



How Turkey's Economic Problems Affect Its EU Relations

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Improving relations with the EU is one element of Turkey's strategy to cope with recent economic problems. The aim is to increase investor confidence and mitigate the consequences of Turkey's disputes with the U.S. Improvement in relations with Turkey is in the EU's interest as long as it is not just an instrument in the hands of the Turkish authorities. It is important to focus the cooperation on common interests and signal the possibility of resuming accession negotiations only when Turkey decides to take real measures to meet the Copenhagen criteria.

Since the beginning of the year, the Turkish lira has declined sharply. In January, the exchange rate of 4 lira to \$1 was regarded as breaking a "psychological barrier". In May, the rate reached 4.93 to 1, and then in the first half of August, dropped to a record 7.24 to 1. Earlier, Goldman Sachs had noted that breaching 7.1 would be a serious sign that the threat of the currency crisis could turn into a banking crisis.

The main sources of the problem lie in Turkish politicians' preference for political goals over economic ones and in the weakening independence of the central bank (CB).¹ The exchange rate was also significantly influenced by the disputes with the U.S., especially the one revolving around American pastor Andrew Brunson, who was arrested in Turkey in 2016 and is being investigated for terrorism-related offences. The Donald Trump administration has been appealing for his release, considering him a political prisoner used by the Turks as an instrument of pressure on the U.S. in proceedings against Turkish bank Halkbank over circumventing American sanctions on Iran.² When the negotiations over Brunson failed, the U.S. imposed sanctions on two Turkish ministers and doubled customs duties on steel and aluminium imported from Turkey. This influenced investors to withdraw from Turkey, contributing to the weakening of the lira.

Turkey and its Economic Problems. Turkish politicians have made use of the U.S. actions to persuade their electorate that the Americans are the main source of Turkey's economic problems. They also argue that worries about the economy are unfounded and encourage Turkish citizens not to sell lira as a patriotic duty. The Turks have also sought to attract foreign funds, succeeding in a promise by regional ally Qatar to invest around \$15 billion in the country and receiving a loan of \$3.6 billion from the Industrial and Commercial Bank of China. Moreover, Turkish President Recep Tayyip Erdoğan has initiated an intense political campaign to convince Turkey's trading partners, including Russia and Iran, to conduct bilateral trade in their national currencies. He also argues that the U.S. currency has become an instrument of political pressure wielded by the American administration. In turn, Turkey's Minister of Finance and Treasury Berat Albayrak has stated that the country intends to limit state spending and guarantees the independence of the CB. However, since the CB had been unable to take enough measures to calm the markets, the government's assurances seemed unconvincing for investors. They reacted positively only in mid-September when the CB decided on a significant interest rate rise

¹ K. Wasilewski, "Turkey's Economic Problems before the Elections," *PISM Bulletin*, No. 78 (1149), 06 June 2018, www.pism.pl.

² K. Wasilewski, "Turkey-U.S. Relations Overshadowed by the Reza Zarrab Sanctions Evasion Case," *PISM Bulletin*, No. 123 (1063), 08 December 2017, www.pism.pl.

of 625 basis points. The “New Economic Plan”, announced by Albayrak on 20 September, was planned as another positive impulse for investors. In the plan, the country’s economic growth target was lowered to 3.8% in 2018 and 2.3% in 2019. Also, it was announced that inflation was expected to reach 20.8% this year and then drop to 9.8% in two years, and the current account deficit would be reduced from the current 4.7% of GDP to 2.6% in 2021. In addition, the minister said that Turkish authorities intend to help banks if they are in a bad financial situation. Yet, investors received the plan with reservation, arguing that the plan was sparse and more details are needed.

Europe, a Recipe for Trouble. Turkey is trying to improve relations with the EU to regain investor confidence and demonstrate that it is not alone in its disputes with the U.S. That is why Turkish politicians have limited their anti-EU rhetoric and have engaged in improving relations with Germany and the Netherlands. Manifestations of this trend include German Foreign Minister Heiko Maas’ visit to Ankara in early September and a telephone conversation between the Turkish Foreign Minister Mevlüt Çavuşoğlu and his Dutch counterpart, Stef Blok. As a result of the talks, both countries agreed the mutual return of ambassadors (absent since March 2017). Moreover, at the end of August, the first meeting in three years of the Reform Action Group, which deals with the harmonisation of Turkish law and EU standards, took place. Ministers of Foreign Affairs, Justice, Treasury and Finance, and Internal Affairs who took part in the meeting declared at the press conference that followed that Turkey intended to prioritise reforms related to EU accession. The efforts, they said, would focus on negotiating chapters 23 (justice and fundamental rights) and 24 (justice, freedom and security). Turkey has consistently indicated that opening these chapters could result not only in a revival of the accession negotiations but also in the improvement of the atmosphere of Turkish-European relations. However, since any real reform in these areas would undermine President Erdoğan’s power, change seems unlikely.

Hence, it appears that despite the positive actions and rhetoric towards the EU, a revival of the accession negotiations is not the real priority of the Turkish authorities. This may be clear also from Çavuşoğlu’s earlier declarations that Turkey is primarily concerned with the abolition of visas and the resumption of talks on reform of the EU-Turkey Customs Union. Both issues were listed in the statement published after the meeting of the Reform Action Group. The visa issue would be a substantial political win for Turkey’s ruling camp as it would not only be a positive signal for the electorate but also another sign for investors that Turkey is not alone in its disputes with the U.S. The customs union talks would greatly benefit the Turkish economy. It is estimated that reform of the Customs Union would result in additional GDP of around 1.5% (the benefits would be even greater if the EU and the U.S. formed a trade partnership in the shape of the recently revived Transatlantic Trade and Investment Partnership). Turkish exports to the EU would also increase significantly, according to some calculations, even by 70%. Thus, it can be expected that Erdoğan will make Customs Union reform a key topic during his visit to Germany on 27-29 September.

Conclusions and Recommendations. Turkey is trying to instrumentalise relations with the EU to improve its economic situation. The signals on the part of the Turkish authorities that they intend to resume reform as part of reviving accession negotiations should be seen primarily in this context. Given these circumstances, it would be beneficial for the EU to avoid a declaration about the possibility of resuming accession talks until Turkey makes real progress towards fulfilling the Copenhagen criteria, such as freeing imprisoned journalists, ensuring freedom of speech, liberalisation of the right of assembly, and improving court procedures.

Turkey’s diplomatic charm-offensive towards the EU, undertaken in light of Turkey’s economic problems and other factors, proves the importance of relations with the EU. The Union could benefit from the Turkish side’s apparent willingness to improve bilateral cooperation. It may consider changing the approach to reforming the Customs Union, making it dependent not on the rather unlikely progress on the Copenhagen political criteria but on, for example, guaranteeing the functioning of a market economy, cooperation in the field of migration and combating terrorism, or solving the Cyprus problem. The last issue is particularly important in the context of reports that Turkey plans to establish a naval base in the north of Cyprus, which would further complicate unification talks.

Turkey’s efforts to improve relations with the EU are positive for Poland. This limits the political cost of maintaining Polish-Turkish relations on good terms. In addition, Turkey’s demand for foreign capital creates opportunities for Polish investors. However, they must consider the risks associated with the still unstable lira and the prospect of aggravating the economic problems if Turkish decision-makers postpone structural reforms.