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TURKEY'S ECONOMIC OUTLOOK

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The macroeconomic situation: performances and shortcomings

1.1 **Salient features**

Turkey's economy displays a striking contrast between its remarkable vitality and dynamism on one side (high economic growth rate, buoyant manufacturing sector), and its deep rooted and dangerous weaknesses (inflation, public and foreign deficits) leading to a high degree of instability, on the other side.

According to OECD analysts, the knowledge of the economic situation is not as satisfactory as it should, and forecasts are particularly difficult due to the low dependability of the options expressed by the officials in charge of economic policy.

Political instability has strong repercussions on the economic life, and links can be noticed between political and economic cycles (periods of increased public spending, high deficits and high inflation lead to polical changes and an adjustment policy reducing the purchasing power of the people.)

The Turkish economy is now widely opened to the outside world, especially the European Union.

1.2 **A dynamic economy**

The average yearly growth rate of the Turkish economy over the last 15 years exceeds 5%. Considering the 2% demographic increase, per capita GDP growth is clise to 3%. After a sharp drop in 1994 (-5.5%), overall growth excceeds 7% in 1995, 1996 and 1997; the estimate for 1998 is between 4.7 and 6.4% . At current market exchange rate, the per capita income in 1995 reaches $2745, at Purchasing Power Parity, it reaches $5000, a figure close to half that for Portugal. The manufacturing sector production accounts for 22.5% of the GDP, and its share is increasing. Since 1995, the growth of exports is superior to 10% per year, and imports are growing still faster.

Following the liberal turn of the early 1980s, the Turkish economy is **opened to the outside world**, and tries to make the best use on foreign markets of its comparative advantages arising from low wages and a 50 years old industrial experience led by state-controlled entreprises. Two sectors are dominant: textile and clothing (37.5% of total exports), and steel products (10%). Industrial exports constitute 87.5% of total exports. The exports capacity however are very limited for high technology and fast growing industrial goods

The agricultural potential is important; Turkey is one of the very few globally self-sufficient Mediterranean countries. The agricultural production accounts for 15.6% of GDP, and over 45% of total employment. The agricultural employment is particularly high in the Eastern and Southern part of the country. The huge hydrolic projects in Anatolia (GAP) will significantly increase the agricultural output..

The private sector, despite the delays and the slow path of the privatization process and the still massive presence of the state in the economic life, is extremely dynamic and able to adapt itself and rapidly seize opening opportunities. Whenever administrative and bureaucratic constraints are too heavy, he strongly asserts its capacities and ambitions through the activities of a widely developed informal sector which, according to OECD's estimates, reach 30 to 50% of the dimensions of the formal sector.

Since 1990, **the Turkish Lira is totally and freely convertible**, and a partial dollarisation of the economy is to be observed. Dollars (and Deutsche Mark) deposits in Turkish banks sometimes represent more than 50% of the monetary circulation. In order to keep the competitiveness of Turkish goods on export markets, the authorities favour a systematic depreciation of the TL, the value of which tends to depreciates faster than the inflation rate would justify.

1.3 Severe weaknesses threaten the continuity of high growth

High inflation has been for long a serious problem for Turkey. During the recent years, the price level increases oscillate between 60 and more than 100%. The estimated inflation rate is 85.7% for 1997, and 80% for 1998. That such a high rate over a very long time span never degenerated into hyperinflation is a particular feature of the Turkish economy, not to be observed in other inflationary economies. Turkey has learned to live with a somewhat "integrated" high inflation, which makes particularly difficult to implement an efficient antinflationary policy as most of the influent social groups are able to protect themselves from the negative effects of inflation. Successive plans to curb inflation met rapid failure, and one can be skeptical concerning the issue of a june 1998 agreement between the IMF and Turkey pledging a reduction of inflation to 50% at end-year 1998 and 20% by year-end 1999.

One of the determinant cause of the persistent inflationary pressures is **the heavy public finance deficit.** The public sector borrowing requirements reach 8.6% of GDP in 1996, 9.2% in 1997, and despite strong commitments to a drastic reduction, the estimation for 1998 is 8.5%. The public account deficits, including Social Security, are financed through monetary creation, a part of which consisting in direct Central Bank advances to the Treasury, and by borrowing on the domestic market. The burden of the debt weighs very heavily on the budget, because of the extremely high interest rates on short term state bonds. (The average nominal interest rate on 3-months bonds in 1997 reaches 116%, the real interest rate attaining between 30 and 35%, debt service payments represented 10% of GDP in 1996). Far reaching tax reforms are a pressing necessity in order to increase fiscal revenues and to compensate the reduction in external duties following the implementation of the Custom Union with the EU.

The Balance of Payment is characterized by a sizable deficit of the Trade balance: $13Bi in 1995, $20bi in 1996, $15Bi in 1997, an estimated $13 Bi in 1998 ($42 Bi for imports, $29.2 Bi for exports). The UN embargo on Irak is estimated to have cost Turkey $30-$60 Bi in lost trade and foregone business opportunities through 1997. One of the many paradoxes of Turkey's economy is the absence of difficulties to reach an equilibrium of the global external accounts, despite the heavy trade deficit. Part of the explanation lies in the important surpluses of the services and transfers flows, with a favorable touristic balance, and important remittances from migrant workers. For 1998, the service surplus is estimated at $10Bi. Another factor is to be taken into account: the paramount role in the recent years of the so-called "shuttle trade". This applies to the non officially registered exports from Turkey of merchandises bought in huge quantities by "tourists" from the former Soviet Union and Estern European countries who sell them back home. IMF estimates give an approximate value of $8 to 9 Bi for those disguised exports in 1996. The present Russian crisis has a very negative impact on these activities, the decline of which may be accelerated by the devaluations of Eastern Asian countries currencies which can justify "touristic" trips in this region. The magnitude of the inflows of foreign currencies linked to drug traffic is not precisely known, but is certainly sizable.

Turkey therefore paradoxically combines **significant deficits and an abundant supply of external ressources**. The foreign debt estimation for 1998 amounts to $83Bi (25% short term), which represents 43% of GDP and 250% of the exports of goods. High real interest rates on foreign currencies accounts attract foreign capital, but volatile portfolio investments and short term loans are the overwhelming majority. Direct foreign investment in the productive sectors are scarce ($612 mi in net value in 1996 for a total long term capital flow of $2.818mi).The Turkish debt has been downgraded in 1996 by the rating agency Standard's and Poor, as it had already been the case in 1993. Globally, Turkey is considered as a high risk country by the international economic and financial community: the immediate cost is an high prices for borrowed financial ressources and the long term implication is the necessity of major structural reforms. It should be underlined however that to-date the Asian crisis appears to have had little effect on the "financially fragile Turkey" .

In the real sector, Turkey knows a significant unbalance between supply and demand in the energy system. Increasing power shortages have a negative inmpact on industrial production and on life conditions of the population. The importance of the energy question justifies a specific treatment in our presentation (See section 4).

Turkey suffers serious **inequalities in income distribution** and weaknesses in human resources development. The average income in remote provinces of the Eastern and Southeastern parts of the country is comparable to South Asian income, and only one tenth of that found in Istanbul and the Egean region, where the figure is nearing the Portuguese or Greek levels. The drift from the land is important: in the early sixties, 38% of the population was urban, to-day it is more than two third. On the average, urban revenues are much higher than the rural ones. During the recent years, an important share of urban incomes (over 24.5% in 1994), are made of rents and interests, expressing the magnitude of the financial transfers arising from high interest rates and masive state borrowing. The monetary rent attracts the entreprises and household savings to the detriment of productive investments. For the majority of the population, by contrast, the public provision of educational and sanitary facilities is considered by the OECD as quite unsatisfactory, a fundamental reorientation of public spending toward those sectors is an absolute necessity.

With its high rate of growth and its open economy, Turkey suffers from numerous **structural maladjustments** which accentuate the disequilibria inherently associated to any rapid growth process, and are the origin of violent political and economic fluctuations. The private sector is the spearhead of growth, but it remains strongly affected by the long lasting tradition of a state managed economy, the privatization process has to overcome powerful bureaucratic and political oppositions, the archaisms of the public financial sector and the lagging modernisation of the banking sector hamper the private sector initiatives, while the monetary financing of public deficits and the high rates of return on public bonds limit the funds available for industry. Genuine entrepreneurs are still a rarity, and the large dimension of the informal sector is a constraint on the strengthening of a modern export oriented economy with the capacity to produce high value added goods in high growth sectors. Presently, Turkey's economy is rather "ill specialised" and not very attractive for foreign direct investments.

1.4 Perspectives

Turkish economic growth is slowing down in 1998, but should probably still reach 5%. The question opened to forecasters is the nature and the path of the expected "soft landing" wich would result from the government efforts to reduce inflation and the public deficits. In june 1998, the Turkish government signed an unconventional 18-month agreement with the IMF in which Turkey pledged to cut its inflation rate to 50% by year-end 1998, and to 20% by year-end 1999. Under the deal, the IMF is to monitor and endorse Turkey's economic policies, while Turkey's government has promised to implement monetary, exchange rate and other economic policies (tax reform, reduction in subsidies), consistent with its inflation reduction goal. The speeding up of the privatization process might help to increase public revenues and thus reduce the deficits. Structural reforms are required in order to create the conditions for a more balanced economic growth. The main targets for reforms are the inefficient fiscal administration and the unjust tax system; the reallocation of public spending to increase investments in human capital; the acceleration of the privatization process wherever it is feasible; the improvement of the financial results of the state economic entreprises in order to reduce the budgetary supports; a complete restucturing of the social security pensions system which is quasi bankrupt. The implementation of this far reaching reforms program depends largely on the existence of a political stability giving a dedicated government the time required for success.

1.5 A synthesis of the main positive and negative factors in Turkey's economic conditions

Favorable factors Global Dynamism and high growth rates,
Big market potential (63 mi. inhabitants, 23 mi. active),
Geopolitical situation: access to European markets, links with "Turkish Asia", and Black Sea states, Arab neighbourhood (inescapable Irak reopening)
Industrial and agricultural high potential.
Often qualified manpower and low wage rates.
High adaptative abilities of the private sector.
A growing agreement on the necessary reforms

Negative factors

Political

Instability, lack of credibility and reliability and frequent corruption of the political class, (but a large political agreement on the economic policy to be implemented).
Islamic "menace".
Endemic violence, poor human rights record, Kurdish question
Negative attitude of the EU and Greek hostility

Social

Drift from the land and urban explosion
High demographic growth
Growing social inequalities
Underdevelopment of human resources.

Economic

Persistent high rate of inflation
Financial unbalances and negative role of the financial rent
Delays in the implementation of structural reforms.

Low level of productive investment and of foreign direct investments.

2 The relations between the European Union and Turkey

2.1 General framework of the relations

Chronology

1952 Through its membership in NATO, Turkey asserts its belonging to the Western World.

1959 Turkey applies for an association with the EEC

1963 Association agreement between the EEC and Turkey

1981 Greece's memberhip of the EEC

1987 Turkey's application for membership of the EEC. EEC aids to Turkey are suspended for human right reasons

1995 March. Treaty establishing a Custom Union between the UE and Turkey.

1996 January I the CU becomes effective

1997 November. The UE decides not to invite Turkey to begin membership discussions. (invited candidates are Estonia, Hungary, Poland, Slovenia, The Czech Republic and Cyprus).

1998 The CU is maintained, but political relations are frozen. The French Parliament "recognizes the Armenian genocide"

Institutions

The mecanisms instituted by the Custom Union Treaty are: meetings of Turkey's Prime Minister with the Presidents of the European Commission and of the Council of Ministers; frequent interministerial meetings within the framework of the Association Council, established in 1963, contacts between high ranking civil servants; the use of existing diplomatic channels. A mixed Consultative Committee (made of 18 Turkish personalities representative of the economic and social world and of 18 members of the European Economic and Social Council), meets at regular intervals. A meeting was scheduled last June 1998 in Ankara.

2.2 Analysis

221 Turkey's positions. When applying for EU membership, Turkey 's aims are both economic and political.

The economic objectives are to accelerate the modernization and rationalization of the economic structure, to help reduce macroeconomic unbalances, especially the high inflation rate, to enhance the international competetiviness of Turkish firms, to attract foreign investments, to "catch up" more rapidly with the Western Europe standard of living, to benefit from global and sectorial financial aids.

The political objectives predominantly express the point of view of the "laïcists", the modernizers and the advocates of a more democratic Turkey. They expect from the membership a decisive insertion in the Western World, the strengthening of "pro-west" political and social currents vis a vis the islamic threat, the international recognition of Turkey as an influent nation occupying a strategic position, an equal treatment with Greece. It is believed that 3 Turks out of 4 would favour the membership.

222 The positions of the Europeans

The gobal EU position. While admitting the necessity and the legitimacy of special relations between the EU and Turkey, (the aptitude for membership of which has been recognized as early as 1963), the EU has always expressed strong reserves toward Turkey's membership, and long delayed any direct and clear answer. The major official objections are the poor human right record, especially with regardsto the Kurd problem, Turkey's occupation of Northern Cyprus, the territorial disputes with Greece. On several occasions, the European Parliament has blocked the aids to Turkey to protest against the violations of Human rights. After its decision not to invite Turkey to begin mmebership negociatiopns in late 1997, the EU reaffirmed that Turkey is still "eligible" for membership, and should prepare its integration by positive moves in the controversial issues. Past commitments, the demographic, economic and geopolitical importance of Turkey necessarily lead to grant it a particular place in EU's post Barcelon "Renovated Mediterranean Policy ". The stake is high, particularly for the future of democracy in Turkey and the peace process in the Middle East.

The attitude of some EU members

Greece had been treated by the EU on an equal footing with Turkey until its rather unexpected membership in 1981. As a member then on, she adopted a policy of violent opposition to Turkey, which it often managed to impose to the Commission through the use of its veto right. All financial protocols, for instance, have been systematically suspended by the Greek government. A Greek animated "anti-Turk lobby" is very active in Bruxelles.

Germany, a country where lives an important community originating from Turkey, (more than 2 millions people, including a high proportion of Kurds,), is the most influential of the opponent to Turkey's membership. The human right question and the repression against the Kurds are a very sensitive issue in Germany. At several occasions, during the past years, the Government has imposed an embargo on arms sales to Turkey. Some German political leaders may be heard invoking the adamant obstacle that would represent the moslem character of the Turkish society. This vision of a "Christian Europe", is the object of violent criticisms from the Turkish government and opinion, which stigmatize an anachronic crusade, and denounce racist attacks against Turks in Germany.

Of all EU members, **France** is the more favourable to Turkey's membership. Beyond an historical reference to a more than 4 centuries old alliance, the central explanation is to be found in the French desire to compensate by an opening to the South the widening Eastward of the UE which is considered as excessively increasing Germany 's and other "Nordic" members' influence in the Union. Due to a growing interest for Turkey, France has become the second foreign investor in the country, and the number of French firms has increased from 7 in 1989 to 150 in 1997. One should notice however the presence in France of an influent community of citizens from Armenian origin: their intense lobbying has led the French Parliament to adopt in the spring 1998 a resolution "Recognizing the Armenian Genocide".

2.3 Present situation and perspectives

2.3.1 Of all non-member countries, **Turkey has the closest relations with the UE.** About half of Turkey's foreign trade is realised with the Eu, and there are numerous trade and exchange agreements, the most important of which is the Custom Union Treaty.

With 63 millions inhabitnts, Turkey ranks tenth among EU clients and the growth prospects for this market are promising.

The recent decision of the EU not to begin discussion on membership has greatly angered Turkey which responded by freezing all political relations with the EU as well as moving towards closer integration of the self-declared Turkish Cypriot state (recognized only by Ankara). By refusing the participation of the Turkish Cypriots to the negociations for Cyprus membership of the EU, the Turkish government can block those negociations. Meanwhile, Greece has vetoed some $400 m in EU aid to Turkey. The purposes of this money are to help Turkey become more competitive.

Economic relations, notwithstanding some Turkish menaces concerning the choices of firms elected after answering tenders for great public contracts, do not suffer too much of the deteriorated political climate, as the Custom Union, which came into effect on January I 1996, has not been suspended.

2.3.2 The Custom Union gives Turkey improved access to the EU member countries' markets (since a 1973 agreement, most Turkish industrial goods entered freely in EEC, to the major exception of textiles and clothing and of many processed agricultural products), and give EU countries full and free access to the Turkish market. It guarantees the free circulation of industrial goods and processed agricultural products. Customs duties and charges are abolished, and quantitative restrictions such as quotas are prohibited. The agreement covers all aspects of trade and commercial policy to ensure that there is a "level playing field" for Turkish and EU firms.

Among the main features of the Decision we find the following:

1 The elimination of customs duties, quantitative restrictions and measures of equivalent effect on trade in industrial goods, including processed agricultural products, between Turkey and the EU. The EU will abolish the Volontary Restraint Arrangements in trade in textiles with Turkey.

2 The adoption by Turkey of the EU's Common External Tariff in its trade with third countries.

3 Agreed competition rules and the alignment by Turkey of its legislation in the area with that of the EU

4 The adoption by Turkey of a legislation in the field of intellectual property protection to secure a level of protection equivalent to that in the EU

5 Grants to Turkey, as that was the case for other countries entering a Custom Union with the EU, of a structural aid (Euro 2 Bi in 5 years) to facilitate the adaptation of its economuy to the shocks of full open competition.

In a March 1998 Report, the Commission reaffirms its demands relative to the implementation by Turkey of "an appropriate economic strategy to improve the public finance situation, reduce the inflation rate and stabilize the curency". It denounces the persistently poor human right record. It tries however to introduce some positive perspectives by proposing the extension of the CU to so far excluded agricultural products and to services, and suggesting the development of a cooperation in such fields as energy, transports, communications and environment. Ankara looks interested, but somewhat skeptical on the reality of the intentions. The crisis in the relations between Turkey and the EU might be long lasting, and the systematically obstructive policy of Greece will not contribute to ease the tensions. This however will not endanger the general orientation of the Turkish economy and its quasi integration in the European orbit.

3 The Privatization process in Turkey

3.1 General Outlook

The drastic change in the orientation of Turkey's economy initiated in the early 1980s, towards a liberalized and open economy, required the implementation of a far reaching privatization process, all the more ambitious because the state presence in the economy was massive. A privatization programme was initiated in the mid-80s. The philosophy of the privatization was 1) to confine the the role of the state in the economy in areas like health, basic education, social security, national defense, large scale infrastructure investments 2) to provide legal and structural environment for free entreprises to operate and thus to increase the productivity and the value added to the economy by ensuring more efficient organisation and management in the entreprises that should be commercialized to be competitive in the market.

The major targets of the privatization are primarily:

To minimize state involvement in the industrial and commercial activities of the economy

To provide legal and structural environment for free entreprises to operate.

To reduce the financial burden of the Sate Economic Entreprises on the budget.

To transfer privatization revenues to the major infrastructure projects.

To expand and deepen the existing capital markets by promoting wider share ownership.

To provide efficient allocation of resources.

In 1984, the first regulation law on privatization was enacted. Between 1984 and 1996, 83 partially or totally state-owned entreprises have been privatized, the proceeds amount to $3.1Bi, but almost $2.5Bi had to be spent on privatization expenditures, especially on capital increase and loans, prior to sales. This is a rather disappointing outcome, as the global portfolio of entreprise eligible for privatization was estimated over $ 60 Bi.

To accelerate the privatization process, a new law was enacted on November 1994. The main objectives are:

To expand the scope of assets to privatize

To provide adequate framawork/funds/mechanisms to speed privatization and restructuring

To establish a social safety net for workers who may lose their jobs as a result of privatization .

To establish a special Privatization High Council (at ministerial level, it is the body in charge of ultimate decisions) and a Privatization Administration (the executive body) to facilitate decision making and the process of privatization.

To regulate the petroleum law in order to facilitate the privatization of related companies.

3.2 Delays and acceleration in the privatization process

The November 1994 law, which provided for the sales of 17 State Economic Entreprises worth $40Bi, constitutes an important step. The commitment of the successive governments to the implementation of the programme is not questionable. Privatizations , the structural changes and the financial resources they are bound to bring, are now a central piece in the overall effort to modernize Turkey's economy. They are an indispensable condition to finance major public investments which the state cannot fund through external borrowing due to its bad external credit.

The progress in the implementation of the programme however is rather slow, and in 1996 and 1997, the results are far below the anounced targets (the expected proceeds of privatization amounted at \$6.5Bi in 1997, the actual figure is less than half this sum). A positive step has been passed in January 1997 when the supreme Court rejected a claim against the privatization of Telecom, and the implemention of the programme has been stepped up. Numerous obstacles: political, judicial, administrative (for example the necessity to create a regulatory instance for energy or telecommunications), and financial are still to be overcome. It should be observed, furthermore, that privatization programmes are presently implemented in many countries and so competition to attract private foreign investors is severe.

The main economic sectors involved in the 1994 law are tourism, cement works, food processing, iron and steel, trade, banks, electric power production and distribution, oil refining and distribution, communication and telecommunications.

The cement sector is now completely privatized, and so are the ports authorities. Several banks and insurance companies are already privatized or in the process of privatization. Shares of Türk Telecom and licenses for mobile GSM telephones were put for sale in early 1998, \$3Bi were expected from 34% of Tûrk Telephon, and \$1Bi from GSM licenses. Tender procedures are proposed for various industrial concerns, from food processing to pulp and paper production or iron and steel), transport companies (the Turkish Maritime Lines, and THY, Turkish Air Lines), touristic activities etc. The drive toward privatization is of particular significance in the energy sector and will be presented in the last section of this presentation.

3.3 Perspectives on privatizations

The privatization process in Turkey looks an irreversible commitment. To meet a complete success, it requires an increased political stability which would favour the economic and institutional environment needed for the security and profitability of private investments. Foreign capital is bound to play a decisive role. In a globalized world economy, where the competition is fierce to attract Direct Foreign Investments, Turkey should provide itself with the economic structures and the social policy able to encourage investors and enhance the value of its comparative advantages, particularly its growth potential and its geostrategic position.

4 Energy questions in Turkey: the country as a bridge and as a terminal.

Energy is an outstanding economic and geopolitical issue in Turkey. An analysis of the main energy questions is therefore of special interest for its own sake but also because it provides a significant synthesis of most of the problems and perspectives bound to shape the economic future of the country. Two determinant aspects can be identified to sum up the fundamentals: 1) The Turkish demand for energy is increasing at a very rapid path, and the traditionnally dominant fuel (domestic coal and more specifically lignite), is quantitatively and environmentally unfit to satisfy the industry and population thirst for energy. 2) The geostrategic position of Turkey makes the country a potential bridge or crossroad between the producing zones of the Gulf and the Caspian and Central Asia, and the oil and gas consumers in Western Europe.

4.1 The main factors accounting for the **rapidly increasing energy needs** in Turkey are the high overall and industrial rates of growth and the rapid urbanization process. Energy consumption increases more than 10% per year, and electricity shortages are not uncommon even in the big cities. The massive utilization of energy inefficient and environmentally devastating domestic lignite adds to the acuteness of the energy problems in the country. A satisfactory answer to the demand for an abundant, environment safer and low cost supply of energy and particularly of electrical power is a major constraint for future economic and social developments.

Technically, the two main directions in the effort to build up an efficient energy system are the growing recourse to imported Natural Gas, and the speeding up of the increase in the counrty's power generation capacity. From an institutional and financial perspective, the privatisation of existing installations and the growing recourse to private capital and market incentives for new capacities are the dominant orientations.

Natural Gas (NG) has been chosen as the prefered fuel for the greatest share of the huge amount of new power plant capacity to be added in coming years. This make sense for Turkey for several reasons: environmental: gas is cleaner than coal, lignite and oil; geographic: Turkey is closed to huge amounts of gas in the Middle East and Central Asia; security of supply: it allows a diversification of energy sources, and Liquified Natural Gas may be shipped in addition to gas transported by pipelines; economic: Turkey could offset part of the cost of imported gas through transit fees it could charge for oil and gas transit; and political: Turkey seeks to strengthen its links with Caspian and Central Asian new independant states several of which are potential hydrocarbon exporters. Actual or potential sellers among Turkey's immediate or close neighbours include: Russia, Irak, Iran, Azerbaidjan, Turkmenistan, and more distant suppliers can be found via the utilization of Liquefied Natural Gas (LNG) chains. In 1996, NG accounted for about 14% of Turkey's total energy consumption, domestic production, and reserves are negligible, and nearly all of the imported 7 billion M3 come from Russia via a pipeline through Roumania and Bulgaria. Gas demand is expected to increase considerably in the near future; it may exceed 40 Bm3 before 2005, and raise to 60 bm3 later in the 2000's according to some optimisic estimates. Although Russia will remain a major supplier, and recent agreements will make possible a significant increase of Russian gas sales (through Georgia and Armenia, and through the Black Sea or Bulgaria), Turkey would like to diversify its import sources. An important and controversial (because of American criticisms) deal is a $23Bi, 23 years agreement for gas shipment from Turkmenistan via Iran, and from Iran itself (the annual delivery would reach 2 Bm3 by 1999 and exced 10 Bm3 by 2005). The supply contract will require the construction of three new pipelines in Turkey. Turkey would like to increase NG imports from Irak once UN sanctions are lifted. Botas (The Turkish Gas public firm) has signed an agreement with Irak for up to 10 Bm3 per year of gas. In addition to increasing NG pipelines imports, Turkey is considering increased imports of LNG to help meet higher projected demand. Under a 20 years agreement signed in 1985, Algeria is shipping abut 2Bm3 a year to a terminal in the Marmara sea; additional supplies of LNG are discussed or agreed upon with Nigeria, Qatar and Yemen. Deliveries from fields in Egypt's Nile Delta should begin in 2000, and talks have been initiated between Turkey and Egypt for the construction of a natural gas pipeline between the two countries under the Mediterranean.

Electric Power. With a young, growing and urbanizing population, low per capita electricity consumption, and strong economic growth, Turkey is one of the fastest growing power markets in the world. Turkey's electric power consumption estimated yearly growth reached 9% between 1973 and 1996 (twice the country's overall energy demand growth). Projections indicate that the demand for electricity will continue to grow at a high rate (8% per year) for the next 15 years. With shortages and blackouts already common (partly as a consequence of generation and distribution losses as high as 20%), increasing the country's electricity generating capacity is a top priority. Turkey may need to triple its total electric power generating capacity to around 64 gigawatts by 2010. (The present 21 Gigawatt capacity is 53% thermal and 47% hydro). Plans have been drawn to install 33 lignite-fired units, 27 natural gas-fired units, 12 coal-fired units, 2 nuclear plants and 113 hydroelectric units. This will require between $35 and $50 Bilion in investment over 10 years. Foreign capital inflows are an absolute necessity in order to finance those investments.

The liberalization, restructuration and partial privatization of the energy sector, especially the power sector, are considered an essential condition for the energy suply to meet demand. The privatization efforts in the energy sector, even more than in the rest of the economy have been delayed by the lack of political consensus and the legal debates in the Parliament and the Turkish Constitutional court. A step toward a more market oriented economy has been taken with the introduction on July 1st 1998, of a new price fixing mechanism for petroleum products aiming at the liberalization of prices and the suppression of the $40 per tonne state support to refineries. Privatization targets in the oil and gas sector include the state oil products distribution company Petrol Ofisi AS: (a 51% stake is sheduled for sale in 1998 and a further 21% in 1999), the Turkish Petroleum Refining company (TUPRAS) and the petrochemical company Petkim Petrokimikya.

For electric power generation, great legal and admistrative obstacles have to be overcome in order to attract domestic and foreign investments. Under the proposed legislation, energy production and distribution would be privatized, while transmission lines would remain state-owned. BOT (Built and Operate Transfer) schemes have been introduced in 1984. Under such a model, private investors build and operate private sector generation facilities for a number of years, at which point they transfer ownership to the state. Legal problems about the status of the agreeement have slowed their implementation; a call for bid for 6 BOT gas -fired plants of great capacity has been offered in early 1987. In 1996, has been introduced the BOO (Build, Operate and Own) financing model, under which developers retain the ownership of the plant and are given the option to sell the power to an end-user, to the state-owned electricity authority or directly into the national grid. Tenders for six "emergency " plants to be financed through BOO have been issued, the plants were to be commissioned between 2000 and 2005, but , again, administrative injonctions cloud the future of these projects.

4. 2 Turkey as an energy crossroad

As a land bridge between Europe and Asia, Turkey has sought consistently to make its geographic avantage serve the cause of domestic development. After the huge increease in oil prices in the 1970s, Turkey tried to persuade Middle East oil producers to use the country as a transit route for part of their exports. The only concrete results of this policy has been the construction and the doubling of capacity to 1.5 mbd of an oil pipeline from Northern Irak to Yumurtalik, in the Gulf of Adana on the Southen Turkish Mediterranen coast. Efforts or projects to build oil and gas pipelines from Iran and from the Gulf countries to Turkey did not materialise, due to political and economic obstacles.

Closed after the Gulf war, in 1991, the pipeline from Irak is presently used to transport part of UN-authorized Iraki oil sales.

The dissolution of the Soviet Union furnished new grounds for Turkish hopes to make use of the country's strategic location between the hydrocarbon rich ex-Soviet republics and the European energy markets. Building on geography and cultural affinities between Turkey and the new independent states, Turkish diplomats launched a campaign to route through their country the oil exports from Azerbaidjan, the oil and gas exports of Kazakhstan and the gas exports of Turkmenistan. The Turks pointed out the utility of offering a fail safe route limiting the present russian transit monopoly both for political and strategic consideration, and for avoiding the transit through the Bosphorus of the additional oil arriving in Russia's black sea port of Novorossyisk. This additional flow of Caspian and Asian oil would increase the already unacceptable ecological threat to the ten million inhabitants of Istanbul living on both side of the narrow Strait. This is a conflictual situation, since the Russians have recently protested that the new transit regulation imposed by the Turkish authorities violated the Montreux Convention ensuring unlimited free passage of commercial shipping through the Straits. The Turks have also to take into consideration a Russian plan to ship the oil from Novorossyisk to Bulgaria and and the Greek port of Alexandroupolis on the Egean. The Turks' preferred option is the construction of an oil pipeline from Bakou in Azerbaidjan to Ceyhan in Southern Turkey, the estimated cost is $3.2 billion for a 758-mile dual pipe. This plan is seconded by Washington which refuses to yield total control to Moscow over the hydrocarbon exports of the former Soviet republics. This route might be used to transport not only Azeri oil, but also oil exports from Kazakhstan, Turkmenistan and Uzbekistan, and via pipelines under the Caspian sea, to move gas from Kazakstan ansd Turkemistan to the West. Besides Russia's efforts to keep its monopoly, the Turkish ambitions of becoming a major transit route and collecting significant fees may be checked by the the possibility that most of the Central Asian oil exports take the much shorter route through Iran to the Arabo-Persian Gulf. The eventuality of such an occurence would increase with the probable improvement of the relations between Iran and the United States. Turkey's hopes of serving as the second, if not the first transit route or the Caspian and Central Asian oil and gas thus remain uncertain.

Annex Statistical overview

Area: 779000 Km2
Population: (1997 E). 64.1 million
GDP (1998 E.market exchange rate): $199.4 Billion
Real GDP Growth rate : 1996: 7.2%, 1997: 6.3%; 1998E.: 5.5%
Per capita GDP (1998E.): $3110
Inflation rate: (1997 E.):85%, (1998E.): 79.8%
Currency: Turkish Lira, exchange rate 8/31/1998: US$1=277800TL
Budget deficit (1998E.): 9.5% of GDP; (1999E): 7% of GDP
Current account balance(1998E) -$0.9 Bi
Merchandise Exports (1998E.) $29.2 Bi
Merchandise im iports (21998E.): $42Bi.
Merchandise Trade Balance (1998E.): -$12.8 Bi.

Main exports products: Textiles, (37.7%), iron and steel (10.4%) agricultural (11.7%).

Main import products: oil (10%), machinery (25%), chemicals (12%), iron and steel (10%)

Major trading partners: Imports: EU(52.8%), other OECD (16.1%), Saudi Arabia (4.1%).

Exports: EU (49.6%), other OECD (10.9%), MENA; East Eu. and FSU

Unemployment rate (1998E.) 5.7%

Foreign Reserves (4/28/98): $24.2Bi.

Total foreign debt (1998E.): $83 Bi