comparative advantage, but does not give information on the distribution of income. The Heckscher-Ohlin model works with multiple factors of production, so differences in resources drive trade patterns and trade affects income distribution.
These models share the idea that production capacity of an economy is given by its production possibility frontier and differences in this give reason for trade. The production possibilities determine a country's relative supply curve, while international trade is determined by both relative supply and demand curves.

The standard trade model builds on four relationships: 1) the relation between the production possibility frontier and relative supply, 2) the relation between relative price and relative demand, 3) determination of world equilibrium from world relative supply and demand and 4) the effects of the terms of trade on a country's welfare.

The model holds the assumption of the production of two goods by both countries, food (f) and cloth (c) and each countries (home and foreign) production possibility curve is a smooth curve. The point where production actually takes place on this curve depends on the relative price of the goods Pc/ Pf. The value of output (V) is measured by $V = QcPc + QfPf$. Relative supply is determined by the relative price of both goods, where an increasing in Pc leads to a higher production of Cloth. Demand equals supply and is also determined by the relative price of goods. Assuming that Home is an exporter of cloth, the rise of the relative price of cloth has two effects on demand. First, home can import more food for any given volume of exports, this is a positive income effect. Secondly, the higher price of cloth leads to a shift in demand from cloth to food, this is a substitution effect.

To determine important issues in international trade from these basics, it is assumed that there are once again two countries, Home (H) and Foreign (F), where the first exports cloth and the second exports food. Home's terms of trade are determined by $Pc/Pf$ and Foreign terms of trade are determined by $Pf/Pc$. The equilibrium world relative price is determined by the world relative supply (RS) and relative demand curve (RD).

Growth of an economy will give an outward shift of the production possibility frontier. This can be caused either by a more efficient use of resources due to technological progress or to an increase in the supply of a production factor. This growth is often biased to a certain sector, which will change relative supply of either good produced. In general one can state that export biased growth worsens a country's terms of trade to the benefit of the rest of the world, while import biased growth tends to improve a growing county's terms of trade at the expense of the rest of the world. The opposite is in general true for H when F is growing. In terms of welfare effects, increasing growth of the own economy in general rises welfare, no matter what the orientation is. However import biased growth of another country can definitely worsen Home's terms of trade. The relative demand can change through the transfer of money. If Home makes a transfer of income to Foreign, Home reduces its income and thus expenditure while Foreign income increases and so can the expenditure. This can lead to a change in world relative demand and change the terms of trade. In general one can state that a transfer
worsens the donors terms of trade if the donor has a higher marginal propensity to spend on its exports, while if the donor has a lower propensity to spend on its exports, its terms of trade will improve. However, in real world most countries tend to have a relative preference for its own goods.

When looking at the potential effect of free trade, one commonly looks for simplicity at the effect of an import tariff on relative supply and demand. The opening up of trade will lead to abolishing tariffs and has the opposite positive effects. When Home imposes a tariff on the imported food of 20 percent, the internal price rises 20 percent compared to the external relative price. Equally, the relative price of cloth in Home decreases 20 percent compared to the external relative price. This has two effects. First Home producers will shift away from cloth towards food, producing less cloth while consumers in Home will shift expenses away from food to cloth. This leads to lower supply of cloth and higher demand for cloth, so world price of cloth rises, increasing Homes terms of trade at the expense of Foreign. All in all, this basic model shows how relative supply and demand are determined, how this affects terms of trade and what the effect of tariffs is (Krugman, 2005: p 85-100).

From this basic theory on international trade a lot of new theories have come forward in order to provide theoretical concepts explaining findings in empirical research on international trade relations. One of the main important contributions to this is the strategic trade theory which will be described shortly below.

3.1.2 Strategic trade theory

Strategic trade theory has come up during the 1980s when new arguments for government intervention in international market came up. While the trade models show that free trade is in general to the benefit of everyone and government intervention is only necessary when market failure occurs, there came an increasing demand for government interventions.

One argument is that when an industry is producing some extra output, so called externalities that the country as a whole profits from, there is a good case for subsidizing them. This is especially the case for high-tech industries, which may create a large spillover effect. Without government support these industries may become reluctant to invest in R&D, since others will profit freely from these investments. This technological spillover argument is one of the best for an active industrial policy.

Another argument comes up in sectors where there is only a limited number of competitors. Because of this small number, the normal rules of perfect competition do not apply. There may be excess returns, an additional profit above what would be earned on equally risky investment elsewhere in the economy. The basic reason for
government intervention would be to alter the rules of the game to shift these excess returns from foreign to domestic firms.

A basic problem with this kind of intervention is that it may lead to retaliation of other governments. These strategic reactions may lead to a situation where one of a country's industries profits from a subsidy while another industry is worse off because of subsidized competitors from other countries. In general strategic trade policies are beggar-thy-neighbour policies, that increase a country's welfare at the expense of other countries (Krugman, 2005: p 260-265).

3.1.3 Regional integration theory
When looking at the trade effects of regional integration, a Customs Union (CU) model is mostly used. This is the simplest model, and gives enough information on the trade effects of regional integration. Basic CU theory defines two important effects, trade creation and trade diversion.

To get some grip on the effect of regional integration on prices, trade flow changes and economic welfare changes, the following figure is commonly used. In figure 2.1 country R is a high cost and country S a low cost producer of some good. Supply is shown by Sr and Ss, which give the differences in production costs. Demand is assumed equal so Dr = Ds. Pw is world price, which is lower than autarky prices of both S and R. This means that with free trade both countries would produce less than they consume and buy at the international market. However both countries have barriers bringing prices to Pr and Ps respectively. For country R this means that demand (Dr) is higher than supply (Sr), thus it imports goods from the world market. For country R, Sp - Sf is production that is too expensive, which does not serve efficient allocation. For country S demand is fully met with supply at price Ps. However, although to a lesser extend, production is still too expensive which also does not serve efficient allocation.

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1 Trade creation is the welfare change due to the replacement of (higher cost) domestic production of import goods by (lower-cost) imports;
Trade diversion is the welfare change due to the replacement of imports from a low cost source by imports from a high cost source (Pelkmans 2001, p. 94)
2 Further elaboration of this model can be found in: Linden, J. van der, (1998), p. 24-25.
Creation of a custom union sets prices at $P_{cu}$. Country R imports increase since this is now $D_r - S_r - P_{cu}$. Supply in R decreases at the new price level while demand is higher. This demand would be completely offset by the excess supply $S_{cu} - D_{cu}$ of S. Demand in S is lower due to the price increase of the common market. The economic effects of creation of the CU, the increased imports for R consist of three effects. First of all, production in R decreases due to lower prices, which creates trade. Second imports from the world market are diverted to the common market. Third increased demand expands trade. So creation of a CU generally leads to increased trade with member-states and decreased trade with non-members. The low cost country will specialize, making the high cost member more dependent on its export. If the model is extended with another product where R is the low cost country and S the high cost country, the story would be the same, so both countries than would be more interdependent. Theory predicts higher trade within a custom union.

### 3.2 Gains from enlargement

There is a lot of literature on the gains of enlargement. In general the literature agrees that there are quite some gains for the new entering countries, but that gains for the current EU member states are quite modest, though still positive. For the CEEC accession countries, Breuss (2002) analyses different channels through which the gains from enlargement occur. These are trade effects, single market effects and factor movement effects. The gains from more free trade and abolition of the last tariffs lead to modest additional trade and welfare effects. The results are modest because the European Agreements that have been signed with the CEEC countries, made free trade possible in a lot of sectors (with the exception of agriculture and sensitive goods like textiles) so the additional gains from accession are modest. Single market effects are somewhat bigger. Measured through the price effect of increased competition it is expected that prices will
especially be lower in the accession countries. Additional demand of these price effects will lead to a GDP growth for both current members and CEEC countries between 0.25-0.5%. The movement of Foreign Direct Investment (FDI) from current EU member states to the new entrants will lead in the medium term to a welfare loss in the current member states between 0.1 and 0.2% due to higher interest rates, while the inflow of capital will lead to additional growth of GDP between 0.5 and 1% for the new member states.

Lejour, de Mooij and Nahuis (2001) also investigate the gains from accession through three channels, namely the accession into the custom union, the extension of the internal market and migration effects. The latter will be discussed separately so the focus here is on the outcomes of the first two channels. Accession to the Custom Union only has some real impact through the abolition of trade barriers on agriculture and food processing goods. The results are therefore modest compared to the situation under the European Agreements, which are in place since 1997. On macro-economic level the GDP increase from accession into the CU for new member states are expected to be around 2.5% growth, while there are hardly any effects for the current member states. The effects of accession to the internal market are simulated by a reduction in Non Tariff Barriers (NTBs). The new member states will on average get a terms-of-trade gain of around 6.7% and not at the expense of the current member states, since they also gain around 0.6%. This results in growth of GDP and Consumption of 5.3% and 9.3 % respectively for the new entrants while gains for the current member states are around 0.1%. These results are more positive than with for example Breuss (2002) mainly because he only measured accession to the internal market as an estimated reduction of trade cost of 5 to 10%. The difference lies with the fact that the model of Lejour et al. (2001) take more dynamic effects of accession such as the increased capital accumulation into account.

An article by Kohler (2004) gives a more thorough view on the welfare gains from the 'eastern enlargement' on incumbent countries. He uses the same channels of the effects as in the studies mentioned above. In the article some country specific shocks are also taken into account. Overall the enlargement results in a GDP growth of around 0.3% for incumbent member states. However, there are big differences between countries, varying from a welfare loss of 1.3% for Portugal to welfare gains of 2% for Austria. Other loosing countries are Greece, Ireland and Spain, while other winners are Germany, Sweden and Finland.

All these studies suggest that for the EU enlargement with CEEC countries both new acceding countries as well as the current member states gain from the enlargement. Most gains are achieved by the new entrants especially through the enlargement of the internal market and the accompanied reduction of mainly technical barriers.
Gains of Turkish accession

The best long term outlook for the economic gains of Turkish accession can be found in Lejour and de Mooij (2004). Using essentially the same method of analysis as mentioned above they give an overview of the expected gains from accession channelled through accession to the internal market and institutional reforms.

Accession to the internal market will lead to gains for both current EU member states and Turkey. Accession will diminish administrative and technical barriers to trade. Next, it will mitigate risk and uncertainty surrounding trade. Compared to a basis scenario of annual 2,5 percent catching up of Turkish GDP to the EU average it is expected that this accession will lead to additional 0,8% annual growth of GDP for Turkey. The returns for current member states are small but positive, created by the effects of increased trade and trade creation.

The gains from institutional change are measured by looking at the Turkish position on the Transparency International Perceptions Index. When Turkey is able to raise its level to that of Portugal, this will lead to an additional growth of 5,6% of GDP for Turkey. The gains for current EU members accrue to around € 7 billion (Lejour and de Mooij, 2004).

Table 3.1 Overview GDP growth Turkey from accession

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<tbody>
<tr>
<td>Baseline catch up scenario</td>
<td>2,5 % above EU average</td>
</tr>
<tr>
<td>Contribution of reduced trade barriers</td>
<td>0,8% annually</td>
</tr>
<tr>
<td>Contribution of improved institutional setting</td>
<td>5,6% annually</td>
</tr>
</tbody>
</table>

Source: Lejour and de Mooij, 2004

A research project by Kalshoven and Kucukakin (2004) focuses on the potential for growth, FDI and trade flows for Turkey in light of Turkish accession into EU. Based on experiences of earlier entered countries, and by comparing the economic situation before and after accession of both EU and the respective country they project the opportunities for Turkey. Based on these comparisons they find that growth opportunities for Turkish economy lie at around 4,9 percent annual growth before accession, rising to 5-6,2 percent in the first decade after accession. For FDI inflow it is expected that annual inflow in the upcoming decade will be around 4,4 billion annually, rising to 11-14 billion after accession. Total trade is expected to increase to around 239 billion by 2013 and will keep growing after accession at the same speed as before accession. They note however, that these estimations will only be feasible if government will be able to keep track with the current restructuring program.
It is interesting to see that the expected gains from enlargement for Turkey are relatively smaller than in the last enlargement process. This has partly to do with the fact that Turkey has a Custom Union agreement with the EU since 1995. Most of Turkish export products are free of tariffs, making additional gains from accession modest. As with the new entrants, most gains are expected to come from adaptation of the acquis and the reduction of NTBs.

### 3.3 Migration issues

Another aspect of enlargement that plays a major role in the political and public debate is the fear of huge inflows of immigrants from the new member states after they get access into the EU. Quite some modelling has been done on the prospects of migration. When looking at expected migration flows from CEEC countries after accession, most researchers agree that the inflow of workers from the new member states will be rather modest. Next, the inflow of workers is highly diverse between different countries. It is expected that inflow of workers from the new member states will be mainly towards Germany, Finland and Austria, the neighbouring countries. Inflow to other countries remains relatively small.

A research project by Brucker (2001) takes three different mechanisms that may influence labour movement into account, namely the wage differential between the two countries, the respective unemployment ratio's as well as some institutional factors. The outcomes estimate an initial inflow of 225,000 workers each year into Germany and 350,000 for all EU 15 countries. This number falls down over time reaching an equilibrium by 2030 when the inflow equals the outflow of people returning to their homeland. By then the number of people from the 10 new CEEC countries count for 3,5 percent of the German population and 1,1 percent of the total EU 15 countries.

Another article by Fertig (2001) estimates even lower inflow of foreign workers. The estimations are only made for Germany under different scenarios concerning the amount of convergence. The analysis shows yearly inflow of workers of around 70,000 persons from all CEEC 10 countries by 2005, lowering down to around 60,000 by 2015. This would mean that the number of workers over 10 years rises by around 650,000 from around 600,000 to 1,3 to 1,4 million workers by 2015. To sum up, both articles conclude that the fear of massive inflow of workers is not necessary.
Migration issues with Turkish accession

From the article by Lejour & DeMooij (2004) it is found that the economic effects from labour migration are expected to be negative for Turkey, leading to a 1.8% decrease of GDP and for the EU to an additional 0.5% gain. This is based on the expectation that Turkish immigrants will mainly fulfil low skilled jobs. When also higher skilled jobs would be filled by them, the losses for Turkey are even bigger but so are the gains for the EU.

When looking at the size of migration flows, two reports are highly relevant. The first by Flam (2004) also provides a basic model for migration flows as can be seen in the figure below. The basic idea is that migration flows without barriers depends mainly on the wage differential. The figure shows the demand for labour in Turkey and Germany (as example) under the assumption of homogenous labour and stable labour supply. In the initial situation, when both labour markets are separated point A gives the labour demand in Germany with Wg and C gives labour demand in Turkey with Wt. When the two labour markets are no longer separated labour flows from Turkey to Germany, until wages in both countries are equalized as in point E. In this situation workers in Germany lose because of the lower wages, while both Turkish migrants as well as workers in Turkey profit from higher wages. For capital owners the situation is vice versa, with Turkish capital owners gaining a lower surplus and German owners gaining a higher surplus. Next, movement of the labour force leads to a decline in GDP for Turkey and a rise in Germany. The social surplus of welfare is given by the triangle ACE and is captured by German capital and Turkish migrants and comes from a more efficient allocation of labour.

Figure 3.2 Migration theory

![Migration Theory Diagram](Image)

Source: Flam (2005), p 181
From this theoretical model the potential migration flows are measured, using the same methodology as Boeri and Brückner in their 2000 report to the European Commission. They estimated how the flow of migration depends on the wage differential, employment rates in the home and host countries, the stock of migrants from the home country, restrictions on migration and country specifics, such as language differences, distance and institutions. The migration decision is seen as dependent on expectations about the future wage differential based on present and past values of the differential, conditioned by the individual probability of finding employment in the host country, relative to the home country, which is assumed to be based on present and past average employment rates, the ease of adjustment, proxied by the number of migrants in the host country, the difference in development between the home and host country and language differences, and agreements regulating migration, such as guest-worker agreements (Flam, 2004: p 184).

With this methodology, Flam estimates for different scenarios of economic catching up the potential migration flows from Turkey to Germany. The example of Germany is taken because of availability of data material and the fact that currently Germany is the country with the biggest Turkish migrant population. The main findings presented are an expected inflow of 2,5 million migrant workers in the period 2000-2030 in a situation with no convergence of GDP. In the scenario with two percent annual convergence the flow will only be 1,3 million mainly due to a lower wage differential. This means that in 30 years Turkish population in Turkey will grow from 2,2 million in 2000 to 3,5 million in the positive scenario and to 4,7 million in a scenario with no convergence. Extrapolating this figure to the whole of Europe or EU25 is difficult because of the different labour market situations and the possibility that migrants will mainly go to countries that already have a high number of Turkish migrants.

A second research project on the potential size of migration flows from Turkey to the current EU especially EU15 member states has been done by the CEPS (Erzan, Kuzubas and Yildiz, 2004). Based on comparison with immigration flows within EU15 as well as with other reference groups (most important Greece, Spain and Portugal) they estimate the migration flows under different scenarios for the period 2004-2030. The table below provides a summary of their main findings.
Table 3.3: Migration forecast from Turkey to EU15

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>High growth, membership, free movement of labour</td>
<td>2004-2015</td>
<td>2015-2030</td>
<td>Total</td>
</tr>
<tr>
<td>Scenario Free</td>
<td>460,000</td>
<td>613,000</td>
<td>1,073,000</td>
</tr>
<tr>
<td>Scenario Guest</td>
<td>564,000</td>
<td>1,274,000</td>
<td>1,838,000</td>
</tr>
</tbody>
</table>

Reference group: 'all Europe'

<table>
<thead>
<tr>
<th>High growth, membership, free movement of labour</th>
<th>2004-2015</th>
<th>2015-2030</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario Free</td>
<td>320,000</td>
<td>640,000</td>
<td>960,000</td>
</tr>
<tr>
<td>Scenario Guest</td>
<td>440,000</td>
<td>1,480,000</td>
<td>1,920,000</td>
</tr>
</tbody>
</table>

Reference group: Greece, Portugal, Spain and Turkey

<table>
<thead>
<tr>
<th>High growth, membership, free movement of labour</th>
<th>2004-2015</th>
<th>2015-2030</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario Free</td>
<td>246,000</td>
<td>1,888,000</td>
<td>2,134,000</td>
</tr>
<tr>
<td>Scenario Guest</td>
<td>760,000</td>
<td>1,974,000</td>
<td>2,734,000</td>
</tr>
</tbody>
</table>

Source: Erzan, Kuzubas and Yildiz (2004), p 14

This report shows that under all different scenario's is that there are some migration flows from Turkey to be expected, although they are rather modest. The most important conclusion is however that attention should be paid to the scenario that Turkey does not become an EU member. Loosing the perspective of membership may reduce economic growth, delay implementation of better institutional rules and so on. This bad economic performance of Turkey may even enhance migration flows to EU15. As with especially Greece, Portugal and Spain, membership and high economic growth may and can reduce migration pressure.

In brief, the different reports provide comparable outcomes, although all using different methodologies. Flam assumes in a positive scenario an inflow in 30 years of 1.3 million for Germany, while the CEPS researchers find in a high growth (catching up) scenario an inflow to EU15 of around 1 million. Compared to total EU population these figures are rather modest. Next, it is assumed that it is possible that without EU membership migration flows could be even higher, if denied membership leads to lower economic growth in Turkey.
3.4 Institutional aspects and the prospect of catching up

Despite the potential positive effects of accession into the EU for both current member states and especially the newcomers, the most important aspect actually is not so much these short to medium term direct and indirect effect, but the question is whether or not these new members will be capable to catch up with the old member states. This aspect is very important since it is of big influence to other issues surrounding the enlargement. For example, higher convergence makes the differences in GDP and income per capita smaller, reducing the incentive for workers to make the 'move to the west'. This is of interest for all member states. A large number of articles has been devoted to the potential of catching up. Since the prospect of catching up is the main important issue when looking at economic growth and growth strategies, the literature reviewed here will only be on the last enlargement. The issue of Turkish potential for catching up will be debated in the next chapters.

Delhey (2001) for example looks back at the catching up process of Greece, Spain and Portugal and based on that discusses the prospects and conditions for convergence of the new member states. As the three main channels for convergence, he mentions regional policy; institutional adjustment; and economic integration. The first should mainly be seen as a kick-off start for convergence. Institutional adjustments to the acquis will give a lot of improvement of institutions for the newcomers, enhancing the prospects of economic growth and social policy. Convergence through economic integration will be mainly caused by inflow of capital, especially foreign direct investment which will bring technical spillovers and increased competition to the economy. In short the three channels for convergence work through the logic of distribution, regulation and efficiency.

By analyzing earlier enlargements he argues that:

- accession to the EU is not a guarantee for catching up but it makes it easier;
- it is a long term, non-continuous process
- premature accession is economically risky and
- although EU policies support convergence, the success mainly depends on the internal potential of the countries.

Based on the earlier enlargements he argues that the new member states will benefit from EU membership and that there will be some convergence but probably only towards the poorer EU 15 member states. He also argues that it is a very time consuming process, which asks for a lot of efforts from the country itself.

Gacs (2003) looks at the concept of structural convergence. By this it is meant that when looking at convergence one should not only look at convergence of GDP or GDP per capita, but more to the changes (convergence) in economic structures. In his analysis he concludes that for convergence of the CEEC member states especially the development of
the services industry is very important. This industry helps the country a lot to move from a planning economy towards a free market economy, since it is an important aspect for the 'invisible hand' of the market economy to work. Restructuring of industry differs between countries. Some countries have already to a large extent managed to reform this originally labour intensive industry, others follow slower. Reforms are important in order to be able to compete with the old EU members, to catch up. A lot of profit can be made in the use of domestic saving and investment. Most countries have low domestic saving rates and highly depend on foreign investment. More efficiency in the use of domestic savings and investment will be necessary to catch up.

These two articles indicate that convergence of new entrants with the old EU members is possible, but it mainly depends on the structural efforts made by national governments to strengthen institutions and the market economy.

3.5 Conclusion
In this chapter the theoretical and empirical aspects of enlargement of the EU have been analyzed. On average all countries can profit from enlargement, although the gains are generally much higher for new acceding countries than for the current member states. For both CEEC countries, as well as Turkey, the gains from free trade are rather modest. This is due to the fact that they both already have almost completely free trade with EU15 prior to accession. The gains from being part of the Single Market are much higher and contribute significantly to growth of GDP. Taking over the acquis leads to a stronger institutional setting in most countries, creating a better environment for economic development. Migration flows are supposed to be modest, both from CEECs and Turkey. The prospect of catching up is positive, although it is not that accession process in itself leads to catching-up. It is a long way process which requires a lot of domestic efforts.
CHAPTER FOUR: THE TURKISH ECONOMY IN A STATISTICAL COMPARATIVE ANALYSIS IN LIGHT OF THE LISBON STRATEGY

So far a theoretical framework for growth, an insight into the growth agenda’s of both Turkey and EU as well as some theoretical and empirical insights on the gains and cost from accession into the EU have been presented. This chapter will provide insights into the current situation of the Turkish economy. To be able to analyze the economic effects of Turkish accession in the light of the Lisbon strategy it is necessary to have an overview of the Turkish economy. Next, a comparison will be made with other countries in the light of the Lisbon goals. The first section will give some insights into the Turkish economy. Starting with the 2001 economic crisis, an overview is presented on the most important policies to overcome the crisis. Some key economic figures provide data for this period give a good insight into the current situation. To give a head start for the second part of this chapter, some differences concerning economic governance between Turkey and the countries that have recently entered the EU are analyzed. The second section will present different comparative statistics. It will start with some figures on economic governance and competitiveness of different countries. Thereafter the current situation of Turkey related to the Lisbon goals is compared with the situation of a number of other countries. Once again the countries that recently entered the EU are the main reference group.

4.1 Turkish economy
The Turkish economy is in the last two decades characterized by volatility. High growth rates have been followed by severe crises, the latest of which came by 2001. This crisis was the result of a combination of factors. It was mainly due to a banking crises which forced the state to recognise its contingent liabilities in the banking sector, combined with a highly risky attempt to achieve disinflation by a nominal anchored exchange rate policy. This combination led to a collapse of the foreign exchange rate and a surge in the stock of public debt, because the Turkish government had to recapitalise the de facto bankrupt state banks. The public debt ratio therefore surged to over 90% of GDP by 2001 (Airaudo et al., 2004: p 3). To prevent this to happen again and to ensure macro-economic stability in the long run there are a number of economic policy issues that Turkey should focus on. Macro-economic stability is priority number one. To achieve this, the main important measures are:

- the reduction of public debt,
- keeping inflation and interest rates low,
- keeping a tight fiscal and monetary policy and
- invest in growth oriented projects
The fast reduction of public debt is very important, especially after a crisis like the one of 2001. High public debt makes an economy more vulnerable to external influences. Tightening the fiscal policy resulted in the three years after the crisis in primary surplus between 4 and 6.5%. Because of these achievements, public debt was reduced. Although these are positive figures, it has been stated that the way these achievements have been reached are not sustainable. Most came from incidental measures like a tax amnesty and draconic cuts in primary public spending. The future fiscal policy should aim more at the quality of adjustment.

Next to the improvement of governments budget, reducing volatility of inflation and interest rate are also very important for improvement of economic stability. A high inflation rates makes a country unattractive to foreign investors. High interest rates are mainly a result of the uncertainty created by high inflation. Reducing inflation by keeping a tight monetary policy by the independent Central Bank should lead to higher public trust in the economy (Airaudo et al., 2004: p 6).

The 2001 crisis has primarily been triggered by a weak financial system. Non-transparent lending facilities have brought the (by then still mostly state-) banking system to a near complete collapse. The government had to take draconic measures to restructure the banking system.

The Financial Sector and banking System Report (2005) of the Banks Association of Turkey, provides insights into the most improvements made in recent years. Most important is the upgrading of financial sector regulation to international best practises. Next, an independent control organization has been set-up, the Banking Regulation and Supervision Agency (BRSA), in order to increase banking supervision and control. A banking restructuring program has been implemented. Within the program assets of the banks were analysed in detail, non-performing assets were determined, and necessary provisions were set aside for bad loans. Within the context of the restructuring program the balance sheet structure of state-owned banks was strengthened, and special importance has been attached to the increasing of the efficiency in these banks.

Total cost of restructuring in the banking system amounts to USD 47.2 billion. The total amount of resources transferred to the state-owned banks, including duty losses and to the banks transferred to the SDIF is USD 39,3 billion (26.6 percent of GDP). On the other hand, the restructuring cost of the banking system to the private sector amounts to USD 7,9 billion (5,3 percent of GDP); of which USD 5,2 billion is by the SDIF and USD 2,7 billion to the private sector.
banks in order to strengthen their capitals (TBB, 2005: p 14). As these figures show, the collapse of the banking sector lead to the sharp rise of government public debt, as mentioned above.

The restructuring program and the changes in financial sector control have contributed significantly to a more healthy financial sector. However there are still some obstacles to sound banking. High macro-economic instability leads to high real interest rates discouraging demand for credit (through uncertainty) and its supply (through crowding out). Next, there still is a large share of state banks. As the restructuring program information above has shown, it is mainly these banks that were responsible for the 2001 crisis. Another remaining problem is the high share of government bonds in total banking assets. Government bonds still have around 40 percent share in total assets by 2004. This also means that there is a relatively small amount of assets available for private lending. The most problematic in this regard are the lending facilities to SMEs. This has first of all to do with the troubled relation between the banking sector and SMEs in the past. Within the highly volatile past, lending’s to SMEs were fast withdrawn in economic downturn or interest rates were increased severely. On the other hand, banks have problems to reduce their information problem on the strength of business since in many sectors there is a high number of non-registered transactions. This makes them reluctant to supply lending facilities. Another problem is the heavy tax burden on lending. Calculations by the BRSA in 2002 show that taxes and fees on intermediation raises the cost of TL (now YTL)-credit by over fifty percent and about as much for foreign currency denominated loans (Steinherr et all, 2004: p 15-20). This short overview shows that significant improvements have been made in the banking sector, but that there are still some problems preventing the sector of working properly.

While keeping the analysis of the latest economic crisis in Turkey and the measures taken to prevent this from repeating in mind, the next table provides some key figures on the current state of the Turkish economy.

Table 4.1 Key economic indicators Turkey

<table>
<thead>
<tr>
<th>Sector output, % of GDP</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>37,9</td>
<td>17,1</td>
<td>5,1</td>
</tr>
<tr>
<td>2002</td>
<td>35,5</td>
<td>17,9</td>
<td>4,5</td>
</tr>
<tr>
<td>2003</td>
<td>34,3</td>
<td>17,8</td>
<td>4,6</td>
</tr>
<tr>
<td>2004</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2005</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
The figures above provide a good overview of the Turkish economy since the last crisis of 2001. Since then, growth figures of GDP have been very good with at least 5 percent annual growth. Tight fiscal policy has lead to a primary government surplus, making it possible to reduce government debt that has risen to over 90 percent of GDP during the crisis. Net public debt is now around 67,7% of GDP. The fiscal policy has been combined with a monetary policy aiming at price stability and implicit inflation targeting. This has lead to a strong decrease in inflation leading to single digit inflation figures for the last two years, something that has not happened for at least 20 years. This low inflation rate has also lead to a strong fall of interest rates.

External trade has also shown strong growth over the last couple of years. As the figures show the current account deficit has been growing to around 4 percent of GDP. This means that imports by far exceed exports. Fortunately the capital account has been changed from capital outflow to still growing capital inflow, which easily weighs against the current account deficit. In this respect a positive aspect is the recent growth of FDI. Since FDI is the most sustainable form of foreign capital inflow, a rise of it is an indication of increasing international trust in the recovery of the Turkish economy. Due to the high volatility, FDI inflow was always been lagging behind the figures of other countries, but is now slowly catching up. Comparative data will be presented in the next section.

There are a number of structural problems in the Turkish economy. The first is the high share of people working in agriculture, which is still around 34 percent. On the other hand the sector share of GDP is only around 13 percent. This combination of low added value to GDP and high employment figures show that the Turkish agriculture sector is highly inefficient. As the figure below shows, the high employment figure of agriculture in Turkey is rather exceptional. Even Poland, which also still has a high share of employment in agriculture is only half the size of Turkey.

---

3 The data within this table have been recovered from: the Worldbank progress report 2005, Dervis et al. (2004), Eurostat structural indicators and SIS.
Table 4.2 Comparison of employment by sector, 2002 (% of total)

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU 15</td>
<td>5.3</td>
<td>26.8</td>
<td>67.9</td>
</tr>
<tr>
<td>Poland</td>
<td>16.4</td>
<td>30.1</td>
<td>53.5</td>
</tr>
<tr>
<td>Hungary</td>
<td>6.3</td>
<td>34.7</td>
<td>59.1</td>
</tr>
<tr>
<td>Czech republic</td>
<td>4.7</td>
<td>39.5</td>
<td>55.8</td>
</tr>
<tr>
<td>Turkey</td>
<td>34.9</td>
<td>18.5</td>
<td>46.6</td>
</tr>
</tbody>
</table>

Source: SPO Preliminary Action Plan 04-06, p 59

Another problem Turkey is faced with is the high level of unemployment. Despite the positive economic growth rates, employment rates did not rise along. A partly explanation for this issue is the fact that the labour force in Turkey is still growing at around 1.5 percent annually. Unemployment figures are rather constant in the past years, at around 10.3 percent. This means that economic growth creates about the same number of jobs as the growth of the labour force. However, the next table provides some deeper insights into unemployment. Here, a diversification is made between different age-groups as well as their respective level of education.

Table 4.3 Unemployment rates young and educated

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Illiterate</th>
<th>No diploma</th>
<th>Primary</th>
<th>Secondary</th>
<th>Tertiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>15-19</td>
<td>18</td>
<td>27.7</td>
<td>13.7</td>
<td>29.5</td>
<td>0.0</td>
</tr>
<tr>
<td>20-24</td>
<td>17</td>
<td>37.5</td>
<td>16.1</td>
<td>23.4</td>
<td>38.5</td>
</tr>
<tr>
<td>25-29</td>
<td>16.3</td>
<td>14.8</td>
<td>12.2</td>
<td>12.2</td>
<td>14.8</td>
</tr>
<tr>
<td>30-34</td>
<td>13.3</td>
<td>16.7</td>
<td>10.3</td>
<td>7.1</td>
<td>5.3</td>
</tr>
<tr>
<td>35-39</td>
<td>11.4</td>
<td>16.7</td>
<td>8.1</td>
<td>5.4</td>
<td>4.1</td>
</tr>
<tr>
<td>40-49</td>
<td>7.5</td>
<td>9.5</td>
<td>7.8</td>
<td>4.6</td>
<td>2.5</td>
</tr>
<tr>
<td>50-59</td>
<td>5.0</td>
<td>4.9</td>
<td>5.9</td>
<td>5.7</td>
<td>2.2</td>
</tr>
<tr>
<td>60+</td>
<td>1.6</td>
<td>1.5</td>
<td>1.4</td>
<td>4.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

Source: Worldbank (2006), p. iii chapter 1

As the figures for 2003 clearly indicate, the biggest problem of the Turkish labour market is the entry of new workers. This applies in general to all education levels. Even for the group of tertiary educated people, it takes till around the age of thirty before unemployment levels decrease significantly. The problem of low accession significantly reduces natural dynamics of the labour market. The main cause is the high level of unemployment protection combined with restriction on fixed-term contract work and the use of temporary working agencies. Turkey and Greece are the only countries with this kind of restrictions (Worldbank, 2006: p 19). Solutions to the strengthening of the Turkish labour market will be provided in chapter five.

Another problem is the relative big size of the informal economy. Although good statistics about the size of the informal economy are not available, some estimations have been made. Very often the division between formal-informal is made on the basis of registration to social security. The next table for example shows that about 11.2 million workers are not covered by any kind of social security system. They are divided in different sub-groups:
The overview shows that the largest part of non-security paying workers is either self-employed or works in family businesses. It is clear that it is difficult for the government to track this kind of informal employment. However, the high share of employed people that do not pay social security taxes give an indication of the lack of government control on the labour market.

According to the answers of Turkish officials to questions of the EU on social policy and employment in light of the screening process the reasons behind the high share of informal employment are:

1. social and economic reasons are: the high unemployment rate, unequal distribution of income, poverty, the high share of agricultural employment, the high level of employment in SMEs and the low education and training level of labour force;
2. legislative reasons are: complex rules and regulations, inadequate enforcement of legislation and legislative gaps;
3. administrative reasons are: the complexity of social security system, lack of coordination among related public institutions and inadequate quality and quantity of human resources in related institutions (e.g. number of inspectors);
4. psychological reasons are: the negative attitude of some employers and the lack of awareness of employees about their social security rights.

Two important reports have highlighted some of the important aspects of the Turkish economy in light of potential accession to the EU. The first report by Kalshoven and Kücückakin (2004) gives a SWOT analysis of the Turkish economy as presented below.
This analysis puts forward a lot of information that has already been discussed based on other reports and data. However, some new issues are brought forward. A positive note is made on the dynamic private sector, as well as the improving legal framework for businesses. A negative aspect is the high taxation that frustrates (legal) business. Next, although the private sector is dynamic, the government is still present in various sectors. Other major problems are the high regional income disparities and the widespread corruption. Concerning the future of the Turkish economy it is expected that privatization of state firms combined with continued macro-economic reform can trigger the interest of foreign investors, boosting FDI. Next to that firm government policies may increase country’s credit rating, making it cheaper and more easy to lend money in the international capital market. Current high interest rates debt can be repaid, reducing pressure on government balance. The major challenges lie with the reform of the tax and pension system as well as the reduction of corruption.

A book published by the Brussels based think tank CEPS on The European Transformation of Modern Turkey (2004) highlights the most important differences between the potential Turkish accession and earlier accessions, especially the most recent one. According to the authors of this book, the biggest differences lie with:

- The advanced current trade relations between Turkey and the EU based on the Customs Union agreement of 1995; this means that Turkey already is within the
framework of EU foreign trade policy. Next, within the framework of the CU a lot of regulations for trading goods has already been implemented.

- The comparative low level of human capital; both the level of education as well as labour participation are lower compared to that of countries that recently entered in to the EU.
- Demographic dynamism; contrary to most other EU member states, Turkish population is still growing by around 1 percent annually. This also means that the labour force will keep growing in the upcoming 10-15 years.
- Dual nature of the economy; Turkey has a small high-performing modern sector very well able to compete within the EU, but also has a large part of the population still working in agriculture.
- External debt and capital flight; after the banking crises of 2001 external debt increased fast and capital flew out of the country.
- Agriculture: Turkey has a trading surplus in agricultural sector because for many of her products the EU is relatively open. This means that accession will not lead to massive gains in this sector through higher exports.
- Migration; concerning the delays in Turkish accession and free movement of workers as with the last new entrants, it is possible that free movement of labour takes at least another 15 to 20 years, when probably EU has to deal with labour shortages. (Dervis et al., 2004).

This short overview brings the main issues far economic policy forward. Macro-economic stability is the core. This is rather well attained through tight fiscal and monetary policy in the last couple of years. Growth rates are stable, but can so far not reduce unemployment. The number of people working in the agricultural sector is still relatively high. The private sector is fairly competitive. On the other hand the state is still present in various sectors. Trade is steadily growing, although the current account deficit could become a problem. FDI is slowly growing which is a good sign of trust of foreign investors in the macro-economic stability. The next section will provide some more comparative data, with reference to the Lisbon goals of the EU.

4.2 Statistical comparative analysis
So far insights have been given on the growth agenda’s of both EU and Turkey. Next, how far accession into the EU can provide additional gains towards economic growth for Turkey has been analyzed. The last section has given some necessary insights into the situation of Turkish economy. This section will provide a comparison of Turkey and some (groups of) EU countries in the light of the Lisbon goals.
It is realistic to assume that the Lisbon agenda may play an important role in the accession of Turkey. So far it was mainly the Copenhagen criteria that were continuously
on the agenda. However, as the EU is aiming more and more for growth, the growth potential and strength of and acceding country as Turkey may become more important.

The Lisbon agenda has been set up before the last enlargement. The 10 new entrants are expected to try as hard as possible to reach the set goals just as well as the old member states, although they have a lower starting point. It is in this light that a statistical analysis of the Lisbon agenda takes place within this work. The first subsection will show some comparative figures on governance and competitiveness of the Turkish economy. The second subsection gives the most important measurable goals that have been mentioned in the Lisbon strategy. For providing a comprehensive overview, the Maastricht criteria on fiscal and monetary policy will also be taken into account. Next, the comparative statistics on these goals will be presented. In the last section the outcomes of the analysis will be discussed. Since it is unrealistic to compare Turkish performance to that of Germany or another rich EU 15 country, a comparison will be made to the following (groups) of countries to provide a better insight:

1. Average of the EU 25
2. Average of Greece, Spain and Portugal
3. Average of the 10 new entrants
4. Average of CEEC 8
5. Average of Bulgaria and Romania

4.2.1 Comparison on governance and competitiveness

Before beginning the comparison of progress towards the Lisbon goals, some other comparisons may be relevant in light of potential accession of Turkey into the EU. Two main aspects that countries have to secure before accession are as follows:

1) To have a well working market economy
2) that is able of competing with other EU economies.

The first table provides some information on the relative quality of governance. It gives an overview of the aspects that are seen as important for a proper working government. A higher value on the indicators mean a higher quality of governance in the respective area.

<table>
<thead>
<tr>
<th>Country</th>
<th>Control of corruption</th>
<th>Government effectiveness</th>
<th>Political stability</th>
<th>Regulatory quality</th>
<th>Rule of law</th>
<th>Voice &amp; accountabilty</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU15 Mean</td>
<td>1.70</td>
<td>1.67</td>
<td>1.15</td>
<td>1.57</td>
<td>1.58</td>
<td>1.42</td>
</tr>
<tr>
<td>Stdev</td>
<td>0.52</td>
<td>0.43</td>
<td>0.31</td>
<td>0.26</td>
<td>0.42</td>
<td>0.20</td>
</tr>
<tr>
<td>Hungary</td>
<td>0.6</td>
<td>0.78</td>
<td>1.08</td>
<td>1.21</td>
<td>0.9</td>
<td>1.17</td>
</tr>
<tr>
<td>Poland</td>
<td>0.39</td>
<td>0.61</td>
<td>0.71</td>
<td>0.67</td>
<td>0.65</td>
<td>1.11</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>-0.17</td>
<td>-0.06</td>
<td>0.56</td>
<td>0.62</td>
<td>0.05</td>
<td>0.56</td>
</tr>
<tr>
<td>Romania</td>
<td>-0.34</td>
<td>-0.33</td>
<td>0.42</td>
<td>0.04</td>
<td>0.12</td>
<td>0.38</td>
</tr>
<tr>
<td>Turkey</td>
<td>-0.38</td>
<td>-0.2</td>
<td>-0.61</td>
<td>0.08</td>
<td>0</td>
<td>-0.47</td>
</tr>
</tbody>
</table>

Source: Dervis et all, 2004, p. 96
First of all, it can be noticed that in comparison with the EU15 average Turkey is performing bad. However, on almost all indicators, also the countries that have recently entered the EU score significantly below this average. On the other hand, the figures show that even compared to these countries the relative performance of Turkey is rather poor. Both Hungary and Poland have strong positive values for all indicators, while Turkey has still negative values for almost all. This means there is a big governance gap among these countries. As the comparative figures show, Turkey can only slightly link-up to the two other candidate countries, Bulgaria and Romania. On the indicators for control of corruption, government effectiveness, regulatory quality and rule of law, the indicators for Turkey are comparable to these two countries. However, it is especially for the political instability and the 'voice and accountability' indicator that Turkey has a relatively poor score. Turkey's performance on governance quality is thus relatively bad. Therefore, based on the figures above, one has to conclude that with stricter implementation of the requested governance level on behalf of the EU before accession, Turkey still has a lot to do for improving the governance system.

Other issues that have been analyzed in order to get a good grasp on the strength and weaknesses of the Turkish economy, are measures of competitiveness. The table below shows the relative performance in different important aspects that relate to competitiveness.

Table 4.7 Competitiveness of different acceding countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Final score</th>
<th>Information society</th>
<th>Innovation and R&amp;D</th>
<th>Liberalisation</th>
<th>Enterprise</th>
<th>Social inclusion</th>
<th>Sustainable development</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU average</td>
<td>4.97</td>
<td>4.61</td>
<td>4.41</td>
<td>4.69</td>
<td>4.74</td>
<td>4.81</td>
<td>5.16</td>
</tr>
<tr>
<td>Hungary</td>
<td>4.12</td>
<td>3.24</td>
<td>3.47</td>
<td>4.10</td>
<td>4.38</td>
<td>3.69</td>
<td>4.17</td>
</tr>
<tr>
<td>Poland</td>
<td>3.68</td>
<td>2.95</td>
<td>3.53</td>
<td>3.75</td>
<td>3.56</td>
<td>3.42</td>
<td>3.99</td>
</tr>
<tr>
<td>Czech rep.</td>
<td>4.16</td>
<td>3.62</td>
<td>3.34</td>
<td>4.01</td>
<td>4.41</td>
<td>4.19</td>
<td>4.09</td>
</tr>
<tr>
<td>Romania</td>
<td>3.35</td>
<td>2.91</td>
<td>2.88</td>
<td>3.04</td>
<td>3.65</td>
<td>3.74</td>
<td>3.33</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>3.25</td>
<td>2.66</td>
<td>2.94</td>
<td>3.26</td>
<td>3.81</td>
<td>3.07</td>
<td>3.06</td>
</tr>
<tr>
<td>Turkey</td>
<td>3.45</td>
<td>2.61</td>
<td>2.72</td>
<td>3.68</td>
<td>3.84</td>
<td>3.45</td>
<td>3.33</td>
</tr>
</tbody>
</table>


This table is a limited version of the original table. In this original ranking of twelve states Turkey takes the 10th place after the nine states that have entered the EU (Malta was not taken into account) by 2004, but ahead of Romania and Bulgaria, the two countries that are expected to enter within a year. It is interesting to note in this brief overview that it is especially the indicators that link best to the Lisbon strategy (information society and innovation and R&D) where Turkey has relatively the lowest scores. As might be expected from a country that has a liberal market system for quite some time, the scores on liberalisation for Turkey are better than for Bulgaria and Romania and is comparable to that of Poland.
In general Turkey’s overall performance on competitiveness is lagging behind that of countries that recently entered the EU. Although these competitiveness indicators probably do not directly relate to the accession criteria, they may play an important role in achieving growth. A better competitive environment may not only boost domestic economic activity, but may also attract more foreign investors. The next subsection will continue with the comparison of the relative performance of Turkey on the Maastricht and Lisbon criteria.

4.2.2 Maastricht and Lisbon criteria
There are a number of measurable criteria within the Lisbon agenda. In this section they are shortly mentioned and explained. The main aims can be divided under the headings of: Maastricht criteria; employment and 'Human capital & R&D'.

Maastricht criteria:
- Keep inflation at a low and stable level. The ECB targets for an annual inflation level between 0-2 percent.
- Rate of public debt to GDP should be at most 60 percent by 2010.
- The annual budget deficit is allowed to be at most 3 percent.

Employment:
- By 2010 a participation rate of 70 percent should be reached, this means that 70 percent of the population between 15 and 64 should have at least a part-time job.
- Reducing by 2010 the average level of unemployment in the EU to the levels already achieved by the best performing countries (around 4%).
- Increasing the number of women in employment from 51% today to more than 60% by 2010.

Human capital and Research & Development
- The share of investment in human resources as a proportion of GDP should be raised by a quarter by 2005 and by 50% by 2010.
- The number of 18 to 24 year olds with only lower secondary level education and who are not in further education and training must be halved by 2004-5.
- By 2010 spending on R&D should be increased to 3 percent of GDP, of which two-third should be contributed by the private sector (Lisbon European Council, 2000).
4.2.3 Comparative statistics
For the comparative analysis a significant number of data will be used. In this context, not only the measurable criteria of the Lisbon strategy, but also some more general figures that can be related to economic growth will be used. The tables below provide data on important structural indicators for the years 2000 and 2004. Different groups are being used for comparative analysis:

1. **EU 25** = the average of the 25 EU countries is with some statistics taken as a reference point so this is why it has been taken into account.
2. **EU10** = the average is the non-weighted average of the 10 new member states as of May 2004.
3. **CEEC8** = the non-weighted average of the 8 new entrants excluding Malta and Cyprus which may give some biased results of EU 10 since it is not controlled for size.
4. **BulRom** = the non-weighted average of Bulgaria and Romania, the two candidate member states that will form the next enlargement to EU 27 by 2007.
5. **GSP** = The non-weighted average of Greece Spain and Portugal. This is taken into account to give an indication of the development levels of the three relative poorest countries of the EU15 member states.

The analysis has two angles. First, there is the comparison of Turkey with the averages of the groups mentioned above. Second, the data for the years 2000 and 2004 are provided. Although this does not give any information on the progress during the years in between, it gives a broad picture of the relative progress of the different groups towards the Lisbon goals. Next to that the 2000 data are important for the progress in light of the Lisbon strategy, since some of the targets for 2010 are measured as a reduction or increase compared to the 2000 situation. The tables are split up to provide data material on different aspects of Lisbon and Maastricht criteria, starting with some general economic structural indicator data. Further information on the description of the different data can be found in Annex 1.

### Table 4.8 General comparative statistics

<table>
<thead>
<tr>
<th>2000/2004</th>
<th>EU 25</th>
<th>GSP</th>
<th>EU10</th>
<th>CEECS</th>
<th>BulRom</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP per capita (PPS)</td>
<td>100/100</td>
<td>81,8/84</td>
<td>55,7/60,5</td>
<td>49,8/56,6</td>
<td>25,7/31,4</td>
<td>29,8/28,5</td>
</tr>
<tr>
<td>Real GDP growth</td>
<td>3,9/2,4</td>
<td>4,5/3</td>
<td>5/5,0</td>
<td>4,9/6,0</td>
<td>3,8/7</td>
<td>7,4/8,9</td>
</tr>
<tr>
<td>Capital formation</td>
<td>18,3/17,1</td>
<td>21,8/21,6</td>
<td>20,5/20</td>
<td>21,6/21,1</td>
<td>12,1/17,7</td>
<td>-/25,7</td>
</tr>
<tr>
<td>Income inequality indicator</td>
<td>4,5/4,8</td>
<td>5,9/6,1</td>
<td>4,7/5,8</td>
<td>4,7/5,8</td>
<td>4,1/4</td>
<td>-/7,7*</td>
</tr>
</tbody>
</table>
The picture on relative performance of Turkey is mixed, according to the general indicators above. GDP per capita is at a relative low level compared to the new EU members. It is comparable to the average of Bulgaria and Romania, which is still only about half of the CEEC8 average. As the figures show, in the period 2000-2004 the relative GDP per capita of all countries have risen towards the EU25 average, except the figure for Turkey. In other words, there has been no catching up effect when looking at GDP per capita. On the other hand, Turkey shows the highest economic growth rate of all comparative groups. This higher growth rate would suggest that there is catching up in GDP. A potential cause of this contradiction is the relative high growth of the Turkish population. With an increasing size of population the growth in GDP does not reflect in the GDP per capita growth.

The size of capital accumulation as % of GDP is at about the same size for Turkey and the other group averages. The price level in Turkey is also comparable to that of other group averages and is even significantly higher than for Bulgaria and Romania. An indicator that is relatively high for Turkey is the regional dispersion of income. This means that the difference in income between the 20% richest persons and the 20% poorest persons is relatively high compared to the other countries.

<table>
<thead>
<tr>
<th>Table 4.9 Maastricht criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2000/ 2004</strong></td>
</tr>
<tr>
<td>General government debt</td>
</tr>
<tr>
<td>Inflation rate</td>
</tr>
</tbody>
</table>

When looking at the Maastricht criteria on the government budget deficit and government debt the results are also mixed. Considerable progress has been made in reducing the budget deficit, which by 2004 goes into the direction of the maximum allowed three percent deficit. This level is comparable to the other group averages. The reduction of the budget deficit over the period 2000-2004 is impressive compared to the other groups. General government debt is still relatively high. It has even increased significantly in the period 2000-2004 where all comparable groups show a reduction or
just a slight increase. It should however be kept in mind that this increase is entirely due to the economic crisis of 2001. By 2001 the government debt was over 90 percent, so in the meantime some significant progress has been made.

A comparison of the inflation rates of the different groups shows a relative good performance of Turkey. Although inflation in Turkey is still relatively high at around 10 percent, this is a strong reduction coming from levels of 50 percent. The fact that Turkish government finally has found a way to significantly reduce inflation shows the strength of the currently implemented stability program and especially the strength of the independent central bank.

Table 4.10 Openness data

<table>
<thead>
<tr>
<th>2000/2004</th>
<th>EU 25</th>
<th>GSP</th>
<th>EU10</th>
<th>CEEC8</th>
<th>BulRom</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>High technology export</td>
<td>21,4/18</td>
<td>6,5/6</td>
<td>13,8/13</td>
<td>8,9/8</td>
<td>3,1/2</td>
<td>4/1,9</td>
</tr>
<tr>
<td>Market integration goods</td>
<td>8,9**/9,4</td>
<td>23,1/20,8</td>
<td>49,6/50,3</td>
<td>49,6/53,1</td>
<td>36,6/42,4</td>
<td>20,9/24,2*</td>
</tr>
<tr>
<td>Market integration services</td>
<td>3,2**/3,3</td>
<td>9,3/8,4</td>
<td>13,7/13,3</td>
<td>11,1/10,3</td>
<td>10,2/10,3</td>
<td>7,4/5,7*</td>
</tr>
<tr>
<td>Market integration FDI (%GDP)</td>
<td>1,3**/0,9</td>
<td>5,5/2,7</td>
<td>4,2/3,3</td>
<td>3,3/2,7</td>
<td>2,7/5,4</td>
<td>0,5/0,6</td>
</tr>
</tbody>
</table>

* 2003 data  
** 2001 data  
Source: Eurostat structural indicators

When comparing the levels of market integration, it is visible that Turkey has far lower figures compared to the new EU member states, but they are still considerably higher than the EU25 average. The most relevant feature in this respect is the relative small size of FDI. Most new EU member states have a percentage of FDI flows to GDP around 4 times higher than Turkey. Although this is not directly a problem, higher FDI inflows might be very useful for the Turkish economy. FDI inflow may lead to spillover effects, especially in high technology industries and services. Domestic investments are low due to the low level of domestic savings, therefore foreign direct investment could give the necessary boost to the Turkish economy. The relative low share of high-tech exports is a negative indicator for Turkey, indicating that it is probably not on a fast path towards a knowledge based economy.
Table 4.11 Employment data

<table>
<thead>
<tr>
<th>2000/2004</th>
<th>EU 25</th>
<th>GSP</th>
<th>EU10</th>
<th>CEEC8</th>
<th>Bul</th>
<th>Rom</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment growth</td>
<td>1.5/2.6/0.3/-1.4/-3.5/-0.4/</td>
<td>0.6/2.3/0.3/-1.8/2.6/-2.6/</td>
<td>100/86.2/57.9/52/29.6/39.4/19/</td>
<td>100/87.7/62.8/59.1/67.4/65.1/21/</td>
<td>62.4/60.4/59.3/59.1/56.7/48.8/11/</td>
<td>63.3/62.8/60.4/60.2/56/46.1/23/</td>
<td>-1.4/-3.5/-0.4/-0.4/-0.4/-0.4/-1.4/</td>
</tr>
<tr>
<td>Labour productivity per worker</td>
<td>100/86.2/57.9/52/29.6/39.4/19/</td>
<td>100/87.7/62.8/59.1/67.4/65.1/21/</td>
<td>62.4/60.4/59.3/59.1/56.7/48.8/11/</td>
<td>63.3/62.8/60.4/60.2/56/46.1/23/</td>
<td>53.6/47.8/52/54.2/51.9/25.8/19/</td>
<td>55.7/51.7/53.2/55.1/51.4/24.3/17/</td>
<td>36.6/42.2/33.2/31.7/35.2/36.3/12/</td>
</tr>
<tr>
<td>Total employment rate</td>
<td>62.4/60.4/59.3/59.1/56.7/48.8/11/</td>
<td>63.3/62.8/60.4/60.2/56/46.1/23/</td>
<td>53.6/47.8/52/54.2/51.9/25.8/19/</td>
<td>55.7/51.7/53.2/55.1/51.4/24.3/17/</td>
<td>36.6/42.2/33.2/31.7/35.2/36.3/12/</td>
<td>41.0/43.7/38.5/37.9/34.7/33.2/21/</td>
<td>8.6/8.8/11.1/12.5/11.6/6.5/5.6/</td>
</tr>
<tr>
<td>Female employment rate</td>
<td>62.4/60.4/59.3/59.1/56.7/48.8/11/</td>
<td>63.3/62.8/60.4/60.2/56/46.1/23/</td>
<td>53.6/47.8/52/54.2/51.9/25.8/19/</td>
<td>55.7/51.7/53.2/55.1/51.4/24.3/17/</td>
<td>36.6/42.2/33.2/31.7/35.2/36.3/12/</td>
<td>41.0/43.7/38.5/37.9/34.7/33.2/21/</td>
<td>8.6/8.8/11.1/12.5/11.6/6.5/5.6/</td>
</tr>
<tr>
<td>Older (55-64) employment rate</td>
<td>36.6/42.2/33.2/31.7/35.2/36.3/12/</td>
<td>41.0/43.7/38.5/37.9/34.7/33.2/21/</td>
<td>8.6/8.8/11.1/12.5/11.6/6.5/5.6/</td>
<td>9.1/9.3/10.1/11.2/9.8/10.3/5/</td>
<td>36.6/42.2/33.2/31.7/35.2/36.3/12/</td>
<td>41.0/43.7/38.5/37.9/34.7/33.2/21/</td>
<td>8.6/8.8/11.1/12.5/11.6/6.5/5.6/</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>62.4/60.4/59.3/59.1/56.7/48.8/11/</td>
<td>63.3/62.8/60.4/60.2/56/46.1/23/</td>
<td>53.6/47.8/52/54.2/51.9/25.8/19/</td>
<td>55.7/51.7/53.2/55.1/51.4/24.3/17/</td>
<td>36.6/42.2/33.2/31.7/35.2/36.3/12/</td>
<td>41.0/43.7/38.5/37.9/34.7/33.2/21/</td>
<td>8.6/8.8/11.1/12.5/11.6/6.5/5.6/</td>
</tr>
<tr>
<td>Long term unemployment</td>
<td>62.4/60.4/59.3/59.1/56.7/48.8/11/</td>
<td>63.3/62.8/60.4/60.2/56/46.1/23/</td>
<td>53.6/47.8/52/54.2/51.9/25.8/19/</td>
<td>55.7/51.7/53.2/55.1/51.4/24.3/17/</td>
<td>36.6/42.2/33.2/31.7/35.2/36.3/12/</td>
<td>41.0/43.7/38.5/37.9/34.7/33.2/21/</td>
<td>8.6/8.8/11.1/12.5/11.6/6.5/5.6/</td>
</tr>
</tbody>
</table>
| Source: Eurostat structural indicators

Data on employment show that Turkey has comparable figures with the average of other groups concerning quite a number of indicators. Most prominent in this respect are the relative figures of the (long term) unemployment rate. The unemployment rate in 2004 is at about the same level as other countries, while the long term unemployment rate is even lower than for example the CEEC8 countries. However, both unemployment and long term unemployment figures for Turkey have risen over the period 2000-2004. The figures suggest that the 2001 crisis has lead to increased unemployment, which has not been reduced in the period 2002-2004 when economic growth rates were high.

When looking at employment rates, the total employment rate is lagging somewhat behind that of the reference countries. This is probably mainly caused by the low (official) participation rate of females, which is only half compared to the other countries average. The only real problematic part of these employment figures is the low productivity per worker for Turkey, which is around 2/3 of the average level in CEEC8. Also the growth of productivity between 2000 and 2004 is rather low compared to other countries.

Table 4.12 Human capital investment data

<table>
<thead>
<tr>
<th>2000/2004</th>
<th>EU 25</th>
<th>GSP</th>
<th>EU10</th>
<th>CEEC8</th>
<th>Bul</th>
<th>Rom</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life long learning</td>
<td>7.9/10.3</td>
<td>3.2/4</td>
<td>3.9/7.5</td>
<td>4/7.7</td>
<td>0.9/1.5</td>
<td>1.1/1.3</td>
<td>1.1/1.3</td>
</tr>
<tr>
<td>HR investment</td>
<td>4.9/4</td>
<td>4.7/4</td>
<td>5/5</td>
<td>4.9/4.9</td>
<td>3.7/3.7</td>
<td>3.5/3.5</td>
<td>3.5/3.5</td>
</tr>
<tr>
<td>Youth education level</td>
<td>76.3/76.6</td>
<td>62.7/64</td>
<td>80.2/81.9</td>
<td>85.3/86.3</td>
<td>75.4/75.4</td>
<td>38.9/41.8</td>
<td>38.9/41.8</td>
</tr>
<tr>
<td>Early school leavers</td>
<td>17.7/15.6</td>
<td>30/28.7</td>
<td>23.5/13.7</td>
<td>14.9/9.3</td>
<td>22.3/22.5</td>
<td>58.8/54.6</td>
<td>58.8/54.6</td>
</tr>
</tbody>
</table>

Source: Eurostat structural indicators

When looking at the comparative data on education and the investment in human capital, Turkey is also performing relatively poor. The figures show that in Turkey the percentage of people profiting from Life Long Learning is rather low compared to the other average figures, but comparable level with the average of Bulgaria and Romania. The percentage...
of the CEEC8 average is almost six times higher. Progress over the period 2000-2004 in this area in Turkey is also relatively poor compared to the progress made by other countries. The relative amount of capital invested in Human capital in Turkey is only slightly lower than the other groups average.

More difficult are the figures on education levels and the percentage of drop-outs. The percentage of young people with at least secondary education in Turkey is only about half of the percentage of the CEEC8 average. This relative bad performance is accompanied by a relative high level of early school leavers, which is about three to four times as high as the average of other countries. These relative weak education level figures for Turkey are endorsed by the OECD statistics in table 4.13. Although Turkey is compared here to only a limited number of countries, the picture is quite clear. When comparing the percentage of people with only below secondary education, Turkey scores much higher than any other country. The percentage of people finishing tertiary education is comparable to that of Poland and Czech Republic. Therefore the biggest problem with education in Turkey lies in the middle segment of secondary and non-tertiary education.

Table 4.13 comparative data on education attainment group 25-64 (2002)

<table>
<thead>
<tr>
<th></th>
<th>Below upper secondary education</th>
<th>Upper secondary and non-tertiary education</th>
<th>Tertiary education</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>47</td>
<td>34</td>
<td>18</td>
</tr>
<tr>
<td>Spain</td>
<td>58</td>
<td>17</td>
<td>24</td>
</tr>
<tr>
<td>Poland</td>
<td>18</td>
<td>69</td>
<td>12</td>
</tr>
<tr>
<td>Hungary</td>
<td>29</td>
<td>57</td>
<td>14</td>
</tr>
<tr>
<td>Czech republic</td>
<td>12</td>
<td>76</td>
<td>12</td>
</tr>
<tr>
<td>Turkey</td>
<td>75</td>
<td>16</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: OECD Education at glance

Table 4.14: R&D investment data

<table>
<thead>
<tr>
<th>2000/2004</th>
<th>EU25</th>
<th>GSP</th>
<th>EU10</th>
<th>CEECS</th>
<th>BulRom</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exp R&amp;D (% of GDP)</td>
<td>1,9/ 1,9</td>
<td>0,9/ 0,8</td>
<td>0,7/ 0,8</td>
<td>0,8/ 0,9</td>
<td>0,4/ 0,5</td>
<td>0,6/ -</td>
</tr>
<tr>
<td>Science and tech graduates</td>
<td>10,2/ -</td>
<td>8,1/ -</td>
<td>6,6/ -</td>
<td>7,3/ -</td>
<td>5,6/ -</td>
<td>-</td>
</tr>
<tr>
<td>ICT expenditure on technology % GDP</td>
<td>-/ -</td>
<td>-/ 1,7</td>
<td>-/ 2,1</td>
<td>-/ 2,1</td>
<td>-/ 1</td>
<td>-/ 1</td>
</tr>
<tr>
<td>ICT exp on telecom % GDP</td>
<td>-/ -</td>
<td>-/ -</td>
<td>-/ -</td>
<td>-/ -</td>
<td>-/ -</td>
<td>-/ -</td>
</tr>
</tbody>
</table>

Source: Eurostat structural indicators

When looking at the comparative figures on Research and Development investments one can see that Turkey is performing about equal compared to the other countries averages. On ICT expenditure the picture is mixed. Expenditure on telecom ICT is at comparable levels, while the expenditure on ICT technology is only about half of other countries' averages.
4.2.4 Turkish situation in light of the Maastricht and Lisbon criteria

When directly referring to the goals set by the Lisbon agenda and the Maastricht criteria one can see that Turkey still has a long way to go. However, one has to keep in mind here that progress of other countries towards achieving these goals is also not that impressive in many areas.

In light of the Maastricht criteria it is especially the general government debt criteria where the performance of Turkey is comparatively bad. Most other country averages are closer to the level of 60 percent of GDP. On the other hand, the relative performance in reducing the public deficit and inflation rate are very promising and proceeding in the direction of the set targets.

The general employment rate of Turkey is relatively low, and at 46.1% by 2004 it is still quite far from the target of 70%. Considering the growth rates of employment in the period 2000-2004 it is not expected that Turkey will soon catch up. This has mainly to do with the low participation of females, which is at around 25 percent, while the target is 60 percent. When looking at comparable data of the other countries one should however keep in mind that they have a higher current participation level, but that they are also quite far from the goals set. Progress towards the goals is also rather low in these countries. According to the figures, the unemployment level for Turkey is comparable with the other country averages. For all countries the percentage around 10 percent is very high compared to the Lisbon goal of 4 percent. The difference in the data for 2000 and 2004 is quite small, so in general little progress is made on reducing the unemployment levels.

Data on the share of investment in human resources are not available for all countries, so no information can be provided on this Lisbon criteria. The comparable data on the education level do not fit well with the setting of the original Lisbon criteria, which is halving the number of persons with only lower secondary education by 2005. However, the data do show that the percentage of people that finished secondary education is very low for Turkey compared to the other group averages. The OECD statistics support this argument. It seems that a lot of efforts have to be made in Turkey in order to link-up to the expectations of the Lisbon goals. This is also the case for the number of early school leavers, which is comparatively high and has only slightly reduced in the period 2000-2004.
The data on investment in R&D are for Turkey only available for 2000. However, with a 0.5 percentage of GDP investment in R&D it was by then still quite far from the targeted level of 3 percent. However, here as well one has to keep in mind that the performance of the other groups is also weak, at only slightly higher investment percentages than Turkey.

As a short conclusion it can be stated that Turkey is still quite far from reaching the Lisbon criteria. However, this conclusion also holds in many respects for the countries that Turkey has been compared with. In this respect there are three areas where Turkey has most catching-up to do, which are:

1. the reduction of general government debt
2. increasing the labour participation rates, especially of women
3. increase the level of education and reduce the number of early school leavers.
In the previous chapters a number of issues related to the economics of Turkish accession into the EU has been mentioned. Based on these issues, in this chapter the main discussion issues are highlighted. The first section provides the most important discussion items. The second section provides the final concluding remarks, providing an answer to the main research question.

5.1 Discussion

One basic idea not mentioned as a whole so far will be the starting point of thought for this analysis and the final outcome. The idea is as follows:

In the previous EU enlargement the Copenhagen criteria had to be fulfilled before accession. The basic economic criteria are to have an open liberal market economy, capable of dealing with competitive pressure from other EU member states. Since Turkey has since long an open market economy this part of the criteria could probably easily be fulfilled, be it with some problematic issues like the regional dispersion, the relative large size of state companies and adaptations in intellectual property law. However, considering the open ended aspect of negotiations and the easy possibility of inserting additional criteria as well as the current negative public opinion of Turkish entrance, it is realistic to assume that these will not be the final criteria. A possible economic criterion in future negotiations could very well be in how far Turkey can link up to the Lisbon strategy and criteria and next, how Turkey can contribute to the goal of the EU to become the most dynamic and competitive knowledge based economy.

To provide an answer to this hypothesis, first the most relevant findings from the previous chapters are represented. Thereafter, some issues in light of unleashing the Turkish economic growth potential are discussed. In light of this growth potential the priority actions to be taken by the Turkish government are presented. The chapter ends with some concluding remarks on the main question whether Turkey would economically fit within the EU in light of the Lisbon strategy.

The first chapter provides insights into the theoretical framework for growth. The Solow model and the elaborations on this model show the most important theoretical paths towards economic growth. First, growth can be achieved by increasing the volume of available production units, labour and capital. This process will however not be sustainable in the long run because of the law of diminishing returns. Therefore, most important for economic growth is technological development. Although this has in earlier growth models been regarded as exogenous input, more recent growth models are
endogenous growth models. Here it is argued that technological innovations will lead to new innovations through spill-over effects. Openness to trade and FDI can contribute to economic growth, mainly through the import of knowledge from abroad. This is especially important for developing countries.

Chapter two shows the similarities and differences in growth strategies for Turkey and the EU. Both growth agendas fit with economic theory. Next to the creation of a stable economic environment through tight fiscal and monetary policy, the main focus is on improving technological capacity. Both Turkey and the EU see the necessity of investing in both R&D and human capital to be able to achieve economic growth. Both also focus on SMEs which should be the main drivers of economic growth. Gains from openness to trade are acknowledged by both Turkey and EU and they’re both aiming for smoothening trade as well as production factor movement. A difference in approach is the priority for EU with the accumulation of labour input, while for Turkey capital accumulation is most important. Related to this is the emphasis on increasing FDI in Turkey.

In chapter three an overview is provided of the potential gains and costs from enlargement of the EU. Put in the perspective of the most recent enlargement, most research projects find a positive contribution to economic growth from accession into the EU. These gains go primarily to the new entering country, but most current member states can slightly profit as well. For Turkey, additional annual growth of GDP is estimated between 4.9 and 6.5 percent due to EU accession. Accession also leads to increased trade with EU countries and higher FDI inflows to Turkey. The biggest potential contribution from accession to growth comes from the improvement of the institutional setting. However, it is noticed that accession in itself does not lead to this improvement, it is the national government that has to make the efforts. On the cost side of enlargement, the potential flow of labour from the entering country towards the old member states is the most important. However, most available research projects show that migration flows after Turkish accession will be relatively modest. Estimation on the total inflow of migrants by 2030 with accession by 2015 range from around 960.000 to around 2.200.000. Moreover, it is possible that migration flows will be even higher without accession, because in this scenario lower economic growth in Turkey is expected.

Chapter four provides a number of comparative figures for Turkey and averages of other countries. Indicators on competitiveness and strength of governance have shown that Turkey’s performance is relatively weak compared to countries that have recently entered the EU. However, figures are rather comparable to those of Bulgaria and Romania, the two countries that are expected to enter the EU very soon. The comparative figures related to the Lisbon criteria show that Turkey is generally far from reaching the goals set in the Lisbon strategy. However, this conclusion can also be drawn
for especially the recent entering countries in the EU when looking at the average of these countries for the different criteria. In comparison to these countries, there are three aspects that Turkey is performing relatively bad, which therefore should be the main priority areas for action. The priorities for the Turkish government for action to achieving the Lisbon goals are:

1. the reduction of general government debt
2. increasing the labour participation rates, especially of women
3. increase the level of education and reduce the number of early school leavers.

As this overview suggests, the gap between the economic performance of Turkey and the EU member states is still rather large. This is even true in comparison to the countries that have recently entered the EU. Turkey's economic performance is comparable to that of Bulgaria and Romania. In this context, then, the question is: Is it possible for Turkey to decrease this gap in economic performance?

The empirical evidence so far suggests that ceteris paribus, a certain convergence can be expected unconditionally if one compares two countries that differ only in their starting level of income per capita, one would expect the poorer country to catch up over time. However, ceteris is almost always not paribus. This applies with particular force to Turkey, which has not converged towards economic performance of the EU although it has had an open liberal market economy for many years. Especially since the privatization and liberalization reforms that have started in the 1980s, convergence might have been expected, but the relative economic performance of Turkey is not catching up. Thus, the key question is: To what extent have the recent drastic structural changes in Turkey improved the prospects of convergence? What is the relative importance of these various factors in determining growth prospects?

The empirical literature on growth suggests that there are two classes of elements that are a key for growth: the accumulation of factors of production and 'institutions'. Neither of these two elements seem to be able to determine growth alone. Thus, it will be useful to analyse both briefly.

The accumulation of factors of production can mainly take three forms: investment in physical capital, investment in human capital and population growth. Starting with the third form suggests that the demographic trends projected for Turkey may be one factor allowing Turkey to grow quite rapidly, due to a rising proportion of the active population in total population. Demographic trends thus put Turkey into a different situation when compared with the new accession countries whose demography makes their growth primarily dependent on total factor productivity (TFP) and foreign
investment. Moreover, Turkey has the potential for a large-scale absorption of underemployed labour, especially from the rural areas and among women, into higher-productivity activities in industry and services (Dervis et al., 2004: p 7-8).

The perspective for gaining growth through the investment in physical and human capital is slightly less positive in the case of Turkey. The high government debt and low domestic savings are primarily debit to this. The high burden of interest and repayment of government debt, prevents government from investing additional money into the education system. Due to the low domestic saving rate and the recent banking crises in Turkey, there is not much funding available for private lending to start up or expand businesses. It is especially the SMEs that are having a hard time finding additional financial resources. Two important aspects of government policy should play an important role in overcoming these problems. To reduce the burden of government debt the current tight fiscal policy should be maintained. The positive primary budget should be used to reduce debt. With the help of IMF and EU new loans with lower interest payments should be arranged. In this way, the burden will be reduced and additional money can be spend on education. To increase available funding for investment, the government should make the country more attractive to foreign investors. The new regulation currently underway should be firmly implemented, in order to attract this financial inflow. Next to that, public trust in the banking system should be strengthened. In this way, domestic saving may increase, making more money available for investment in physical capital (Dervis et al., 2004: p 9-10).

Concerning institutions, the most important goal is to improve all governance structures and reduce corruption. Lower corruption will increase the strength of institutions and enhance both foreign and domestic trust in them. Next to this government should keep up their job in increasing the number of independent controlling agencies. Reducing the relative high influence of politics on for example the central bank and the competition authority will strengthen the power and trustworthiness of these institutions (Dervis et al., 2004: p 11).

According to the perspective on convergence presented by Dervis et al (2004), Turkey's prospect for growth lies mainly in increasing labour participation and strengthening of the institutional setting. How does this growth potential fit within the analysis of the Turkish economy in light of the Lisbon strategy?

First of all it is important to remember the timeframe of both projects. The Lisbon goals are set to be achieved by 2010. Turkish accession negotiations have started only recently and will probably not be finished before 2014. Because of this large time frame, trying to
answer the central question leaves quite some room for speculations, but it is thought to be useful nevertheless.

**How will Turkish economic growth opportunities fit within the European Lisbon agenda?**

This question can be separated in two sub-questions. The first is whether Turkey would be able to enter the EU if the Lisbon criteria are the main economic conditions for accession. The second question is if Turkey is assumed to be capable of contributing to sustainable economic growth in the EU after accession.

When comparing the Turkish situation in light of the Lisbon strategy with that of current EU members, especially the new member states as of 2004, it has been shown that there is a pretty wide gap with these countries in many respects. Most important in this light are the relative lower GDP per capita, low labour participation, low labour productivity and the low education level. The figures in chapter 4 show that these countries are also still quite far from reaching the Lisbon goals and it is very much questioned if they will in the upcoming five years. In this light, it can be argued that Turkey's relative performance towards the Lisbon goals is so much lagging behind, that it can hardly be expected that Turkey will be able to reach the Lisbon goals within the next decade. Based on this way of reasoning Turkey's accession into the EU would be denied with fulfilment of the Lisbon criteria as economic condition for accession.

On the other hand, what would be the situation within about 8-10 years if Turkey is capable of exploring its growth potential to the fullest in the upcoming years?

First consider growth of GDP. If Turkey is capable of sustaining its current growth performance of around 5 percent annually and the EU average remains around 2,5 percent, this would mean annual catch up with 2,5 percent. This would mean that within 10 years the economic gap between Turkey and the EU 25 average would be reduced by approximately 30 percent.

Sustaining the current tight fiscal and monetary policy could create the right environment for FDI inflow. The 2005 level of net FDI inflow to Turkey of 6,06 billion US $\textsuperscript{5} accounted for 2 percent of GDP. This is already a major growth compared to the 2004 figures when FDI accounted for only 0,6 percent of GDP. These data imply that FDI inflow is growing fast. Nonetheless, the CEEC8 average by 2004 was still higher at 2,7 percent. If Turkey would be able to attract FDI flows representing around 3 percent of current GDP, this

\textsuperscript{5} Turkey SPO Main economic indicators, FDI inflow, http://ekutup.dpt.gov.tr/teg/2005/12/tv.21.xls
would mean annual inflow of around 10 billion US$. Combined with high economic
growth which increases the attractiveness of the Turkish economy for foreign investors,
this inflow might be even larger.

Increasing labour participation could also firmly contribute to growth. The 2005 figures\(^6\) show that the participation rate of people in the age of 15-64 is 48,3 percent, or 24,56
million people. Increasing this rate to a level equal to the current average of the CEEC8
countries (60,2 percent) would lead to an additional 6,0 million workers in the Turkish
economy. No good estimations can be made on the effect of additional labour for
economic growth, because of the unknown availability of capital and per worker and
therefore on labour productivity. However, a combination of increasing FDI, higher
domestic capital availability and increasing labour participation might create a high
growth potential.

Last but not least a major contribution towards being a strong economic player could
come from the combination of investment in human capital (education) and technology
(R&D). As has been shown in the previous chapter the education level in Turkey is
significantly lagging to the average figures for other countries. Although it is not possible
to give a clear indication of the effect of higher education on economic growth, one could
argue that considering the relatively high capital accumulation in Turkey an increase in
the education level could contribute significantly to labour productivity. Increasing
investment in R&D could increase the competitiveness of Turkey vis-à-vis other
countries.

Of the aspects mentioned above, increasing labour participation and productivity are
probably the most difficult to achieve. A very extensive report on the Turkish labour
market has been recently published by the Worldbank\(^7\). For sustainable growth it is most
important to create more and better jobs. In a presentation by A. Vorkink (2006), the
Worldbank country director for Turkey at the TISK Ankara meeting, a number of
recommendations is made to solve the problem of low employment growth. The most
important recommendations are:

\(^6\) Turkey Statistical Yearbook 2005, p 154
\(^7\) See: Worldbank (2006), Labour market study, report no 33254 TR
1. Reduce informality
   - Reduce registration fees and licenses by replacing them with better reporting and stronger enforcement
   - Further simplify tax system and conclude functional restructuring of tax administration

2. Increase competition and promote FDI
   - Clarify responsibilities of the Competition Authority in regulated sectors; safeguard competition in privatization; reduce compliance burden for small firms.
   - Monitor state aid, phase out distortions and create a state aid monitoring agency

3. Reduce non-wage labour cost
   - Bring severance pay to international levels
   - Increase minimum employment for eligibility for severance payment
   - Reduce payroll taxes on labour

4. Increase Benefits for the Unemployed
   - Protect Workers not Jobs
   - Reduce Unemployment Insurance contributions
   - Ease eligibility conditions for Unemployment Insurance
   - De-link unemployment benefits from minimum wage and target a higher level

5. Increase Labour Market Flexibility
   - Allow fixed-term contracting for economic reasons
   - Permit employment agencies to offer temporary worker services to firms

6. Increase Efficiency and Competitiveness in Financial Sector
   - Continue with privatization of the state banks
   - Enact a framework law for the insurance industry in line with EU requirements
   - Develop legal and regulatory framework for credit bureau for consumers and corporate business
   - Create legal framework and effective filing system for security interests on movable collateral

7. Increase Technology Absorption and Innovation capacity
   - Develop a national innovation strategy and increase R&D
   - Align Innovation policy and regulatory framework with EU requirements
   - Evaluate results and fiscal impact of Technoparks; R&D fiscal incentive schemes, matching grants and loans
   - Recognize tests and standards from countries with which the EU has mutual recognition agreements

8. Improve Education System
   - Modify curricula with a view that all secondary school graduates are taught academic as well as applied competencies, to prepare both for university studies and employment
   - Eliminate rigid separation of vocational and general secondary students, while offering vocational skills to all students
   - Restructure OSS into battery of modern examinations that challenge students to demonstrate learning across all academic disciplines and at high standards
Although these measures are mentioned by the Worldbank in light of the creation of jobs, most of them are in general applicable as important facilitating measures towards economic growth. Most recommendations relate to the institutional setting of Turkey. The first relates to the reduction of informality mentioned before by Dervis et al. (2004). Increasing competitiveness of the Turkish economy should be strengthened by increasing the capacities of the independent Competition Authority. To strengthen the financial sector more state banks should be privatized and credit facilities of the banks should be increased. To increase the dynamics of the labour market the most important recommendations are to reduce the current high non-wage labour cost, to stop the protection of jobs and only focus on the care for unemployed workers and to allow for more flexible labour contracts, through the use of fixed-term contracts and the work of employment agencies.

The recommendations fit to a large extend within the Turkish growth agenda and industrial policy. The most prominent recurring aspects are the focus on competitiveness, reduction of administrative barriers and improving investment in R&D and education.

Considering the positive features mentioned above, one could change the earlier answer to the question whether Turkey can enter the EU with the Lisbon goal as condition. As with previous enlargement, once a country shows significant progress towards the set of requirements this may be enough for a positive stance from the EU. Therefore, if Turkey is capable of maintaining the current growth and make the necessary institutional changes the economic criteria would probably not be the biggest issue for accession.

However, even the assumption that Turkey would be able to significantly decrease the current economic gap with even the poorer EU members would probably not be satisfactory. The question then would be if Turkey can contribute to achieving the Lisbon goals by the EU as a whole. Stated otherwise, could accession of Turkey into the EU be a stimulant for the Lisbon agenda?

In a recent report by Gelauff and Lejour (2006) the potential gains of achieving the Lisbon goals are estimated. Assuming the Lisbon goals are met by around 2010 and sustained until 2025 the level of EU average GDP would be 12-23 percent higher, while employment would be 11 percent higher. The table below shows the potential gains of reaching the five most important targets of the Lisbon strategy for different countries.
Table 5.1 Increase in GDP by 2025 reaching Lisbon goals

<table>
<thead>
<tr>
<th></th>
<th>Employment</th>
<th>Human</th>
<th>Services</th>
<th>Administrative</th>
<th>R&amp;D</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>capital</td>
<td>capital</td>
<td>market</td>
<td>burden</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EU25</td>
<td>6.3</td>
<td>0.5</td>
<td>0.2</td>
<td>1.4</td>
<td>3.5</td>
<td>11.9</td>
</tr>
<tr>
<td>Germany</td>
<td>4.9</td>
<td>0.5</td>
<td>0.2</td>
<td>1.5</td>
<td>3.2</td>
<td>10.3</td>
</tr>
<tr>
<td>France</td>
<td>7.9</td>
<td>0.4</td>
<td>0.2</td>
<td>1.5</td>
<td>3.2</td>
<td>13.1</td>
</tr>
<tr>
<td>UK</td>
<td>2.3</td>
<td>0.7</td>
<td>0.1</td>
<td>1.1</td>
<td>2.8</td>
<td>7.0</td>
</tr>
<tr>
<td>Sweden</td>
<td>1.9</td>
<td>0.3</td>
<td>0.3</td>
<td>1.3</td>
<td>0.7</td>
<td>4.5</td>
</tr>
<tr>
<td>Spain</td>
<td>8.8</td>
<td>0.7</td>
<td>0.1</td>
<td>1.4</td>
<td>4.7</td>
<td>18.4</td>
</tr>
<tr>
<td>Portugal</td>
<td>2.5</td>
<td>2.4</td>
<td>0.1</td>
<td>1.3</td>
<td>4.5</td>
<td>10.9</td>
</tr>
<tr>
<td>Greece</td>
<td>10.9</td>
<td>0.9</td>
<td>0.2</td>
<td>1.2</td>
<td>4.3</td>
<td>18.0</td>
</tr>
<tr>
<td>Poland</td>
<td>17.2</td>
<td>0.6</td>
<td>0.2</td>
<td>2.0</td>
<td>5.7</td>
<td>25.7</td>
</tr>
<tr>
<td>Czech rep.</td>
<td>6.4</td>
<td>0.3</td>
<td>0.4</td>
<td>1.7</td>
<td>5.1</td>
<td>13.9</td>
</tr>
<tr>
<td>Hungary</td>
<td>10.4</td>
<td>0.4</td>
<td>0.7</td>
<td>2.0</td>
<td>5.9</td>
<td>19.4</td>
</tr>
<tr>
<td>Slovakia</td>
<td>11.9</td>
<td>0.3</td>
<td>0.9</td>
<td>1.8</td>
<td>8.1</td>
<td>17.8</td>
</tr>
<tr>
<td>Slovenia</td>
<td>9.9</td>
<td>0.4</td>
<td>0.4</td>
<td>1.9</td>
<td>5.1</td>
<td>15.2</td>
</tr>
</tbody>
</table>

Source: Gelauff and Lejour (2006), p 15

As this overview shows, even in this lower bound scenario\(^8\), the size of GDP grows significantly by 2025. As can be seen, it is especially the countries where the difference between the current situation and the targets are biggest that profit the most. This is in line with the catching-up principle. Therefore, gains are especially high for the countries that have recently entered the EU. This kind of reasoning would imply that if Turkey is able to achieve the Lisbon goals, it would reach an even higher growth of GDP because of its current relative lagging position. However, with these kind of rapports, one has to keep in mind that it doesn’t show how countries can reach the Lisbon goals. This matter of implementation is of course most important.

However, if Turkey is capable of achieving the Lisbon goals, it would be one of the major contributors to economic growth. The potential positive contribution of Turkey towards economic growth is strengthened by the structural problems the EU is facing in the upcoming years, of which the ageing population is probably the most prominent. With a relative smaller working population and an expanding group of older people (over 65) that has to be supported by the government the question comes up how this will be financed by the EU. Putting the burden completely on the working population may probably be completely unfeasible with income taxes so high that there is hardly an incentive to work anymore. To spread this burden, the aim is to put more people longer to work. Sound macro-economic policies aiming for growth should support the central element of keeping

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\(^8\) The different scenario's are based on different expectations about two targets, the effect of R&D investment and the growth of employment. Difference between the low and high bound scenario for R&D is the size of social returns of the investments, estimated at 30% in the low bound scenario and at 100% in the high bound scenario. For employment the difference lies in the assumption that in the low bound scenario the growth of participation of females is natural and will increase, Lisbon agenda or not, while in the upper bound scenario counting starts from the 2003 level. Next, in the low bound scenario only additional low skilled jobs are expected, while in the upper bound scenario a diversified development based on the current situation is expected.
the social security system payable and to keep up economic growth. However, it is argued that without big changes in the social security system it will still be unsustainable.

Turkey does not have this problem. On the contrary, for the next two decades Turkish working population (15-64) will be expanding. Therefore one could see the current backward position of Turkey also as an opportunity with a large potential for growth. Utilizing the labour and growth potential of Turkey in the right way could be a very supportive policy for achieving the Lisbon goals. Using the labour market potential will give a strong boost to the economy. Labour productivity is also comparatively low, which to a large extend has to do with the low availability of capital. This lack of capital is partly caused by the high public debt burden of the government, leaving little space for investment projects. Next to that a poor performing banking system and low domestic savings do leave little opportunity for investment. To increase the available amount of capital in order to increase labour productivity there are multiple measures that can be taken. First of all Turkey should stick to its tight fiscal policy to reduce public debt, unleashing additional money for future investment. Low interest rate loans of the European Investment Bank (EIB) might be very helpful in this respect. More important measures are probably to upgrade trust in macro-economic stability and good governance with less red-tape to increase incoming FDI, which is currently still at a relatively low level. Strengthening the financial sector and a change from government lending to private lending by banks would also contribute to increasing available capital. Providing the labour force with an adequate amount of capital could give a strong impulse to productivity and with that to economic growth, increasing consumption and domestic savings, which in turn could strengthen the intermediate position of the banking sector.

It is not only growth of the Turkish economy itself that can contribute to reaching the Lisbon goals. Turkish labour migration towards the current EU member states can contribute to economic growth, as has been analyzed by Lejour and de Mooij (2004). The inflow of low skilled migrants could lead to an additional growth of 0.5% in GDP. This could be even more when the inflow also consist of high skilled migrants. Next to that, the contribution of this additional workforce through taxes may make it more easy to sustain the social security systems.
5.2 Concluding remarks

Does Turkey economically fit within the EU in light of the Lisbon Strategy?

This question has been the starting point for this research project. In order to answer this question an analysis has been made containing:

1. A theoretical framework for growth
2. A comparison of the growth agenda’s of Turkey and the EU
3. An analysis of the gains and migration aspects from enlargement
4. The current relative performance of Turkey in reaching the Lisbon goals.

In the discussion of these aspects in relation to the main research question the basic argument is as follows:

The current economic situation is lagging behind with the situation of the EU. However, growth theory predicts that a process of catching-up is possible through an increase of the production factors labour and/or capital, or for sustainable growth, investment in technological development.

An analysis of the growth strategy of Turkey and the EU shows that there are a lot of similarities. Both Turkey and the EU prioritise the creation or stabilization of stable macro-economic structure. Investment in 'the knowledge society' through R&D and telecommunications should be a strong trigger for economic growth. SMEs create much employment and added value and are very important for an economy to function properly. This is why special attention is paid to strengthening the position and possibilities for these firms. A major difference is the focus within the EU on employment, while this is not the primary goal in the Turkish strategy.

When comparing economic indicators of Turkey to the figures of the EU member states in light of the Lisbon strategy, the most sensible comparison would be within the framework of the average figures of the countries that by 2004 entered the EU, and also Bulgaria and Romania. Like Turkey, all of these countries have a long way to go to reach the Lisbon goals. Compared to these countries, Turkey is especially lagging behind with:

1. The low labour participation level, especially of females
2. the low labour productivity
3. the high government debt
4. the relative low level of education, especially secondary education attainment.

However, Turkey has the potential for growth. It has especially a high additional labour potential, which could boost economic growth. Next, significant increases in FDI can be
expected if Turkey is capable of maintaining the current macro-economic stability. If Turkey is capable of unleashing this potential and if it can upgrade to the current situation of the recently entered EU members within the next 10 years, it would probably fit quite well within the EU. The progress in light of the Lisbon goals would probably be not enough to reach these goals, but the significant convergence towards it would already be sufficient to be accepted as an EU member in this respect. Moreover, with the growing labour force of Turkey, compared to the decreasing labour force in almost all EU countries, it could even become one of the main contributors of the EU in achieving the Lisbon goals.

Unleashing the growth potential of Turkey in the upcoming years, will stand or fall with the improvements in the institutional framework. Although a lot of different issues to be dealt with have been mentioned in this thesis, the most important are:

1. To sustain the current tight fiscal and monetary policy in order to create a stable macro-economic environment with a healthy government budget and low inflation;
2. To enhance the business environment especially for SMEs by lowering corporate taxes and by increasing lending facilities;
3. To increase labour market flexibility;
4. To increase the number of people with at least secondary education level and improve in general the education system and
5. To improve governance as a whole in Turkey.

All these different measures can not be attained over day. However, as has been stated earlier, the negotiation process of Turkish accession is expected to last at least another 10 years. This long timeframe can be seen as a burden on especially Turkey, but on the other hand can also give Turkey the opportunity to show its strength. Next, it creates time to implement the measures mentioned above. Maintaining the current tight government policies is the basic condition. In the years since the 2001 crisis, significant progress has been made. Especially low inflation will contribute to a stable macro-economic environment. With this, additional foreign (direct) investments may strengthen the capacity for using capital goods and increase labour productivity. Further progress in the financial sector reforms, especially enhancing the lending facilities for SMEs might contribute to their economic performance. Company tax cuts and stronger control on the actual tax payment obligations may reduce the size of the informal market. These two measures can be established in a relative short run, and contribute fast to sustainable economic growth. Creating a more flexible labour market would in the medium run contribute to a further increase in labour participation. This would increase the number of people profiting from economic growth. Next, more people in regular jobs would increase tax income, making it possible to further reduce the tax level, without further reduction
of government income. In the long run, the investment in human capital through higher investment in education and should strengthen the sustainability of economic growth and make the final contribution to Turkey as a 'knowledge society'. Improving governance is a slow ongoing process, and should be improved along the other targets over time. Concluding, with these measures in place, it is expected that Turkey can finally explore its growth potential and will be able to enter the EU in light of the Lisbon strategy within the timeframe of around 10 years.
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ANNEX 1: DESCRIPTION OF STRUCTURAL INDICATORS

GDP per capita in PPS - GDP per capita in Purchasing Power Standards (PPS), (EU-25=100)
Real GDP growth rate - Growth rate of GDP volume - Percentage change on previous year
Labour productivity per person employed - GDP in PPS per person employed relative to EU-25 (EU-25=100)
Total employment growth - Annual percentage change in total employed population
Inflation rate - Annual average rate of change in Harmonized Indices of Consumer Prices (HICPs)
Public balance - Net borrowing/lending of consolidated general government sector as a Percentage of GDP
General government debt - General government consolidated gross debt as a percentage of GDP
Total employment rate - Employed persons aged 15-64 as a share of the total population of the same age group
Employment rate females - Employed women aged 15-64 as a share of the total female Population of the same age group
Total employment rate of older workers - Employed persons aged 55-64 as a share of the total population of the same age group
Life-long learning (adult participation in education and training) - total - Percentage of the population aged 25-64 participating in education and training over the four weeks prior to the survey
Total unemployment rate - Unemployed persons as a share of the total active population
Spending on Human Resources (total public expenditure on education) as a percentage of GDP
Gross domestic expenditure on R&D (GERD) - As a percentage of GDP
Science and technology graduates - total - Tertiary graduates in science and technology per 1000 of population aged 20-29
ICT expenditure - IT expenditure - Expenditure on Information Technology as a percentage Of GDP
ICT expenditure - Telecommunications expenditure - Expenditure on Telecommunications Technology as a percentage of GDP
Youth education attainment level - total - Percentage of the population aged 20 to 24 having completed at least upper secondary education
High-tech exports - Exports of high technology products as a share of total exports
Comparative price levels - comparative price levels of final consumption by private Households including indirect taxes (EU-25=100)
Price convergence between EU Member States - Coefficient of variation of comparative Price levels of final consumption by private households including indirect taxes
Total State aid - as a percentage of GDP
Market integration - Trade integration of goods –
Average value of imports and exports of goods divided by GDP, multiplied by 100

Market integration - Trade integration of services –
Average value of imports and exports of services divided by GDP, multiplied by 100

Market integration - Foreign Direct Investment intensity –
Average value of inward and outward Foreign Direct Investment flows divided by GDP, multiplied by 100

Business investment - Gross fixed capital formation by the private sector as a percentage of GDP

Inequality of income distribution (income quintile share ratio) –
The ratio of total income received by the 20% of the population with the highest income (top quintile) to that received by the 20% of the population with the lowest income (lowest quintile) Income must be understood as equivalised disposable income.

Dispersion of regional employment rates - total - Coefficient of variation of employment rates (of the age group 15-64) across regions (NUTS 2 level) within countries

Early school-leavers - total - Percentage of the population aged 18-24 with at most lower secondary education and not in further education or training

Total long-term unemployment rate – Long-term unemployed (12 months and more) as a Percentage of the total active population
ANNEX 2: THE CONCEPT OF CONDITIONALITY

The concept of conditionality has come forward in the process of eastern enlargement, where the CEEC countries have undergone a major process of external governance. Accession to the EU would only be granted after complying with a large number of criteria, the so-called Copenhagen criteria. The main channel of this rule transfer is through (external) conditionality. A commonly used definition of this concept is:

\[
\text{Conditionality} = \text{`The linking by a state or international organisation of benefits desired by another state to the fulfilment of certain conditions’} \quad (\text{Zalewski, 2004}).
\]

Before getting into the main important conditions for conditionality to work, it is important to keep in mind that there can be different forms of conditionality. First there is the difference between \textit{ex ante} and \textit{ex post} conditionality. The first means that you have to live up to the criteria before getting the reward while \textit{ex post} conditionality means that you first get the reward (for example, accession to the EU) and after that have to make the necessary improvements to live up to the criteria. Next to that there is the difference between positive and negative conditionality. The first means that you'll be rewarded when living up to the criteria while negative conditionality means that you'll be punished when you do not live up to the criteria after a certain time span. Research has shown that negative conditionality works worse than positive conditionality (Zalweski, 2004, p. 3-4). When applying the definition and the different concepts of conditionality to the current EU enlargement politics, we can see that the EU basically uses positive, \textit{ex ante} conditionality. This means that accession into the EU will only happen after certain criteria are met. This is the underpinning of EU policy and can also be called a bargaining strategy of \textit{reinforcement by reward}.

There is a number of conditions that are necessary for or will improve the working of the concept of conditionality. The most basic necessary condition is that there should be a \textit{power asymmetry}, for conditionality to work it is necessary that the rewarding party has power over the receiving party. Next to that it is of major importance that benefits should outweigh the cost. For conditionality by reward to work it is important that (at least in the eyes of the receiving party) the \textit{benefits exceed the cost} of living up to the criteria. If this is not the case there is no incentive to make the requested changes. Attached to this it is important that the incentives should be clear to increase effectiveness. The effectiveness of conditionality will also increase with higher size and speed of implementation of the promised rewards. This has also to do with the \textit{credibility} of implementation of rewards (Schimmelfennig and Sedelmeier, 2004).