9th Edition

ita-turk FORUM

Rome, November 12-13, 2012

UniCredit

SAM center for strategic research
Republic of Turkey Ministry of Foreign Affairs

Italy and Turkey as Mediterranean Powers: Seeking Joint Partnerships in the Neighbourhood

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Italy and Turkey share long-standing economic and political ties. During the Ottoman Empire, when the Turks became a naval power, they began to assume a significant commercial role in the area that had hirtherto been so important for the Genoese and Venetian maritime republics. Over the centuries, Italy and Turkey built important trade ties in the region and up until this day they continue to share complementary economic and political interests in the Mediterranean, as well as a common Mediterranean identity. It is against this backdrop that Italy is one of the most ardent supporters of Turkey's membership of the European Union (EU).

With the EU now deeply embroiled in the Eurozone crisis and with historical political upheaval underway in the Mediterranean, it is high time to take stock of Italian and Turkish common interests and activities in the Mediterranean, highlighting how these could be fostered through enhanced bi- and multilateral cooperation. This paper first analyses the general economic and political complementarities between Italy and Turkey in the Mediterranean in the areas of trade, energy, and security, before turning to specific opportunities and challenges presented by the Arab awakening and the Eurozone crisis. It then examines the prospects for joint Turkish-Italian partnerships in the Mediterranean, considering the economic characteristics of both countries. It concludes by arguing that the interests of both are best be served through re-energized cooperation, particularly in areas such as value chain enhancement efforts in selected industries and countries, bilateral design and a R&D foundation, joint funds for venture capital and private equity, and joint initiatives in selected policy areas.

Turkey and Italy: Complementary Powers in the Mediterranean

Turkey and Italy share substantial interests in key areas such as economy and trade, energy, as well as security, making it appropriate to define their relations as a potentially strategic partnership. From an economic perspective, Italy is Turkey's second largest European trading partner after Germany, and Turkey plays a strategic role for Italy's economy. Mutual trade has steadily increased over the past ten years, exceeding the 20 billion USD mark in 2011. Economic ties are solid, based on energy, defence industry, tourism, infrastructure, automobiles, and chemicals. Indeed, the backbone of the complementarity of their production systems is the vibrant dynamism of Turkish and Italian small and medium-sized enterprises, which, as explored below, should be further strengthened and extended to third markets as well. It is remarkable that Italian-Turkish joint ventures are currently working on building a metro in Warsaw, a new

airport in St. Petersburg and a highway in Oman.[1]
Turkey is also central for European energy interests. It is not only a significant energy consumer, but also lies at the heart of energy geopolitics, being a central transit state located at the intersection of the east-west and north-south energy corridors in the Mediterranean. Since Italy must import considerable volumes of energy, Turkish cooperation is a crucial component in the transportation of hydrocarbons from the Caspian sea and the Middle East to Europe. Its strategic position has helped Turkey to solidify its position in energy diplomacy and has provided the basis for implementing strategic projects. The completion of the Turkey-Greece-Italy Interconnector (TGI) in 2007 was welcomed for its sizeable impact on the amounts of gas transported through the Mediterranean. Vice versa, it is becoming a daunting task to achieve convergence of political will on the Nabucco project, which faces competition from its monopolistic rival, the Gazprom-ENI South Stream Pipeline.[2]
Besides economic and energy interests, Italy and Turkey also share security and strategic interests, underpinned by their NATO membership and engagement in operations in Afghanistan and Kosovo. Furthermore, Turkey and Italy have joined efforts in discussing key global issues such as reforming the UN Security Council to make it more reflective of shifting international power balances and developing new international summits with wider country representation. This is not to say that Italy and Turkey have always seen eye-to-eye on major international questions. Positions diverged over the 2003 Iraq war, over Israel, since the cooling of Ankara's ties with Tel Aviv, and on the Iranian nuclear file. The Arab Spring has led, however, to a re-convergence of views. Both Turkey and Italy support the democratic aspirations in the Mediterranean region and have worked shoulder to shoulder over the crises in Libya and Syria.

The civil war in Libya, where Italy and Turkey have historical ties, has seriously impaired both countries' activities.[3] Libya was Turkey's seventh largest trading partner in Africa and the 41st largest goods export market in 2011. However, the crisis took its toll on Turkish-Libyan trade, with a loss of about 1.5 billion USD compared to the level it would have reached in the absence of conflict. Also Italy suffered from the Libyan crisis, although it is now rapidly activating itself to revive a friendship treaty between Italy and Libya suspended during the 2011 conflict. The volatility of the situation in Syria displays similar affects, if not more serious. Due to the violent crisis, trade relations with Syria have suffered tremendously. Syria was Turkey's 22nd largest goods

1. *Diplomatic Source, Ankara*
2. *T. Umucu, M. Atunisik, V. Kok, "Turkey as a Major Gas Transit Hub Country" in Energy Sources, vol. 34, n. 4, 2011, pp. 377-384.*
   G. Winrow, "'Turkey an Emerging Transit State and Possible Energy Hub'' in The İnternational Spectator: İtalian Journal of İnternational Affairs, vol. 46, n. 3, 2011, pp. 79-91.
3. *A. Varvelli, "Italy and Libya: Renewing a Special Relationship" in The International Spectator: Italian Journal of International Affairs, 45:3, 20102, pp. 117-130*

export market in 2011. The crisis has led to a loss of about 600 million USD compared to the level it would have reached in the absence of the conflict.[4] A similar path was followed by Italy: the economic ties between Italy and Syria had grown stronger, but the outbreak of revolts has wound economic ties to a halt. In 2011, the value of Italian-Syrian trade amounted to 1.86 billion Euro, down 19% compared to 2010, while Italian exports to Syria totaled 905.6 million Euro, down 22.6% compared to 2010.[5] Political change and crisis in the Mediterranean has led to a high degree of uncertainty about the region's future. Hence, strong bilateral and multilateral cooperation between Turkey and Italy is an even higher necessity now.
Italian-Turkish cooperation is also warranted in view of the Eurozone crisis. The recent stage in the development of the Eurozone crisis poses various risks related to a decrease in Turkey's exports to Europe and a reduction of European FDI in Turkey, altering the nature of foreign capital financing the Turkish current account deficit, with a surge of volatile portfolio investments. Given the need for the Euro as an international reserve currency and the vital role of the European economic model in affecting and shaping the world economy, an appropriate management and solution of the Eurozone crisis is of the essence. In this context, Turkey can prove to be a valuable asset for the EU and Italy. While Italy is a medium-size power and remains the 8th economy worldwide but has a weak current economic predicament, Turkey is a rapidly emerging country, having become the 16th largest economy in the world that attracts billions of dollars in investment thanks to its internationally competitive companies. [6]

From an Italian perspective, Europe, with its ongoing crisis and ageing population, would benefit from accepting Turkey into its fold, in view of Turkey's young and dynamic population, work ethic and entrepreneurial spirit that lie at the heart of its stellar economic growth. For Turkey, the EU still represents the most important political and economic reference point. Turkish reformers still remember vividly that it was under the EU's impulse that Turkey engaged in the most radical and at the same time consensual reform of its political system. Many today yearn for the long-lost EU political anchor. Turkey's economy also continues to be intertwined with that of the EU. In 2012, the EU still represents 40 percent of Turkish exports and 75 percent of Turkey's foreign direct investment stock. Turkey will thus continue to represent an economic powerhouse for Europe; equally, its political and economic future will continue to be deeply intertwined with that of the EU.

4. *Republic of Turkey, Ministry of Economics, http://www.economy.gov.tr/index.cfm?sayfa=countriesandregions&country=SY&region=4*
5. *ICE source, http://www.ice.gov.it/paesi/asia/siria/index.htm*
6. *R.A. Del Sarto and N. Tocci, ''Italy's politics without policy: Balancing Atlanticism and Europeanism in the Middle East'' in Modern İtaly, vol. 13, n. 2, 2008, pp. 135-153.*
   E. Alessandri, ''Italian-Turkish Relations :Potential and Limits of a 'Strategic Partnership'"in Perceptions, Spring 2011, Volume XVI, Number 1, pp. 91-110.

Naturally, the best and only long-lasting way to reap the full potential of Italian-Turkish cooperation is within the framework of the European Union, and thus through Turkish membership into the EU. Not only will EU membership assist Turkey to successfully complete its democratization and modernization process,[7] but it will also allow Europe, with Turkey in its fold, to rise to the Mediterranean challenge in its neighbourhood. At the current juncture, however, the accession process is de facto frozen. At the same time, the Arab uprisings and the Eurozone crisis are raging on, suggesting that closer collaborative ties cannot wait. Developments within the EU and the Mediterranean have in fact created the conditions for strengthening economic and political synergies between Italy and Turkey to be reaped in the immediate future.

It is with this logic in mind that we argue that Italy - a traditional Mediterranean power and one of Turkey's principal allies in the EU - and Turkey - with its privileged relations with both the EU and the Arab world - should join forces to confront the Mediterranean challenge together. How could such a cooperation look like concretely to realize the transformative power of Italy and Turkey in the Mediterranean? Building on the complementarities just outlined, we now turn to a number of concrete project ideas.

Exploring Joint Turkish-Italian Projects in the Mediterranean

Today, conceptualizing and hopefully operationalizing a joint set of high impact projects is timelier than ever for Turkey, Italy, as well as the southern Mediterranean countries. Regarding Turkey, the reasons are obvious. Having reached 52 % of the EU-27 income per capita, Turkey now strives to reach 25,000 USD GDP per capita and become a 2 trillion USD economy by 2023, the hundredth anniversary of the Republic. However, making this leap will entail a different set of institutional structures and policies than the ones in place. For instance, in overall terms, Turkish industry can no longer compete with the low cost East Asian producers, nor can it come to par with the innovative, high quality and design-focused producers such as several Italians firms. In a nutshell, just like Turkey learned in the 1980s and 1990s to be open to the world, to export and to jump from being an agriculture and low tech economy into a medium tech one, it will now need to jump to the next level and learn to become a more innovative, high tech, high productivity and high income country.

Regarding Italy, the effects of the Eurozone crisis are highly visible. Despite its impressive capacity in design and creating global brands, productivity growth in Italy

7. M. Monti in "Turkey is a treasure for us", interview published by Yasemin Taşkın in Sabah, 8 May 2012. http://english.sabah.com.tr/national/2012/05/08/italys-pm-turkey-is-a-treasure-for-us

has been rather slow vis-à-vis other OECD countries in recent years. Italy faces the challenge of giving a boost to its competitiveness through reforming its labour and product markets as well as upgrading its innovation, education and public sector efficiency. Italy does not seem to have any serious problems in branding and quality, but its main bottleneck is on the cost side and in accessing new markets competitively.

Regarding the southern and eastern (extra-EU) Mediterranean countries, there are vast differences across their economies not only in terms of their structures but also in the extent to which political transformation is unfolding. Each country has its unique context that offers different avenues for Italian-Turkish cooperation. The Egyptian economy faces the daunting task of engaging in public finance reform, a gradual removal of subsidies, employment generation and enhancing connectivity; Libya and Algeria need to diversify their economies, focus on private sector development and - especially in the case of Algeria - strengthen the rule of law; Tunisia offers a significant growth potential provided that the business playing field is leveled, a clear industrial policy is pursued and that economic integration with its neighbours proceeds apace; Morocco needs to consolidate its competitiveness gains through better governance and ongoing economic reform; Jordan should capitalize on its competitive business environment by enhancing governance and tackling corruption; Israel, while possessing a high tech economy with a high level of labour productivity and R&D capacity, is penalized by its regional relations, including its worsened ties with Turkey; Palestine is persistently hampered by its non-state status with no cross border trade; and finally Syria, in the midst of civil war, cannot even begin to pursue feasible business-driven economic projects.

Just like Germany was the leading transformative actor in Eastern Europe's integration into the EU, Italy and Turkey can assume a similar role, together, for the Mediterranean's economic integration and transformation. Neither Turkey nor Italy can face this challenge alone and they would pursue their joint collaboration more effectively within an EU framework and by joining forces with other leading Mediterranean countries such as France and Spain.

To support economic transformation, a practical approach would foresee a focus on well-defined high-impact projects, as opposed to focusing on grand schemes. A joint action plan, supported by a concrete set of projects, could mark the beginning of a new form of Italian-Turkish cooperation in the Mediterranean. Both economies have not only a strong industrial base, but are also characterized by vibrant SME activity. They are similar, but also have a lot to contribute to each other. As outlined above, Turkey could gain from Italy's technical and design skills in the industrial area. Italian firms, in turn, could gain from Turkey's dynamism and entrepreneurial spirit especially when it comes to opening up to new markets. These gains could certainly be multiplied when building trilateral links with the Mediterranean countries.

Before listing a number of concrete project proposals, it is worthwhile to sketch some principles that could be used when prioritizing across different project proposals. Different priority levels could be assigned to each project proposal by Italian and Turkish authorities, depending on the extent to which these projects fulfill a set of jointly agreed selection criteria. At the outset, the following could be taken in consideration:

- ***Bottom up:*** Both Italy and Turkey should give priority to the needs of the Mediterranean countries in transformation. Italy and Turkey should benefit economically, but if this is the only motivation, participation of the Mediterranean countries may be limited. Often, when it comes to forging foreign economic relations in the region, decision-makers have the natural inclination to view the countries as markets rather than partners. To reverse this knee-jerk approach, efforts could be channeled towards first understanding local needs and then tailoring Italian-Turkish projects jointly towards these. From the design to the implementation stages, utmost attention should be paid to including all the relevant public and private bodies in the targeted Mediterranean countries so as to maximize inclusiveness and sustainability. Going from a bilateral to a genuinely trilateral approach is no easy task, but it is essential to change the landscape of the Mediterranean.

- ***SME focus:*** Selected projects should have an SME focus for a number of reasons. First, as mentioned above, both Italian and Turkish industrial bases are dominated by SMEs, which provide a solid potential for the involvement of many small and medium scale actors from both sides, hence democratizing the economic integration process. Second, paving the way for foreign SMEs will be the true litmus test for all Mediterranean countries in transformation as they reform their respective investment environments. Larger firms possess the financial (and often political) means to overcome policy uncertainties and business climate hurdles, while such bottlenecks crowd out the participation of smaller sized enterprises in most countries in the region. So, placing emphasis on SMEs in joint projects in the Mediterranean would be another way of improving investment climate reform in the countries in question. Lastly, if public funding is to be channeled toward these projects, eligible sectors should be well defined. Certain sectors are dominated by large actors and have relatively limited room for SME participation. For instance, military and energy, the two typical areas in which Italy and Turkey are already cooperating, can be assigned a lower level of priority to pave the way for other areas such as agrofood and machinery.

- ***Short term results, long term vision:*** The prioritized projects should deliver positive results in the short term in terms of creating positive expectations and generating political support. Ensuring visibility could be an important element for all projects and parties involved. The focus on the short-term, however, should not lead to a digression from a jointly defined long term vision. This vision may take the form of creating a diversified, competitive, and connected economic hinterland in the Mediterranean. The way to achieve this would entail enhancing and expanding regional value chains. Integrating the value chain of respective sectors in Italy and Turkey by encouraging SME linkages and then jointly expanding these value chains into the Mediterranean hinterland could constitute a joint Italian and Turkish long term vision. The projects could prioritized according to the extent to which they would contribute to the joint vision proposed above.

A final set of disclaimers regarding the operationalization of a joint strategy could be the following: (i) These projects can be jointly implemented by Italy and Turkey at a Mediterranean country level or through a multi-country approach. (ii) Each project idea should turn into a concrete project proposal after a thorough analysis of the Mediterranean country toward which the project is geared. (iii) If successful, a combination of these projects could also be turned into a programme at a later stage.

Project idea #1: Value Chain Enhancement Efforts in Selected Industries and Countries

Triggering business synergies between Italian and Turkish private sectors to jointly venture in neighbouring markets is an idea often cited by decision-makers from both sides. This is already happening in sectors like energy and infrastructure. Taking this joint potential to the level of SMEs and broadening the range of countries and industries where such joint projects are carried out would require a more targeted approach. The Global Business Bridges Initiative, which aims to support trilateral business undertakings between EU-Turkish and Egyptian/Tunisian/Palestinian companies, has exactly this approach. Italy and Turkey could undertake a similar and targeted effort in countries of strategic importance for both.

Going beyond narrowly defined sector definitions, which are often used when thinking of bilateral relations, should be the starting point. Indeed employing a value chain perspective could help the two sides leverage the potential compatibilities of different actors in different industries. We can take a core economic activity and cover its backward-forward linkages, its supporting and related industries. For example when we consider the "cheese" industry, its value chain potentially includes a wide variety of SME activities such as milk production, milk collection, packaging and its components, health and environmental standards, logistics, retail etc. With this approach it becomes easier to see where Italian and

Turkish firms or the local Mediterranean country SMEs can fit in this entire value chain. In identifying such value chains, it would be important to employ a bottom-up approach and to prioritize those areas with strong local economic capacity and growth potential, so we could maximize benefits for the domestic companies, and not only for Italian and Turkish firms.

The modus operandi of this project could be trilateral matchmaking events that would bring together companies from Italy, Turkey and selected Mediterranean countries. At later stages, more in-depth value chain analyses could be conducted to shed light on private sector performance gaps and policy related bottlenecks. At the country level, this project can be thought of as a "trilateral" cluster enhancement effort and the identified bottlenecks of these selected clusters could partially form the backbone of the new economic programmes in the region.

Project idea #2: Bilateral Design and R&D Foundation

This project idea aims to foster joint projects by Turkish and Italian companies in design focused manufacturing activities and high-tech industries. Turkey is at the juncture of its transformation from an efficiency-driven economy to an innovation-driven economy, in which active policies to promote access to new and more sophisticated markets is crucial. Turkey has emerged as a large and diversified manufacturing hub. Yet, Turkey's high-tech exports remain around only 5% as a proportion of its total exports. Italy, instead, enjoys a worldwide recognition of its design focused capabilities, but also performs relatively poorly in high-technology products exports.

In accessing sophisticated new markets in innovative high-tech products, Italian and Turkish firms would benefit from collaborating with each other. And this collaboration requires active intervention in matchmaking for joint design and technology development projects. Typically, the fixed costs of developing a product for the EU or American market dealing with patent and legal issues as well as customer development are too high for a Turkish firm. This is why market entry usually occurs with a local partner. But finding a local partner also involves high search costs. A binational matchmaking mechanism for joint product development would resolve this coordination failure. Such a mechanism would also be beneficial for Italian firms to enter into the Turkish market and markets around Turkey, in which Turkish SMEs enjoy a well-established presence.

In terms of matchmaking for joint product development, the Binational Industrial Research and Development Foundation (BIRD) between the US and Israel constitutes a successful example. Established in 1977, the BIRD Foundation provides innovative Israeli firms a shortcut to American markets. BIRD was established by the two governments to generate mutually beneficial cooperation between the private sectors among high-tech industries. Each government pledged $55 million to support non-defence related strategic partnerships between US and Israeli companies for joint product development in industrial R&D. In the BIRD model, typically a mid- to large-size American high-tech company would use its experience in product development and marketing in the US, while an Israeli start-up would bring a new technology. Similar tools were used in other countries as well, for example India, Ireland and Bulgaria. While these programmes provided some benefit, the key to the Israeli BIRD model's success is its focus on technology development within firms that directly target commercialization.

Project idea #3: Joint Funds for Venture Capital and Private Equity

As discussed above, all the southern Mediterranean countries currently face diverse but equally challenging economic transformation agendas. Helping this economic transformation is in the interest of both Italy and Turkey as expressed in many high level platforms. One of the critical elements is supporting the corporate sector's transformation. A viable way to do this is to support high impact entrepreneurship and fast growth companies. In this context, Italy and Turkey could jointly start a number of initiatives to foster not only high growth projects in the region but also to directly provide equity or debt financing to Italian and Turkish firms that do business in Mediterranean countries.

A number of caveats regarding the viability of this proposal include the following. First, different mechanisms should be in place for a venture capital fund targeting early stage entrepreneurs and for a private equity fund targeting established high growth companies. This is because these two fields require different types of expertise. Second, mechanisms need to be tailored based on the local contexts of Mediterranean countries as legal and commercial systems differ from one country to another. For instance different set of private equity investment teams are required for Egypt, which uses the British system, and Tunisia, which is based on the French system. Third, even though the proposed initiatives entail public funding from Italian and Turkish governments, funds must be managed professionally with minimal political interference. Large scale Italian and Turkish corporations that are already active in the region such as banking, energy and telecom companies could also join these funds as shareholders.

Project idea #4: Joint Initiatives in Selected Policy Challenges

A last set of project ideas could focus on policy related challenges in areas that are of concern to Turkey and Italy as well as the Mediterranean countries. At the outset, these areas could start with (i) green growth and energy efficiency, (ii) urban development and transformation, and (iii) skills upgrading and vocational education. All of these three areas are highly relevant for Turkey's own transformation process, i.e. in its move from a middle income / medium technology to a high income / high technology economy. Hence, projects could be first designed at a bilateral level between Italy and Turkey with a view to enhancing policy dialogue and learning between the two. At later stages, these projects could be both deepened to become programmes with project finance and also broadened to cover other Mediterranean countries.

Additional project ideas could easily be added this to tentative list. In turning these ideas into concrete project proposals, technical correctness, political feasibility and administrative implementability should be given utmost importance. We should also not forget that successful implementation of these projects in the complex setting of the Mediterranean countries in transition requires more art than science. Both Italy and Turkey should dedicate a high profile team of policy officials and experts to monitor and oversee the implementation process and make the necessary changes if needed.

As well-positioned players in this region, Turkey and Italy can do a lot to leverage their complementarities to contribute to the Mediterranean region's development. Doing so would assist Turkey to transform into a high-technology / high income economy, Italy to exit the crisis by deepening its economic outreach in Turkey and the Mediterranean and enhancing its productivity, and, perhaps above all, the Mediterranean countries to face the daunting task of their political and economic transformation. This low-hanging fruit eagerly awaits to be picked.

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