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TURKEY'S ECONOMIC TRANSITION AND TRANSATLANTIC RELATIONS

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P R O C E E D I N G S

MR. KIRIŞCI: Morning. If you will allow me, I'd like to give it just another one or two minutes. I hear there are people still suffering the consequences of the storm.

Well, then let me welcome you to our event on Turkey's Economic Transitions and Transatlantic Relations.

I'm Kemal Kirişci, the TUSIAD Senor Fellow here at Brookings, running the Turkey Project.

The event is based on this huge report. There are copies of it outside if you think you have the right biceps to carry it away back to your homes and offices. It came out in December, and I'm sure that the discussion we hope to have around it will be an enriching and a fascinating one.

Let me also thank you for being so loyal and braving the elements out there.

However, those of you who know me a little bit, I'm sure you will imagine the amount of nail-biting I have done, and I am so grateful to whoever has fixed the weather just enough for Martin's flight to manage to leave Istanbul Airport in the midst of a snowstorm and manage to make it here to Dulles Airport.

I'd like to welcome Martin Raiser, who is the Country Director for the World Bank in Ankara in Turkey. The World Bank recently has put out a number of very rich reports on Turkey, the one that I made references to but also an earlier one from last April about Turkey's customs union.

We also have Professor Sebnem Kalemli from the University of Maryland, professor of economics, as well as former Ambassador Stuart Eizenstat, who is now with Covington & Burling, the law firm.

I will introduce them in a bit more detail in due course. Allow me to make a few remarks about today's events.

News from Turkey these days are not particularly uplifting, to put it mildly, as only a few years ago the picture was a very different one. Today's leadership, today's -- Turkey's future today is tied up with the priorities and preferences of its current rulers. However, it's also -- its future is also closely linked to Turkey's economic performance.

The news, on the other hand, from the economic front continues to be, dare I say, a qualified promising one. You will find the details of it in the World Bank report, and Martin will shortly reflect on them.

From my personal perspective, the news is still promising because Turkey, contrary to what many people in Turkey think, by and large, has handsomely benefitted from the Western-led global economic order that was put into place in the aftermath of World War II. However, this took a while to take off. It had to wait until the 80s when Turkey's trade was liberalized and, maybe more importantly, the mid-90s when the customs union I made references to was adopted.

I am fortunate enough to have, first-hand, as a citizen of Turkey, watched and experienced those transitions that the report makes references to.

One of the parts of the report that brought me some of my memories back from my university years was the story, Martin, about *mavi* jeans -- *Mavi* is blue for, in English, blue jeans -- on page 63 if you're interested to read it for yourself.

In the early 70s -- 1970s, that's some time ago -- when I was at the university as a student and Turkey was solidly anchored in the Western alliance, the Turkish economy had more similarities to the ones in the Soviet bloc. Wearing a pair of jeans on my campus in those years was simply a sign of prestige. Today, as the report details, Mavi Jeans is a global brand.

Also, I learned driving in my old man's 1966 Chevy Impala, and at the time never would I have imagined that I would be here at Brookings but also see the streets of D.C. flooded with these small utility vans that are imported to the U.S. from Turkey.

Just to give you some additional examples of what that transition amounts to, Istanbul Airport, from where Martin took his flight, was, I suspect, no larger than 1/20th of what it is today. What distinguished it at the time was that when you cleared passport at Istanbul Airport and made your way to the waiting lounge, the boarding holes, you had to go through a very narrow, wood paneled corridor.

And at the end of those corridors, there was always very Soviet-looking officers, usually in civilian clothing, nastily eyeing the few passengers coming through, and then some would be hauled aside to check if they were carrying more than $200 that was allowed for Turkish citizens traveling abroad.

Now that has changed significantly.

At that time, foreign trade in Turkey was only 10 percent of Turkey's GDP.

Today, the picture is a very different one. Turkey trades extensively in manufactured goods with the United States and the European Union. Its traditional exports back in the 60s and 70s of hazelnuts, carpets, and pistachios only constitute a tiny percentage of that trade.

Turkey has also become a major importer of goods and services from the European Union and the United States. Today, foreign trade constitutes -- corresponds to 50 percent of Turkey's GDP.

And, much more importantly from my point of view, a lot of people move in and out of Turkey with very little harassment at all, if any paperwork.

When the Cold War came to an end in 1991, 2.3 million foreign nationals entered Turkey. In 2014, that number is more than 35 million, almost half the size of Turkey's current population.

I have no intentions of hijacking the show from Martin, but the report attributes to this massive transformation by referring to multiple transitions. I won't go into the details of it and flag out how the report notes -- goes into the details of these transitions, fascinatingly offers lessons to other countries that may wish to go through those transitions, but much more importantly, Martin, it also offers lessons to Turkey itself on what to do in the coming future.

One reason for doing that is Turkey, since 2007, appears to be stuck in what economics call -- economists call the "middle income trap," about $2,000 short from making it into the high income group of countries.

Turkey looks like a typical successful manufacturing economy of the 20th Century. But what should Turkey be doing to become successful in the 21st Century and make it into those first 10 economies that the leadership of Turkey today has promised to put Turkey in there by the centenary of the republic in 2023? I humbly would suggest that they heed to the advices embedded in the report.

Martin, I'd like to invite you to share the report's wisdom with us, and then I will turn the floor to Sebnem.

Let me introduce them very briefly.

Sebnem Kalemli, by a very nice coincidence, is the daughter of the Speaker of the Turkish Parliament in the very years when Turkey was liberalizing its trade and when the customs union was ratified in the Turkish Parliament in the mid-1990s.

We are also accompanied by Ambassador Stuart Eizenstat who also has a personal connection to that period. He was the American Ambassador in Brussels and played a critical role in giving -- in helping the customs union being put together.

And the Ambassador has also mentioned to me that he was at Brookings a while back, just after the Carter administration, and he is putting together a book on that.

Martin will reflect on the report for 15-20 minutes, and then we will have the responses from Professor Sebnem Kalemli and Ambassador Stuart Eizenstat.

I'm turning the floor, Martin, to you. Thank you.

MR. RAISER: Thank you very much, Kemal Bey.

And thank you, Professor Kalemli and Ambassador Eizenstat, for joining us.

Ladies and gentlemen, it's really a great pleasure to be here at Brookings to speak on this, on Turkey's Transitions and Turkey's Transatlantic Relations.

Now I'm going to focus my remarks on the first part of the topic, Turkey's Transitions, and then I hope that Professor Kalemli and Ambassador Eizenstat will bail me out and consider the second half of the topic so that you don't come in vain.

I do wonder whether we -- whether you're going to be able to see the slides that I prepared.

Are we going to be able to put them on? Great. Yes.

So Turkey's economic rise, as Kemal has already mentioned, has been a sort of inspiration for many emerging markets around the world. At the World Bank, we have hosted delegations since I arrived in Ankara from more than two dozen countries, from Mali to Malaysia, from Tunisia to Turkmenistan, and they're interested in Turkey's experiences from restructuring the banking sector, achieving universal health care, managing urbanization, or stabilizing public finances. So this is clearly a great demand out there for lessons from Turkey's transitions.

But, as Kemal also pointed out, as economic growth has slowed, and regional and domestic politics has become more turbulent, Turkey's star has dimmed in the past three years. Indeed, some worry that the country's commitment to free markets and democratic principles, which are key features of Turkey's appeal in Western capitals, can no longer be taken for granted. I'm sure this may be one of the topics for our discussion today.

But these concerns have hardly dented the interest of developing countries in learning from Turkey's experience. We may be worried about, or we may care about, the role of external policy anchors. But for a lot of emerging markets looking at countries like Turkey, what is really interesting is what were the domestic factors that led to this kind of transformation and what can they learn from it.

And it's against this background that we set out about 18 months ago to prepare a report on Turkey's transitions, containing the lessons we believed other countries might learn from Turkey but also analyzing the shortcomings that still stand in the way of Turkey completing its transition to high income and what are the lessons that Turkish policymakers need to take away from that.

So let me then, in the remainder of my remarks, summarize the key points of this book. Two key themes have dominated Turkey's recent economic history.

First, Turkey represents a successful case of economic integration. Economic liberalization has opened up opportunities eagerly seized upon by the private sector, and this has been a driver of growth ever since Turgut Özal's reforms in the early 1980s.

The second theme is the theme of inclusion. Socioeconomic differences have been narrowing between rich and poor, East and West, and men and women. Thanks to the fiscal windfall that followed the 2001 macroeconomic stabilization program, the Turkish government has had the money to spend on improvements in public services, and this has ensured that growing prosperity has been shared. A buoyant labor market has helped, too.

A third theme is likely to dominate Turkey's path toward high income -- the quality of its institutions. From the business climate to public finance management, from the regulation of public -- of infrastructure and PPPs to the allocation of land zoning rights, from intellectual property rights to contract enforcement and the rule of law, Turkey has yet to establish the institutional prerequisites of a high income country. This, in my view, is the main reason why many in Turkey worry about their country being trapped in middle income.

The structure of the book is easily followed on this slide. So the theme of integration is on the left; the theme of inclusion is on the right, four chapters each for the two themes, and then an overview or an outlook chapter at the bottom, talking about the "middle income trap" and the role of institutions.

Now I'm going to go rather quickly through a fair amount of evidence to substantiate the points I just made.

Let's first look at the overall outcome of Turkey's growing international economic integration.

After an extended period during which Turkey's per capita income relative to the EU, the blue line, stagnated and indeed relative to the U.S., the red line, declined, since the mid-1990s, there is a gradual reversal of that trend.

Turkey, like many other emerging markets has begun to converge towards income levels in the advanced economies. One could say Turkey has been a winner of globalization.

With economic growth has come a dramatic reduction in poverty rates.

Between 2002 and 2011, poverty fell more than by half, which counts among the top 20 percent of episodes of poverty reduction that we have tracked in the World Bank.

Likewise, Turkey's middle class, the chart on the right, has doubled over the last 20 years although, as you can see on this line, it is still slightly below what would be predicted as a result of Turkey's current per capita income.

Turkey's growth has overall been inclusive, and prosperity has been shared.

Now let me go through some of the main drivers of Turkey's progress over the past three decades, and let me emphasize that we are talking about the past 30 years and not just the period since 2002.

The success of Turkey today has many fathers, some of which probably sit in this room. It is not appropriate to divide the period up into neat political episodes, some of which were successful and others less. This is really a period of transition that stretches all the way back to the initial opening at the early -- in the early 1980s.

So, first, Turkey opened up to international trade in the early 1980s, when it was essentially a closed economy, which Kemal so colorfully described. Since then, its share in global trade increased by more than three times.

A customs union agreement with the EU, which entered into force in early 1996, played a critical role in Turkey's successful trade integration. For one, it anchored Turkey's external tariffs for manufactured goods, and this you can see here on the chart.

The black ones are the goods and services, agriculture and services, not covered by the customs union, and the black parts -- bars here mean tariff increases.

The gray bars are goods and services covered by the -- sorry. Manufactured goods that are covered by the customs union, and they represent tariff reductions.

What you can see on this chart, essentially, is everything covered by the customs union has basically ensured a low level of tariff protection; everything not covered by the customs union has seen tariff increases.

The second reason, though, why the customs union has been a very important anchor of Turkey's integration is that it has obviated the need for costly rules of origin that are typically the case in free trade agreements, and as a result, Turkey's trade with the EU, we estimate, has been 7 percent higher than it would have been with a free trade agreement. This amounts to a total of around 20 billion U.S. dollars annually at current trade levels, quite a very significant economic gain and one that is not sufficiently appreciated.

Finally, the customs union has also formed as a kind of -- has had the effect of a kind of institutional tractor beam on regulatory reforms and the nature of economic institutions. This surely is one of the reasons why we have seen such a dramatic expansion of FDI in Turkey after the conclusion of the customs union, three-quarters of the FDI being from the EU.

Since 2007, however, FDI has declined again, and one may ask the question whether the weakening of the EU anchor may be one of the reasons.

Turkey's banking system, which used to be the economy's Achilles' heel, has become the foundation of financial stability and a lubricant for private sector-led growth. After 2009, when European banks struggled to raise capital and, hence, retreated from their forays into Europe's eastern and southern periphery, Turkey was an exception.

You can see this here on the right-hand side. Banks going to Eastern Europe -- those are the green line -- deleveraged after the crisis, and funding going into the eastern and southern periphery declined.

The same banks, however, continued to lend to Turkey, and this is one of the main factors that has allowed Turkey to come out of the crisis relatively successfully. The stability of Turkey's banks was one main reason why they continued to be able to access funding.

Indeed, when I served as Country Director for Ukraine of the World Bank in 2007-2008, it was Turkey's management of its own financial crisis in 2001-2002 that we took as the model for Ukraine to emulate. Unfortunately, the work in Ukraine continues to this day.

If there's a hero of Turkey's economic rise, it is the Turkish entrepreneur. Battle-hardened by years of macroeconomic turmoil in the 1980s and 90s, Turkey's private sector has responded vigorously to the new opportunities that opened up as a result of European integration and political and economic stability.

Turkey's productivity growth since the mid-1990s has been higher than the average in the BRICS, and its export growth rate has not been far behind.

Productivity growth in Turkey received a big boost from structural change. In 1990, Turkey was still, by and large, an agrarian economy. Since then, the share of agriculture in total employment has more than halved while the share of industry has increased by 5 percentage points, and the share of services has almost doubled. You can see the shares in agriculture here on the right chart.

The shift of labor from agriculture into modern industry and services has been a key driver of productivity growth in a lot of countries, particularly in Asia. However, as Dani Rodrik, amongst others, points out, this is not at all an assured phenomenon, and therefore, why this was a positive factor for productivity growth in Turkey deserves some further investigation.

One reason why structural change contributed to productivity growth was that the movement of goods and services and people was greatly facilitated by investments in infrastructure. Today -- and you see this on the right chart -- Turkey is ranked in the top 30 countries worldwide in its logistics performance, a key to successful global integration and spatial development at home.

The private sector -- and this is another interesting lesson from Turkey -- has played a key role in improved connectivity. A long tradition with public-private partnerships and improved sector regulation, particularly after 2000, has compensated for limited fiscal space.

And Kemal was mentioning Istanbul Airport. The airport sector, or the airline industry, is one good example, much of it financed through public-private partnerships, very successful expansion of air freight and passenger travel.

But, as Turkey's ambitions have grown, so have the challenges of managing the risks associated with a large PPP pipeline.

Another reason structural change has gone hand in hand with rising incomes is Turkey's successful urbanization experience. Turkey's cities have grown faster than almost any other cities in the world, and its urban population has increased by 30 percentage points since the 1980s. Only eight countries have experienced a larger increase.

And in only a dozen countries -- and you see this on the left chart -- including Turkey, has increasing urbanization been associated with income gains per capita of more than 5,000 U.S. dollars.

The most dramatic transformation of Turkey's cities has incurred -- has occurred in secondary cities such Kayseri, Konya or Gaziantep, sometimes called the "Anatolian Tigers." A municipal regime that facilitated coordination in large metropolitan areas, settlement and housing -- and social housing policies, and infrastructure investments to connect the rural hinterland, have ensured that the rise of Turkey's cities has been a driver of both growth and regional convergence. And you can see the regional convergence on the right chart here.

But, as Turkey's cities become more congested, better planning is a must. The extensive powers of Turkey's public housing agency, TOKI, were expedient in the past. Today, they're an increasing source of urban discontent. A second generation agenda looms for Turkey's cities.

The next achievement is perhaps one of the great remaining puzzles of Turkey's recent economic history. At a time when leaders worry that the world is running out of jobs, Turkey has increased jobs and has created jobs by leaps and bounds. Indeed, since the economic crisis, since 2009, Turkey has added 5 million jobs to its labor force.

How did this happen? The targeted reductions in social security contributions after 2008 and a decline in the tax wedge may account for some of the shift in labor demand, and yet, this is probably not the whole story. There's also been a shift in the structure of the economy towards more labor-intensive sectors such as construction and agriculture.

The upshot of this rapid employment creation -- and, indeed, this is -- Brookings recently came out with a report on what are the 10 most dynamic cities in the world. Four of the most dynamic cities in the world are Turkish cities. The reason they are counted among the most dynamic cities in the world is because of employment creation.

But the upshot, as is very clear also in that Brookings ranking, is that per capita incomes and, indeed, per capita productivity or per worker productivity has not increased nearly as much as it used to. So you have massive employment creation but since 2009, essentially, flat productivity. This is a challenge that Turkey will need to address going forward.

But perhaps the most positive change in the eyes of many Turkish citizens over the past decade and a half, or so, has been the improved access to public services. First among them is healthcare. The introduction of universal health insurance and coverage by public health services has not only led to a significant reduction in the gap in health outcomes between the rich and poor -- and the poor. It has also been a major source of public support.

On the left you can see how the gap to the OECD average in variety of health outcomes has declined.

On the right -- and this is perhaps more important -- you can see how the gap between rural and urban, East and West, and rich and poor, has also declined. This is inclusion for you.

Turkey's success in the area of health care is an acknowledged international case study, and we use it quite regularly in advising on health reforms in other countries.

The story is similar, albeit much more controversial, in education. Between 2003 and 2012, Turkey improved faster than any other country on the OECD's PISA ratings. Moreover, the improvements in the average ratings are due mainly to the poorer segments closing the gap. Major reasons are to be found in the 1997 reform that lengthened compulsory schooling to 8 years and the measure to improve access, particularly among the poor, since.

Despite these achievements, Turkey remains behind most OECD countries in the quality of education. You can see the glass as half-empty or half-full.

Sadly, instead of focusing on the real challenge of improving quality, education has become the focus of political polarization.

Investments in infrastructure and municipal services, universal health coverage and improvements in access to education, none of this would have been possible without the stabilization of Turkey's public finances and the subsequent decline in public debt. Debt service since 2002 has declined by 10 percentage points of GDP while social spending, public investment, and other spending all increased substantially.

After a fiscal windfall lasting for over a decade, however, fiscal space is gradually eroding as entitlements have grown and discretion has crept back into the allocation of public resources.

Some of you may ask, having seen all of this evidence, whether I'm looking through rose-tinted glasses. In fact, I have no glasses at all.

All these achievements, in many ways, stand in contrast to the far more circumspect narrative about Turkey's future prospects that is prevalent in much of the current analysis both outside and inside the country.

Now let me try and bridge some of this apparent disconnect.

The doubts about Turkey's economic future are often summarized under the slogan of the "middle income trap," a slow growth malady that seems to afflict emerging markets just as they are poised to close the gap to the advanced economies.

Whether such a trap, in fact, exists remains debated. What is clear, however, is that few countries have escaped from middle income since the 1960s.

And, on this chart, middle income is essentially defined as having between 30 and 50 percent of the U.S. per capita income. Countries that are on the top in the middle are the countries that escaped from middle income by that definition.

In fact, the ones that did escape, the ones up there, either found oil, the

Gulf monarchies in particular, or had savings rates in excess of 30 percent of GDP, the East Asian Tigers, or are new members of the European Union either in Southern Europe or -- in the case of Ireland or, more recently, Poland and the Baltic States -- in Eastern Europe.

Now Turkey does not have natural resources. Its savings rate is one of the lowest among emerging markets. That leaves the uncertain prospect of EU accession. From this perspective, the debate about the "middle income trap" acquires particular salience.

Now what is clear to most observers is that the growth model of the 2000s, which relied on cheap financing from abroad to fuel domestic demand, has run its course. Cheap international liquidity, thanks to extraordinary monetary policies in the U.S. and the U.K. and, more recently, in Japan and Europe, have papered over a marked slowdown in structural and institutional reforms and losses in external competitiveness.

This is just a summary of the reform progress before the crisis in blue, and after the crisis in red, and you can see a noted slowdown in the progress of reforms. Macroeconomic volatility and pressures on the currency, whenever sentiment turned against emerging markets, have been the result.

The final chapter of our book is devoted to the challenges that Turkey faces in overcoming the "middle income trap." We identify three main priorities.

First, Turkey needs to find ways to sustain productivity growth once the benefits of reallocating labor from agriculture to industry and services peter out. Over the past three years already, productivity growth has been flat as the plentiful new jobs created have not always been of higher productivity. Key policy measures in this regard concern the business climate, the attraction of FDI, and the promotion of innovation.

And, just one vignette in the interest of time. With FDI inflows currently at around $12 billion, Turkey's share in global FDI inflows to emerging markets today is roughly the same as it was in 1988.

Second, Turkey needs at least to maintain the current pace of job creation to ensure that it makes full use of the double dividend of a young population and the growing labor force participation rate among Turkey's women, who have traditionally been mostly excluded from nonagricultural jobs. This means that more than one million new jobs need to be created each year, unlikely without much more flexible markets and without policies that help women combine family life and work life.

And men, I might add. It's, presumably, a burden or a challenge or a joy that is shared.

Third, Turkey will need to create the institutional prerequisites of a high income country. Around 15 years ago, a deep economic and political crisis catalyzed a series of deep institutional reforms such as the introduction of an independent central bank, independent regulatory institutions, fundamental reforms to public financial management, public procurement, and public administration, as well as the strengthening of individual rights and liberties. Unfortunately, these reforms have remained incomplete, and some have recently been challenged in the domestic political debate.

I want to end with a chart that summarizes this last point. This shows the correlation between per capita income and an average score of institutional quality derived from the World Governance Indicators that are compiled by Danny Kaufmann and his collaborators.

You can see that Turkey is not far from the level of institutional quality that corresponds to its per capita income. Moreover, up to a certain point, the correlation between the two does not seem to be very strong.

When you're a poor developing country, problems of health care, geography, access to infrastructure, lack of education, et cetera, may all be more binding constraints on economic growth than the quality of your public procurement system, the independence of a central bank, or an independent energy regulator.

But once countries have reached a certain level of income, around $20,000, not far away from where Turkey stands today, the correlation becomes a lot steeper.

Turkey's achievements in integration and inclusion remain noteworthy and contain rich lessons for many other countries, but Turkey will remain an inspiration only if it successfully tackles the challenge of building the institutional foundations of a high income country.

The fact that around half of the escapees from middle income since the 1960s have been EU member states, first in the South and then in the East, suggests the powerful role external anchors can play in guiding the necessary reforms.

Can a widening of the customs union or Turkish membership in TTIP play a similar role? Let me leave the answer to that question to my co-panelists and the subsequent discussion.

Thank you very much for your attention.

(Applause)

MS. KALEMLI-OZCAN: All right. Can I just like close this and then open?

MR. KIRIŞCI: Don't look at me when it comes to technology.

MS. KALEMLI-OZCAN: Oh, okay. Thank you very much.

I would like to start by saying -- thanking Mr. Kirişci and Brookings for inviting me to take part in this extremely interesting panel and on a topic that is dear to my heart.

I would like to also say to Martin that it was an impressive presentation.

I mean, the report is itself impressive. As you see, I read it, with my Post-Its and sticky notes. But this is not enough. I'm going to go through it again.

So it is full of like very interesting charts, figures, numbers, put together in an amazing narrative that is, as Martin put it, not just about like this government or that government but encompasses like the past five decades. So the report goes back to the 1950s.

It is extremely detailed, extremely comprehensive. So I can't say, you know, enough good things about it.

In fact, there is really no room for nitpicking, which is generally what, as academics, we do in our challenging roles. So I don't think I can be able to do that because this is a comprehensive report.

So, in my 10 minutes, I'm going to actually summarize key findings and then have a few comments relating to, you know, more to the international dimension of the issue, you know, kind of trying to tie it a little bit to TTIP but not as much. I'm expecting, you know, the other speakers to say more about that, but mostly to FDI and institutions and both financial and trade integration.

So the three key findings of the report, as Martin put it, are also the three pillars of the Turkish economy during the past decades, as the report puts it.

So the report is written from the angle like -- from this angle that there are these three pillars -- integration, inclusion, and institutions. And these also turn out to be the key findings and the key policy recommendations. So it is, you know, put together very wisely and intelligently.

Now if we start with integration, integration is about trade and financial integration of Turkey, mostly with Europe but also with the rest of the world. And this is a process that started with the open market policies, economic liberalization policies of later with Özal in 1980s, and this led to what Martin calls the private sector-driven development model of Turkey.

This is a development model that is not unique to Turkey. Actually, many emerging market countries that went through similar liberalization policies, open market policies, in 1980s adopted the same type of model.

Now, as you can see in my first figure -- and I'm going to use figures from the report and miraculously managed to actually decide on using different figures. So that's really good. So you'll be seeing more figures from the report through my presentation, but they will be different than Martin's with the exception of one, I believe.

This Figure 1, which is also the original Figure 1 in the report, shows you how much you can achieve with openness. Okay?

So this starts in 1980s, and you can see this is growth rate, simple GDP growth rate, something that we really focus a lot in terms of a country's economic success.

And Turkey is the blue bar, and others -- the others here are peers -- are the red bar.

Now, since 1980s, you see that Turkey is either at par or doing better than its peers.

But I would like to mention here the definition of the peers. These peers are also open economies.

So, if you do the same figure by using, you know, like Cuba here or North Korea, you would see that these open economies are going to surpass tremendously this type of closed economies.

So, in that sense, this figure is saying since 1980s, 90s and 2000s

Turkey did as good as at the minimum, and even more so in certain periods, compared to other open emerging markets like itself.

Now I would like to, of course, here take your attention to some -- you know, weaknesses come with the openness. The weakness that comes with the openness is what we would like to call in the economist jargon the current account deficit.

Now what is a current account deficit? So this is a figure. This is the original Figure 4 from the report in my talk. This is really a picture on trade. Okay?

So, share of global exports by Turkey. So, blue -- the dark blue is Turkey's global import share. Red is the global export share. And openness is kind of an index, the light blue.

But what you need to see in this figure is, as you see, the report put it as Turkey's rising global presence. Correct.

This is the first thing you need to see because, as you see, this share is going, you know, somewhere around like 0.2 percent to around 1 percent as a percent of GDP. You go from levels like 10 to 80. So this is very impressive. This is saying Turkey is becoming a more open economy both in terms of exports and imports.

The thing I would like to take your attention to is actually the fact that the dark blue is above the red. What does it mean the dark blue being above the red? Dark blue is, again, imports, and the red is the exports. So Turkey has been a country where imports are always more than exports.

What does it mean? That means what we owe to foreigners -- most of the time this is, you know, to Americans or Europeans because this is in terms of dollars or euros -- is more than what they owe to us, okay, in terms of the same currency.

So what this is saying is the other side of the amazing increase in trade -- you know, it is in the more form of imports than exports. That means this is going to create a current account deficit, which is also an imbalance, which is actually the key economic vulnerability for Turkey at the moment.

So why, again, this is important is because -- why this is typical is Turkey is not alone here. Many emerging markets that are growing at the speed like 4 or 5 percent are going to have a typical picture, meaning imports are more than exports, you know, leading to a current account deficit because these countries need to import to be able to export.

This is exactly why agreements like customs union and TTIP are very important -- because you have to, first, develop that pace to be able to produce things high quality enough that will move you up to the global value chain in various exports so that your exports are going to start, you know, surpassing your imports. To be able to do that, of course, first, you're going to import a lot in terms of raw materials, in terms of intermediate goods.

And that's exactly when oil prices go down; current account deficit improves. Why? Because a big part of that import is oil. Right.

So when oil is cheaper, that bill, like the total bill on the imports, is lower. So that's going to improve the current account.

But let me say that this is a chronic problem.

These things like oil price decline or when the United States Federal Reserve starts increasing the interest rates by 2015, you know, that is going to be expected to have a positive effect on Turkey's current account. Why? Because then the capital is going to flow back to the United States, out of emerging markets.

These things, you know, changes in oil price or another country having high interest rates like U.S., are short-term quick fixes to this chronic problem.

This is a chronic problem that has been fixed with structural reforms both on the export-import side, which is what I said, like you have to develop a pace where your exports are becoming more and more high quality, but on the saving and investment side, a point Martin made forcefully. You know.

So the other side of this identity is saving and investment. Right.

If your exports are less than your imports, that means your savings are less than your investment. Right.

Turkey is one of the -- you know, always has a kind of low savings rate.

So unless, you know, we find ways, policies, structural reforms, you know, that fix the savings and investment issue imbalance and the export-import imbalance, this problem is going to stay.

Now let me -- so this is, you know, part of the integration. I'm going to come back in terms of foreign direct investment and financial integration, but let me go first to the second key finding, inclusion, because I want to come back to FDI when I'm talking about institutions.

So, as I said, the first key finding is the integration.

The second key finding, inclusion. Here, the report underlines the importance of the regime change brought about by the 2001 crisis.

Let me tell a little bit about this 2001 crisis Turkey went through. This was a typical emerging market crisis, what we call a twin crisis.

What does it mean? It means your banks completely collapse and your currency tanks. Okay. This happened in East Asia. This happened in Mexico. This happened in Argentina. This happened in pretty much all the emerging markets in the last 20 years and, also, in Northern European countries known as the ERM crisis in the early 90s in Finland and Sweden and Norway.

This type of crisis is actually very, very detrimental. In fact, you know, this was pretty much the biggest one in Turkish history.

It is typical when countries -- emerging markets grow very fast, very sudden, under a fixed exchange rate regime, which was the case before 2001 in the Turkish economy.

What happened after the crisis is there was an amazing, very rigorous program on restructuring the banks and the public sector because the crisis had, you know, brought forth the bad debts of the financial system and the bad debts of the public sector.

And that's actually part of the IMF support, and there was conditionality. And that exactly had the very good effect of leaving these resources free, as Martin put it.

So because of the, you know, severe fiscal consolidation which, as we know, European countries are also going through right now -- you know, the buzz word is fiscal austerity -- the Turkish economy moved from servicing that public debt and banks moved from, you know, keep lending to government to banks lending to private sector, and government, instead of servicing that debt, servicing the public in terms of health, education and so forth.

So this was an amazing development, very welcome, but again, Turkey is not unique in that sense. This, pretty much, we observe after any emerging market crisis of this extent.

Now what I would like to take your attention to is although this money is used well -- I fully agree with Martin that a lot is spent on education and health -- there is still a lot to do. In my view, the two key structural reforms for the Turkish economy should be on education and on labor markets.

Let me tell you why first on education. As I said, many gains but not enough. So, by no means, I'm trying to say, you know, we didn't come from one point to another. We definitely, you know, came a long way.

But, as you can see in this chart, this is the share of labor force who had at least a secondary level of education. You know, Turkey is the last, and the country after Turkey will be China there.

And then you see the country that we keep hearing as Turkey should, you know, look up to and inspire to; Korea comes as the first country. Okay.

And then the little triangle is the young portion, 25 to 34-year-olds, and the rectangle is the old, 55 to 64.

So even you forget that. You say, okay, let's look at the future, the younger generations. We still have to improve this a lot, okay, meaning given that all that money well spent, freed from the public debt service after the crisis, and now that room is over, as we heard from Martin, fiscal space. Clearly, the government has to be really creative and needs to pick right policies to find more money to spend on education.

The second key structural reform in the sense, again, that we need, you know, government to spend is the labor markets.

Now the problem with the labor market is both the gender gap and the rigidity. Martin mentioned this a little bit, but let me just put this chart up because it is very telling.

The unemployment problem in Turkey, or the lower labor force participation compared to OECD, as you can see, is completely explained by the lack of female workforce.

The first, blue and red, is Turkey and OECD. So Turkey is blue, and OECD is red.

And then the total at the end is blue is Turkey; red is OECD.

And the middle two blocks -- blue is Turkey; red is OECD -- is the female.

So you can see the total labor force participation difference between Turkey and OECD is fully explained by the lack of women not working. This is not an easy thing to fix when it's combined with the rigidity.

I don't have the figure here, and Martin didn't show it, but it is in the report, that Turkey has the highest rigidity in OECD countries in terms of labor market.

What does it mean? It means it is the most costly to hire and fire people as opposed to, let's say, the United States who has very, very flexible labor markets. Europe also has rigid markets, but Turkey's markets are even more rigid, meaning it is very hard to hire and fire people.

When you combine that type of rigidity in labor markets, the fact that women are also not working, you have a problem, especially at the moment. Again as Martin put it, you know, fiscal space is now smaller. All that money that is saved by fiscal consolidation after the 2001 crisis is now spent. It is spent, again, well, but you know, now we have to come up with additional sources and right policies to fix the education and labor markets.

Okay. And then here I have to mention one more thing. In terms of education, Martin put it very well; we should focus not only on quantity but quality, meaning we should focus on content.

So it is not only about opening universities, providing more access, but making sure the content is there because one problem actually we keep hearing from Turkish businesses is the skill mismatch. And this is going to be a bigger issue if you want to talk about multinational companies, FDI, and which is going to be really related to the trade agreements.

We really want businesses to find the right skilled people. That means content of the education starting at an early age, but most importantly, universities have to be completely reshuffled.

And as somebody who taught both in American universities and in Turkish universities, you know, I can tell you that actually they have a long way to go. In fact, in the last five years the applications not only to Master's and Ph.D. programs in the United States but also to universities, meaning the undergraduate programs, have not quadrupled, increased five times, in the last five years. This is a very boring trend.

I mean Master's and Ph.D. program, yes. I mean, that was always a trend. But that increase and then, you know, the undergraduate applications also increased, which now we are having actually a very hard time to go through all these applications.

And the Turkish ones, pretty much, I go through since I know the university system there very well because I taught there for three years.

Okay. Now let me talk about the -- yes, yes.

Okay. So let me talk about my last point, yes, the last point of the report which is the third finding of the report, which is the institutions, fixing the institutions, and now what can we do there.

Here, I would like to say that actually this is another figure from the report, and you see Turkey is the red one and there are several indicators of institutions here. And then this shows that, with several indicators of all these countries, Turkey is always going to be in the mid-group.

So here, I would like to emphasize the report makes an issue out of that, saying this is a very serious issue because improving institutional quality -- things like rule of law and, you know, governance -- is going to improve many things.

But the report -- that's the one thing that I find really puzzling about the report -- doesn't go into details. So this is something easier said than done. Right? It is very easy to say yes, you know, clearly, we need to improve.

And we know from the literature that improving institutions is going to increase productivity, bring FDI. In fact, my research and many others show that the most important determinant of foreign direct investment is institutional quality.

And if you look at this figure, FDI is too little compared to other emerging markets. On average, it says 5 percent. This is Turkey's share among the group of emerging markets.

It increased after the customs union and came up.

It increased, you know, during the cheap global liquidity conditions when the developed world was in trouble after -- in 2000.

But now it is at a level where, as Martin said, pretty much the same level in 1980s when we started with all these open market policies. So this is very important, but you know, how to do it, I think, requires more thinking.

And let me finish with this last slide, which really requires further thinking. This is a very interesting slide that shows us a growth accounting exercise.

I'm not going to go into details, but growth accounting exercise pretty much takes your growth rate -- let's saying you're growing at 5 percent -- and looks at how much of that 5 percent is due to investment capital, how much of that 5 percent due to investment is human capital/education, how much of that is real productivity growth.

And you need FDI for that because FDI is going to bring you technology know-how. And you correspond from an economy of know-who to know-how, right, how to do things.

So that is the dark blue.

And when you look at that -- so the dark blue is like really the technology part, light blue is like the education part, and the red is the physical capital investment part. And the top is the overall growth.

The interesting thing is starting with open market policies, trade integration, financial integration, with Özal, that's on up to 1983.

And now, looking at -- forget the 1990s. Because of the coalition governments and the crisis, that's a lost decade.

And then the AKP Government, 2002.

It's pretty much the same. There's no difference. So which again says the importance of the open market policies, trade integration, financial integration, this type of policies, work. But you know, they can also hit the wall at some point if you don't pick the right policies.

So, in that sense it is very important to think further, especially at the moment like this. What can we do more now to get out of the "middle income trap" and to make Turkey a high income country?

To conclude, Turkey has come a long way. Picking the right policies in the next five years is critical for the journey. And I believe the key message the report wants to take us away from is really about that.

So we came a long way, we have a lot more to do, and we have to pick the right policies.

MR. KIRIŞCI: Thanks.

(Applause)

MR. KIRIŞCI: I would really like to thank Martin and Sebnem for having dissected the Turkish economy's transition in such detail, but one angle of it has been missing so far, and it's the external anchor part of it. And I suspect that it's the Ambassador that's going to reflect on it.

Ambassador Eizenstat, the floor is yours.

AMBASSADOR EIZENSTAT: Thank you very much, Kemal.

I think the presentations were just extraordinary.

I'm not an economist although some of my best friends are economists.

I spent six months here at Brookings after the Carter administration.

And my relationship with Turkey goes back a very long way, well before the customs union. As President Carter's Chief Domestic Adviser, we were involved in getting Congress to lift -- and it was a very tough lift -- the arms embargo on Turkey in the 1970s. And that began a process of more political and military inclusion, with Turkey being, of course, a valued NATO member and a stabilizer of NATO's eastern borders.

My theme is that there is a direct correlation between geopolitical relationships between the U.S. and the EU and Turkey and Turkey's economic reforms and its economic performance and -- and -- its commitment to the rule of law. The closer the relationship is, the stronger its economic reforms and its commitment to the kinds of structural reforms that have been described so well by our two previous speakers.

This does not mean that Turkey has to somehow lose its Muslim identity that it has to become a carbon copy of the West. These reforms can come arm in arm with maintaining its identity but making the kinds of changes that will integrate it more into the global economy and into the West.

My second involvement with Turkey after the arms embargo was during my tenure from 1993 to 1996 as the U.S. Ambassador to the European Union, and I was a very strong supporter and, if I may say, shaper of that customs union.

I traveled to Ankara and worked with our excellent Ambassador there, Ambassador Grossman, to help shape the customs union, to encourage Turkey's won government and parliamentarians to embrace it, and then when I came back to Brussels, worked with Turkey's extraordinarily able Ambassador to the EU, Cem Duna, who remains a very close friend of mine.

I testified before the European Parliament on the customs union and lobbied very actively with him. It was like my old days in the White House, going through checklists of members leaning positive, negative. We were extraordinarily engaged.

Why? Because we believed that anchoring Ankara in the West was critically important to Western interests and to Turkey's interests, that the closer they were to the EU, the more they would reflect the kinds of reforms that would be necessary to their progress and to strengthen our relationships.

And that relationship with Turkey continued when I came back to Washington. I had a succession of jobs. People said I couldn't keep a job. I was Under Secretary of Commerce and Under Secretary of State and then Deputy Treasury Secretary.

But when I was Under Secretary of State for International Trade, I worked with then the late great Commerce Secretary, Ron Brown, and we designated Turkey as one of the big emerging markets, which meant more than just a label, that it meant priority in terms of trade missions which I helped lead, encouragement of foreign direct investment, and it really tried to put Turkey on the radar screen of the American business community. Quite frankly, that kind of attention has waned.

Now the World Bank's report, which we've heard so eloquently described, has indicated that trade flows quadrupled since the customs union began in 1996 and that exports grew during the 2000s by 15.3 percent annually and its global market share also grew.

Three-quarters of Turkey's FDI comes from the European Union countries. Intra-industry trade between the EU and Turkey has increased some 30 to 50 percent since the customs union as trade costs have fallen and regulatory harmonization has increased.

It's estimated today that over 55 percent of European economic legislation is reflected in corresponding Turkish laws, a legacy of the customs union reforms which drove growth, investment, and economic integration.

Some 150,000 Turkish entrepreneurs employ 600,000 workers inside Europe. How many Europeans realize that? You can count them in a thimble.

Today, Turkey is the EU's sixth largest trading partner for goods, ahead of Japan and Brazil. Its exports, its economic diversification, and its productivity dramatically increased in the years following enactment of the customs union and then during the 2000s until the financial crisis. Trade with neighboring countries increased over 20-fold, and business and tourism travel to Turkey grew by multiples.

The customs union and early accession talks encouraged Turkey to become more open and to undertake serious reforms, benefitting the EU and neighboring countries.

The process of developing and implementing the customs union, and what started out as serious discussions on accession as it became a candidate for accession formally in 1999, generated substantial reforms, fast growth in exports in the EU.

Now with the recent turbulence in the Middle East, it is clear to me that Turkey is increasingly important but is at an inflection point in its own history. There clearly has been backsliding on democratic reforms with crackdowns on press critiques and the opposition.

I happened to be present at Davos in 2009 when the Prime Minister walked off the stage with Prime Minister Peres and came home as a hero.

The orientation of Turkey now is very much in flux. It remains a moderate, upper middle income, majority Muslim nation of over 75 million. But with the region in such turmoil, it is critically important that the European Union and the U.S. pay much greater attention to Turkey than we have.

How many of us realize that Turkey is deeply affected, for example, by the violence in Syria, Iraq, Afghanistan and Libya? By the end of this year, 2015, Turkey will host nearly 2 million refugees -- 1.7 million from Syria and 100,000 from Iraq, and thousands of Afghani, Libyan and other refugees.

We also urging -- and Turkey needs to do more -- to cut down on accepting oil from ISIS, which helps, literally and figuratively, fuel its terrorism.

The UN, by the way, gives Turkey high marks for meeting its refugee needs.

And just within the last week or so, when there were widespread protests against a brutal murder of a young woman who fought back against her attacker, it was very encouraging to see President Erdoğan issue a very positive statement about the scourge of violence against women.

It is in our deepest interest to engage Turkey intensively now, to find creative ways to revitalize and deepen our ties, but we have to do so being clear-eyed, realistic and tenacious.

First, we have to be honest that there's no realistic change that Turkey will become a part of the TTIP, Transatlantic Trade and Investment Partnership, negotiations. They're complicated enough as they are without adding any third countries, and if we added one, we would have to add multiple. But, as I'll talk about at the conclusion of my remarks, that doesn't mean that Turkey should be excluded from TTIP.

Second, there is no practical likelihood in the near term of Turkey immediately acceding to the EU. At the same time, as accession became more distant and less likely, in my opinion there was a direct correlation with backsliding on the kinds of reforms that our colleagues have talked about as being necessary on the economic side.

And with all the Islamophobia that is in Europe now, for reasons that are obvious, there are many in Europe who say this is the last thing we need.

But I say to you very strongly, and to my colleagues in the EU, that to send a signal that the door is forever closed would be a tremendous mistake.

Turkey first applied to join what was then the European Economic Community in 1959. 1959. Since then, the size of the EU has tripled.

Countries like Bulgaria and Romania and Croatia, which were far below where Turkey is economically, are now members on the theory that by including them it will lift their commitments to the rule of law, their economic reform.

I mean, were they really ready for EU membership when we see some of the problems in those countries?

But the concept was let's include them because it will elevate their standards.

They became an associate member -- Turkey has -- in 1963 when President Kennedy was President, with the Ankara Agreement.

Accession talks were launched in a serious way in 2005 and '06, and it's not coincidental that investment ticked up, reform-enabled growth strengthened, until the recession.

Only 1 of 38 EU chapters has been completed, 8 of the 14 chapters that have been negotiated have been frozen in 2006, over EU demands that Turkey provide customs union benefits to Cypress. Is that really so critical?

Only 2 chapters now, 23 and 24 on judiciary and fundamental rights and justice, freedom, and security, which require tough rule of law reforms, are slated for discussion.

The energy chapter is not even under discussion at all, at a time when Russia has reached out to Turkey and gotten it to accept a pipeline that otherwise would have gone through Ukraine, to deepen its energy relationship with Russia.

My goodness, where are we? What is our thinking?

There was a recent, quite recent Pew Center poll which indicated, interestingly, that with all of this, public support in Turkey for EU accession is actually increasing. I think because broad segments of the Turkish public see potential membership as enhancing regional stability and domestic reforms.

And the new government of the Prime Minister, the Turkish Prime Minister, has taken a positive public stance on EU accession.

Perhaps there's something between full membership with chapters including, for example, the free movement of people, and membership otherwise. I mean, if the British Prime Minister can talk about cutting down on immigration, maybe we should be thinking about a different relationship as well but one that brings Turkey closer to the EU.

The 2012 European Commission's positive agenda is designed to focus on common EU-Turkish interests.

There was a very welcome statement recently by EU Commissioner Štefan Füle, and he said it was important to keep the accession process alive and put it properly back on track after a period of stagnation, which has been a source of frustration for both sides. And one can only say "Amen" to that.

The EU's 2014 Progress Report on Turkey acknowledged substantial progress on a wide range of economic and political issues including refugees and regional security related to the EU accession requirements, along with, however, lapses of freedom of expression and good governance.

I think it would be a serious mistake for EU officials to emphasize the distance Turkey must travel to be "good enough" for membership rather than the distance it's already come. It's important to emphasize shared interests in actively promoting further reforms in Turkey. Everyone should understand that we're best able to minimize extremism and violence by supporting out partners and strengthening moderate politics and policies.

Europe and the U.S. share an interest in having Turkey's leaders embrace market-based reforms as we've seen here, but that's not going to come if they get the political signal that we really don't care about Turkey; indeed, we'd just as soon push them off.

We can't have it both ways. If we're going to help, as our two speakers have so eloquently described, having Turkey escape the "middle income trap," then we have to also embrace Turkey more closely.

So let me be specific as I close.

Number one, we have to communicate clear support for Turkey's efforts to gain future inclusion in TTIP after the negotiations, with an open architecture concept. Once we negotiate it, if others want to join and embrace those changes, even if it takes a long time for them to do so, we should encourage that negotiation. We should, in the meantime, keep Turkey informed of progress, if there is any.

Second, we should realize that the EU has a plethora of free trade agreements. They're closing one now with Canada. I mean more than the fingers on my hands and toes.

So why can't the EU do the following?

The customs union, which we've talked about, is actually a very narrow agreement. We made a big thing of it because it was a big thing.

But that was 20 years ago. It really basically only covers the manufacturing sector and fully processed industrial products from agriculture. It doesn't cover services. It doesn't cover agricultural trade.

Just think; if we now made our energy as part of this EU positive agenda to broaden the customs union to include services in these new areas, to show that we want an even further integration, it would do wonders for Turkey's economy and, may I say, also for the EU's as well, which could use some.

And perhaps that would then lead to a full-blown EU-Turkey free trade agreement. Why not?

If you look at some of the countries that the EU has negotiated free trade agreements, it's already got a customs union albeit not as broad as one would like. So perhaps one could shift as we make progress in broadening the customs union into beginning a process of FTA. That would send a very important, not just economic, but geopolitical signal that Turkey is considered to be part of the broader West, that it's desirable to have it as part of the West.

Next -- and this, by the way, could also include disciplines like public procurement and other issues -- we also should encourage Turkey's inclusion in the EU's energy community, which includes countries in Southeast Europe and the Black Sea, to promote integrated, sustainable supplies.

Last week, the Russians sought Turkey's agreement to advance the so-called southern gas pipeline as an alternative, as I mentioned earlier, to transporting Russian gas through the Ukraine.

Are we just going to sit there and let that happen without trying to counter it when there is a framework with the EU with the energy community and charter?

Next, we should support and encourage and accelerate discussions on judiciary and rule of law and capacity-building to meet the requirements of Chapters 23 and 24 to help unblock their accession progress. We should engage Turkey, in short, more vigorously on foreign policy, regional security, counterterrorism, including visas and migration which are also concerns to investors.

There is some hope, I believe. Quite recently, the EU -- a new EU External Affairs Commissioner, Frederica Mogherini, visited Turkey and said that it is critically important that we have a closer relationship between the EU and Turkey and that we, as she put it, align our foreign and security policies.

If that's really carried through, I really believe that we would see a repeat of the history from 1996 at the customs union to today and that that would be a stimulant to help them escape this "middle income trap," to take that next step, which our speakers have so eloquently aligned themselves with, and that it would be a stimulant and encouragement to do so.

So, again, the long and the short of it is geopolitical collaboration and cooperation can go hand in hand, and has gone hand in hand, with economic reform. The two are integrally interconnected.

Thank you.

(Applause)

MR. KIRIŞCI: Well, thank you very much, Ambassador.

I really feel myself very lucky that here I am in the midst of economists and a great diplomat, somewhat difficult for me because I've been a frustrated economist and I've been a frustrated observer of diplomacy as a professor of international relations.

But I think I am very lucky that I have witnessed so much experience, so much wisdom, and so much richness being shared with us.

I have many questions that I would have loved to raise with the panelists, as well as comments, but I have also realized that I have not lived up to my Swiss connections on my mom's side and almost run out of time.

We started a little bit late, and I'd like to plead with you to allow me to add just three or four minutes to our time allowed for this morning and turn immediately to the floor to take, let's say, three or four quick questions for the panelists to address.

Yes, sir. Yes.

Maybe two more from this side in the meantime, yes. Okay.

QUESTIONER: I am --

MR. KIRIŞCI: What is your name and institution? And try to be brief, please.

QUESTIONER: I'm Mahir Zunelo from *Zaman Daily* from Turkey. I have a question for Mr. Raiser.

As you may already know, earlier this month, Turkey's state insurance fund has seized most of the management of the Islamic lender, Bank Asya, which is linked to Gülen, the Turkish President's chief nemesis. Do you think it may somehow negatively shake the foreign investors at a time when there is a tremendous outflow of the FDI from Turkey?

Thank you.

MR. KIRIŞCI: Thank you.

Miriam, please.

QUESTIONER: Miriam Sapiro, Brookings.

Stu has done an eloquent job of laying out what the U.S. and the EU should want and should try to do although I suspect Turkey is far more interested in an FTA with the United States right now than with the European Union given the history of the enlargement process.

But my question is really for the other panelists. Turkey has a very strong president at the moment, with very strong views. What is your sense as to what Turkey wants?

How willing is Turkey to make some of the difficult decisions, politically and economically, that it would need to in order to have a much closer relationship and, ultimately, to move into the next income level?

MR. KIRIŞCI: Thank you.

Yes, ma'am.

QUESTIONER: My name is Lia.

And I hope when you answer her question I hope you address the issues of public-private partnership, whether it is 50-50 and who bears the burden of the final burden, whether that is taxpayers or general population or just a few corporations, multinational corporations especially.

And I also want to say if they can maintain their social and cultural strength, and I just wonder if that's possible that they can do it and maintain their fairness and consciousness rather than capitalism, which goes nowhere, maybe going down.

MR. KIRIŞCI: Many thanks.

There's one more question in the back there.

QUESTIONER: Thank you. It's Dana Marshall with Transnational Strategy Group.

Stu, I appreciate your comments about trying to expand an FTA between Brussels and Ankara although I think we're all aware that the Ministry of Economy has been talking about rather than to expand either to renegotiate or perhaps even to leave the customs union.

The question specifically, rather than the politics of that, is more the economic analysis. Has there been -- maybe Martin could answer this, or others. Has there been much economic analysis about the pluses or minuses of what it would mean for Turkey if they actually left in case there is a TTIP that is formed between the U.S. and the EU? From an economic point of view, is this a plus or not?

MR. KIRIŞCI: Thank you.

I think I'll turn to Martin. There are some good, tough questions there.

MR. RAISER: Look, on Bank Asya, I'm going to be a little diplomatic in my response quite simply because this is a case that is ongoing.

There is, you know, a regulation that allows the BRSA to intervene. They have explained the reasons for that intervention.

I am not party to the case. I have not studied the materials. And I think to have a view on whether this would impact confidence positively or negatively one really needs to look at the case in much more detail than we have done.

What I will say is the independence of the banking regulator, the independence of regulatory institutions more generally, is a very important aspect of Turkey's attraction to foreign investors. And, in that sense, strengthening that independence and completing regulatory reform remains a very important part of the policy agenda for Turkey.

What does Turkey want? I really think one needs to ask the Turkish government. I'm not going to sit here and try and interpret what the authorities would like.

But I do think, from a more general perspective, there is awareness of the challenges that Turkey faces to escape the "middle income trap." There's been a tremendous degree of effort gone into 25 transformation plans, a very detailed 10th National Development Plan. There are plenty of good ideas.

And I think there's a general sense that Turkey cannot rely on the past growth model to just keep -- you know, keep going.

Turkey, however, has had a series of elections, and as we know, during an election campaign, that typically is not the best time to implement very ambitious reforms although I would argue in many ways there may be more public support for difficult reforms than people in government believe. That is true in Europe. That's true in Turkey as well. So I think one could very easily go faster in implementation without jeopardizing electoral prospects, but I leave that calculation to the authorities.

And I do think there is a great degree of public support for a Turkey that is open, that is internationally competitive, and that is integrated in a positive and constructive way with international institutions and the international order, and that is despite of some of the rhetoric that would perhaps indicate differently. But I think that is very strong, and I think that makes me optimistic.

On public-private partnerships, who bears the burden? It depends very much on the deal. And a big part of being successful in managing public-private partnerships has to do with managing precisely that allocation of risk.

Sometimes a deal that looks like the private sector is bearing a lot of risk, on closer inspection, leaves all of the risk on the government and then is probably not a very good deal because the private sector walks away with all of the profit and the private -- and the public sector has to ensure the losses. That is not what I would regard as a positive public-private partnership.

But in a well-structured deal, the risks are evenly balanced, and the private sector takes the risks that they can, and the public sector takes the risks that the private sector cannot take, and then everyone is better off.

So there are very good models, including in Turkey, but there are also some indications of risks that remain to be addressed, including in Turkey.

Whether integration and identity can go hand in hand, I can only reaffirm what Ambassador Eizenstat said. I think the two are entirely compatible, and trading them off against each other is a grave mistake in my view.

And then finally, what is the impact of leaving the customs union? I think it would be disastrous.

The easiest way to explain this is the calculation I showed, that going from a customs union to a free trade agreement reintroduces rules of origin. The rules of origin are actually quite costly.

And one of the reasons why Turkey has benefitted from EU integration and manufacturing so much more convincingly than the rest of the Southern Mediterranean is precisely because the Southern Mediterranean was in an FTA that required very complex rules of origin. Because each of them had a bilateral FTA with the European Union but they didn't have FTAs amongst each other, it prevented regional integration. That led to a spaghetti bowl of regional trade agreements that has not been as successful as the customs union has been.

The customs union does not require these rules of origin, and as a result, the degree and the depth of integration is much deeper between Turkey's manufacturing sector and that in the EU, very similar to what you see in Eastern Europe.

However, as Ambassador Eizenstat pointed out, it is a narrow agreement and the benefits would be considerably larger if it were complemented with, say, a free trade agreement for services and agriculture.

But leaving the customs union, in my view, is of absolutely no economic interest to either Turkey or Europe.

And I think in Europe there is a certain degree of complacency with respect to Turkey's very justified grievances about the imbalances that are part of that agreement, and so when Turkish officials are claiming that they may consider even leaving the customs union, they reflect that sense of grievance.

And I think Europe should take that very seriously because these dissymmetries are a somewhat awkward construction and should be addressed. And they can be addressed. We have, in our customs union evaluation, made a couple of suggestions on how they could be addressed.

If they were addressed, I think you would have the benefit of a very strong agreement and the possibility to widen the agreement to include services and agriculture in ways that I think would have very positive economic impacts and maybe impacts that go beyond, as Ambassador Eizenstat pointed out.

Thank you.

MR. KIRIŞCI: Thanks, Martin.

Sebnem, really briefly. We're not at the university.

MS. KALEMLI-OZCAN: I just would like to say one thing. I mean, you know, Martin answered all the questions.

In terms of, you know, trade integration and FDI -- so, if you remember the figure I showed you, there were two increases.

Again, remember that, first of all, the share of Turkey in the FDI among the emerging markets is 5 percent, but there were 2 increases. Right. One is like this, and the other one like that.

The first one is after the customs union because trade integration is a prerequisite to FDI. Right. You just can't start FDI without first having trade integration.

And then when I said the most important determinant of FDI, with the prerequisite of trade, is institutions. That is the second big increase, which is the EU accession.

So I fully agree with the Ambassador in that sense.

So EU accession means an umbrella of institutions, a commitment to rule of law, which is what the multinational looks for.

Ninety percent of the world FDI is by U.S. and European multinationals. I mean, yes, China is a newcomer now, but even Japan is in the turn. So all FDI that you need in terms of know-how and technology is either going to come from U.S. or Europe.

Without that institution umbrella and without trade integration in that sense, forget about leaving customs union or any, you know, weakening relationship with trade. That's not going to happen.

Without that happening, you are not going to, you know, move up in the technology and innovation and productivity. So, without that, you cannot just move further.

There is no way you can get out of "middle income trap" without trade integration, without bringing FDI. That's not just going to happen.

MR. KIRIŞCI: Thanks, Sebnem.

Ambassador, the last words of wisdom.

AMBASSADOR EIZENSTAT: Well, they'll be the last words. I'll let other people decide if ...

I appreciate the comments that my dear friends, Miriam and Dana, made.

You know, when I was Ambassador to the UN, I was traveling around the then member states and trying to learn why there was this concern during the 1990s about Turkey's accession.

I remember very clearly being in Austria, and I asked the question very clearly, and they said, "Don't you know your history?"

And I said, "Well, tell me."

"Well, in 1389, the Turks came to the gates of Vienna."

And I said, "Yeah, but this is 1999." You know.

So memories are very solid.

But you know, this is not a joking matter because when I talk about Turkey being at an inflection point in the direction it takes I think the Western-Turkish relationship is at an inflection point.

And, my goodness, at a time when our relationships in the Middle East are in tatters, when our influence is lower than it has been in decades, with Turkey we have the opportunity to forge, as a NATO member, the kinds of deeper political and economic relationships which will be to the benefit of each.

Now maybe one of the ways that we can stimulate this, one of the ways we can make sure that not only does Turkey not withdraw from the customs union, which would be catastrophic, but that it is broadened, is to do the following:

First, for the EU, like now, to say that it's going to include Turkey in its energy discussions and, far from retreating from the customs union, to broaden it to include services, to include agricultural trade. I mean, this is an agreement that was done, you know, over 20 years ago.

I'm dating myself. Over 20 years ago.

And it needs to be modernized, and just the effort to do so would show an interest and attention.

And, second. And, second, I know Mike Froman has got his hands full with TPP and TTIP, but if we were to indicate our interest in beginning a process of an FTA with Turkey I believe it would encourage, as just a pure competition matter, the EU to do more on the customs union and maybe on free trade as well. This would be an area of some healthy competition.

But it all comes down to the bottom line of showing Turkey that we care, that we want Turkey to be part of the global economy, the Western economy, that it can keep and should keep its Muslim values, that those are not incompatible, and they have never been incompatible, with tolerance and democracy and empowerment of women.

And Turkey has -- you know, those charts may not be great, but they're a heck of a lot better than you'd see in most of the Arab World.

So that's really my plea. Let's pay attention to Turkey. Let's reach out to Turkey at every dimension -- economic, political, military, strategic. And we will find if we do so, I'm absolutely convinced, that there will be an acceleration of the kinds of reforms that my colleagues have urged as important for Turkey to take the next step.

MR. KIRIŞCI: Thanks, Ambassador.

I'd like to close the meeting by just remarking the other side of the medallion that the Ambassador emphasized. In Turkey, I think we need to recognize that being part of the West from the end of the Second World War has benefitted Turkey, thank you very much, and begin to dismantle the anti-Westernism that has become louder and louder recently.

I can't help but raise the question; if Turkey, in the late 40s, hadn't become a part of the Truman Doctrine, then IMF, OECD and other institutions, and had not joined NATO, in today's Middle East, where would we have been?

Egypt, I suspect, would probably have been the best option we could -- we can imagine about it.

And I'd like to close by responding to Miriam's very good question. Where does Turkey want to go?

The Ambassador made references to those surveys, public opinion surveys, and the message coming out of those surveys is extremely loud at a very important point in time, as you pointed out.

But the economy is also sending out the clear messages. From 2013 to 2014, exports to Russia have fallen more than 10 percent. To Iran, from 2012 to 2014, it has fallen by 60 percent. To Ukraine, not surprisingly, by more than 20 percent. To the European Union that is recession stricken, it has increased by 9 percent.

I think the message there is clear, and Miriam, I think that message is being told by the business world and the employment world there as well.

I'd like to thank you for your patience. And enjoy the rest of the day. Thank you.

(Applause)

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