Introductory remarks

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Points on Enlargement - general

The EU's enlargement process has gained new momentum with the entry into force of the Lisbon Treaty: this ensures that the EU can pursue its enlargement agenda, while maintaining the momentum of European integration.

The EU's commitment to the enlargement process reflects the Member States' conviction that it is in the mutual interest of the Union and the aspirant countries.

The EU's enlargement process contributes to stability in Europe and to the security and well-being of its citizens. It provides a unique incentive for political and economic reform in the enlargement countries.

Enlargement needs to remain credible for all involved. Aspirant countries and their citizens need a clear perspective of accession, once conditions are met, and should see tangible benefits along the way. Member States and EU public opinion must be sure that new accessions are prepared well through rigorous conditionality.

Closer integration through the enlargement process helps the EU to achieve its objectives in a number of areas which are key to economic recovery and sustainable growth, including energy, transport, the protection of the environment and efforts to address climate change.

With the entry into force of the Lisbon Treaty, the EU has given itself the means to pull its weight on the global scene. In a world where emerging powers are playing an increasing role, enlargement gives the EU greater weight and strengthens its voice in international fora. As regards Turkey in particular, provided that the country's role in its own region is developed as a complement to its accession process and in coordination with the EU, it can add to both parties' weight in world affairs, not least in the Middle East and the Southern Caucasus. By acting together, the EU and Turkey can strengthen energy security, address regional conflicts, and prevent cleavages developing along ethnic or religious lines.

Turkey

Political

Turkey has continued its political reform process. Turkey amended its constitution introducing key reforms to its political and legal system which address a number of priorities in the areas of judiciary and fundamental rights. The reforms limit the competence of military courts; restructure the constitutional court; widen the composition of the high council of judges and public prosecutors, making it more representative of the judiciary as a whole; broaden trade union rights in the public sector; provide the basis for the adoption of special measures protecting the rights of women and children; guarantee protection of personal data; and grant the right to apply to an ombudsman, thus providing the legal basis for the establishment of the ombudsman institution.

The constitutional amendments are an important step in the right direction. However, broad public consultation involving all political parties and civil society, with their full engagement, is needed to strengthen support for constitutional reform. It is now essential to ensure proper implementation of these reforms through relevant legislation. A new civilian constitution would provide a solid base for a further strengthening of democracy in Turkey, in line with European standards and the EU accession criteria.

Regarding fundamental rights, freedom of expression and of the media needs to be strengthened in Turkey both in law and in practice. A number of shortcomings remain in the exercise of the freedom of religion. Progress is also needed regarding, women's rights and gender equality and ensuring full trade union rights. The 'democratic opening' aimed notably at addressing the Kurdish issue has produced only limited results.

As regards, *public administration reform*, some progress has been made with the adoption of the constitutional amendments, in particular towards the establishment of an Ombudsman institution, protection of personal data and access to information. Further efforts are needed in particular on reforming the civil service.

Accession negotiations advanced, albeit rather slowly. They have reached a demanding stage requiring Turkey to step up its efforts in meeting established conditions. By advancing in the fulfilment of benchmarks and of the requirements specified in the Negotiating Framework, Turkey will be able to accelerate the pace of negotiations. During the next months, Turkey should give particular priority to the *competition policy, public procurement* and *social policy and employment* chapters.

Economic

Macroeconomic stability

GDP contracted by about 5% in 2009, a sharp contrast to the 6% average annual growth rate in the period 2004-08 and the growth of 0.7% in 2008. Turkey's GDP per inhabitant stands at 46% of the EU average. The global financial crisis hit the economy hard dramatically reducing fixed investment and external demand. Fiscal and monetary stimulus measures combined with a healthy banking sector, helped cushion the blow. After a severe contraction in the first half of 2009, economic growth resumed in the second half and then gained pace in the first half of 2010 recouping the output lost in 2009. Domestic demand drove the fastest expansion in almost six years. Real GDP increased in the first half of 2010 by 11% from a year earlier. All sectors demonstrated strong positive growth: trade, industry and construction expanded by over 15% in the first semester of 2010. The Turkish economy has demonstrated high resilience. It is recovering rapidly from the crisis and growing at robust rates since mid-2009.

Pressures on the current account – which had seen a major crisis-led improvement – started in late 2009, as robust domestic demand and higher energy prices fuelled imports, which increased by 30% in the first half of 2010. In tandem with the rise in imports, exports performed relatively well and rose by about 15% in the first six months of 2010. Consequently, the trade deficit more than doubled passing from 3% of GDP in the first half of 2009 to 6.2% of GDP in the same period in 2010. The current account balance broadly shows similar patterns and the deficit is widening rapidly. External imbalances and financing needs have been growing significantly on the back of high domestic growth. Access to external finance remained unproblematic.

In 2009, the unemployment rate amounted to 14%. In tandem with the recovery, the unemployment rate declined to 11% by mid-2010 from 13% in mid-2009. The youth unemployment rate dropped faster, most likely due to the priority given to this segment in the employment package, to 20% from over 24% in July last year. Female employment remains particularly low, at just half the overall rate. The prevalence of undeclared work remains a crucial issue.

Annual inflation was 6.3% in 2009. Between November 2009 and April 2010, inflation rose from 5.1% to 10.2% before falling to 8.3% in August, reflecting large volatility in food prices. The central bank expects inflation to fall towards the end of 2010, although it is unlikely to reach the central bank end-year target of 6.5%. The Turkish central bank is looking ahead to a period of strong growth and has announced plans to roll back the extraordinary measures put in place during the economic crisis in 2009 and to inject less liquidity into the market. Price stability worsened, chiefly because of pressures stemming from energy and food inputs and buoyant economic activity, triggering a tighter monetary stance.

Turkey's fiscal consolidation over the past decade was very significant as, in the wake of the 2001 financial crisis, the government managed to cut the public debt to GDP ratio from a high of over 70% in 2001 to less than 40% by mid- 2008. Structural loosening as well as cyclical factors weakened the fiscal balance from mid-2008 to mid-2009. The deterioration in public finances accelerated as fiscal measures to stimulate economic growth**,** equivalent to about 5% of GDP over the period 2009-2011, were taken to minimise some of the adverse effects of the crisis. They appear to have successfully propped up private consumption and are being phased out gradually. But they also caused the budget deficit to soar from 2.2% of GDP in 2008 to about 5.7% in 2009. So far, the budget performance has improved in 2010. Budget realisation in the first six months of 2010 was much better than anticipated, as strong consumption is leading to higher tax revenue performance (up 20% year-on-year). Subsequently, in the first half of the year, the budget deficit declined significantly to only about half last year's. The exit strategy was less visible on the spending side, as real expenditure remained at the same level as in 2009. Although the anti-crisis measures have cushioned the economic downturn, they must be exited in a timely fashion and targeted in order to lay the foundations for strong, sustained and balanced growth.

The Public Financial Management Law was supposed to be implemented between 2007 and 2010 and to make Turkey's public finance administration broadly consistent with EU standards on internal controls. However, three years after the adoption of the law, the accountability, efficiency and transparency of the budgeting process would benefit from a modernisation of the public audit, while the adoption of the State Aid Law establishing the State Aid Authority would contribute to less opacity on state aids in public finances. The unification of all tax administration functions under the Revenue Administration announced earlier has not been implemented in full. This unification would strengthen the audit capacity and facilitate greater use of standard risk-based audit techniques, thereby enhancing transparency and providing significant support for reducing informality.

Over the last few years, Turkey had successfully implemented a strong stabilisation programme and the resilience of the Turkish economy had benefited from in-depth structural reforms in many key areas, including banking, restructuring of enterprises and privatisation, education and energy. Although the financial crisis has hit the Turkish real economy hard, the earlier regulatory and supervisory reforms have paid off and growth resumed rapidly and strongly. Turkey's fiscal and monetary policy mix proved successful during the crisis and adjustments are being made in order to benefit from the recovery. A new draft law establishing a fiscal anchor that has potential for considerably improving the fiscal performance over time, as well as removing the current pro-cyclical bias of fiscal policy, was submitted to parliament in mid-July, but its discussion was postponed. Making more progress with fiscal transparency, strengthening the inflation targeting and preserving financial stability will be important to minimise the risks of a boom-bust scenario.

Market entry and exit

In 2009, the economic circumstances had a major impact on market entry and exit. The number of newly established firms decreased by 10%, while the number of firms which were closed down increased by 8.5%. Foreign owners still face restrictions in various areas, including maritime transport, civil aviation, ground-handling, road transport, radio and TV broadcasting, energy, accountancy and education. Licensing procedures are relatively lengthy. For example, 25 different procedures are still needed in order to build a warehouse, from securing licences and permits to completing the necessary notifications and inspections and obtaining utility connections. Market exit is difficult too, as closing a business still takes 3.3 years on average. Moreover, claimants recover only one fifth of their claims from insolvent firms. Market exit procedures remain relatively cumbersome. The crisis had a negative impact on the number of newly established firms.

Legal system

Turkey has established most of the legal framework of a market economy, but must ensure further implementation. A reasonably well functioning legal system, including in the area of property rights, has been in place for several years. Registering a property requires six procedures and takes six days in Turkey. However, enforcing commercial contracts remains a lengthy process, which involves 35 procedures and takes 420 days on average. The specialisation of commercial court judges is insufficient, leading to lengthy court proceedings. The expert witness system still functions as a parallel judiciary system, without improving the overall quality. Use of out-of-court dispute-settlement mechanisms remains low. The legal environment, in particular court procedures, continues to pose practical challenges and create obstacles to a better business environment.

Conclusion

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