Chapter 9

The Impact of Turkey’s Internal Economic Situation in 2000s on Its Foreign Economic Relations

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ABSTRACT

Turkey is an important country both in terms of population and geographical location. In terms of population, Turkey is the second largest country in Europe after Germany. Geographically, Turkey serves as a bridge between Europe and Asia. This feature enables Turkey to develop economic relations with a lot of countries and regions. However, Turkey has experienced negative results in the field of economics in many areas because of political uncertainty and government structure based on coalition and could not make full use of its potential for many years. After living one of the worst economic crises in history in 2001, the people in Turkey has decided to a government of one party than government based on coalitions. With the political stability, Turkey became a center of attraction in direct foreign investment and portfolio investment for both countries in the region and developed countries. Despite these positive developments, the greatest difficulty encountered in the economy in this period is the current account deficit problem.

INTRODUCTION

With a population of 75 million and a Gross Domestic Product (GDP) of US$786 billion, Turkey is accepted as the 18th largest economy in the world (World Bank, 2012a). However, Turkey has experienced very different economic and political periods on its way to earning this position. After the long-term state import-substituting industrialization strategy ended, in early 1980 the country became a primarily private sector, export-oriented nation. The 1970s were known as the “lost years” due to increasing political tension in society and unstable monetary and fiscal policies.

The problems in the balance of payments and the fall in the currency value in the second half of 1970 increased the pressure for liberalization in the economic system in the 1980s. In the early 1980s, the government gave the task of preparing a new economic program to Turgut Ozal who served as Prime Minister of Turkey. Ozal's economic program aimed at liberalizing the economy and reducing the role of the state in the economy. The program was successful in reducing inflation and stabilizing the currency. However, the program also resulted in high interest rates and a large current account deficit. Despite these challenges, Turkey continued to attract foreign investment and became a center of attraction for both countries in the region and developed countries. However, the greatest difficulty encountered in the economy in this period is the current account deficit problem.
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Minister during 1983-89 and as President in 1989-93. Under Ozal’s leadership, the government embarked on an economic program known as the “24 January Decisions” aiming at liberalizing the Turkish economy. Key parts of the program included the abandonment of the import-substitution strategy of economic development, the devaluation of the Turkish Lira (TL), the pursuit of exchange rates which more closely approximated those that would be determined by supply and demand in the market, tighter control of the money supply and credit, maintenance of positive real interest rates, decontrol of prices, elimination of subsidies, reform of the tax system, and encouragement of Foreign Direct Investment (FDI) in Turkey (Celasun & Rodrik, 1989). The 1990s may be referred to as the “lost years” with regards to banking and financial stability. The stabilization program conducted in the scope of an agreement with the International Monetary Fund (IMF) after the banking crisis in 1994 was not successful and so the economic crisis of 2001 occurred.

Turkey’s population and its geographical position give it an important opportunity to develop economic relations with many countries. Historically, Turkey has had intensive economic relations with the European Union (EU) which started with its application to the European Economic Community (EEC) in 1959. This application resulted in the so-called “Ankara Agreement” in 1963. In 1987, Turkey officially applied for full membership in the EU. As a first phase of integration with the EU, Turkey entered into a Customs Union with the EU in early 1996 which provided the EU with an opportunity to reach a wide market, while Turkey was able to resolve the structural problems of its economy. In particular, the Customs Union led Turkish firms to enter into a more competitive environment and encouraged these firms to produce high-quality goods by using advanced technology.

Increased relations with the EU have also led to positive developments in the political sphere. In the context of the full membership process with the EU, some harmonization studies in the strengthening of civil society, universal human rights, and further democracy have been conducted. Turkey’s geographical location has made it develop economic relations with many other nations and regions beyond the EU. After the collapse of the Soviet Union in late 1991, Turkey began to build economic and political relations with the Central Asian Republics called relatives communities. Turkey also plays a very active and leading role in many economic organizations such as the Organization of Islamic Conference, The Economic Co-operation Organisation (ECO), the Organisation of Islamic Conference (OIC), the Mediterranean Forum, and the Black Sea Economic Co-operation.

However, Turkey could not make full use of its potential because of political uncertainty and government structure based on coalition for an extended period during which issues such as high inflation, external debt, high budget deficits, and high current account deficit led Turkey to remain quite weak against internal and external shocks. After experiencing one of the worst economic crises in Turkey’s history in 2001, the people decided via general parliamentary elections in 2002 to elect a government of one party (the Justice and Development Party, or AKP), instead of one based on coalitions. That election caused some parties, which had a voice in the management of the country for a long time, to remain outside Parliament and brought significant changes in both economic and political arenas.

With a one-party government, the Turkish economy has achieved a high level of growth accompanied by gradually declining inflation. Many reforms including the banking and finance restructuring program have supported this growth. During this period, political and economic concentration has shifted from the EU to neighboring countries and the Middle East. With the political stability, Turkey has become a center of attraction for FDI and portfolio investment for both countries in the region and in developed countries. The success experienced in the economy was also reflected in foreign aid. Despite these positive developments, the greatest difficulty encountered in the economy today is the current account
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