

M. Erkan Üyümez / Canatay Hacıköylü (eds.)

Current Debates on Public Finance

Theory and Practice



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Özlem Genç¹ & Özlem Atay²

EU Anchor, Turkish Governance and Economic Performance

1. Introduction

Institutions play a crucial role in economic growth and development of a country. Inclusive and extractive institutions approach developed by Acemoğlu and Robinson (2012) states that while inclusive institutions contribute to economic growth positively, extractive ones have damaging effects on the economy. In this context, governance emerges as the main element, wide-ranging repercussions of which affect the economy and well-being of citizens positively. Common aspects of governance are maintaining rule of law and democracy, establishing a participatory and inclusive governance approach and combatting corruption. Transparency, accountability, equitability and responsibility are prerequisites for good governance.

International organisations such as International Monetary Fund, the World Bank and the European Union have attached great significance at the concept of governance. Particularly, the European Union, by exerting great influence on its partnership relations makes effort to impose good governance. The model based on Copenhagen criteria in the process of admitting a new country to the Union, entails the country in question to comply with rule of law, free market economy, and the ability to take on obligations of membership.

Outcomes of Turkey–European Union relationship have been the establishment of customs union and negotiation process, both entailing regulatory requirements. In terms of Turkey's expectation to become a member, the status of affairs has been unsatisfactory, somehow had transformative effects on its institutional structure and governance.

The main hypothesis of this research is that the period in which Turkey has had close relationship with the European Union has contributed to economic performance through governance; on the other hand, derailing from the

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European Union process has had negative impacts. Apparently, the European Union process together with agreements with International Monetary Fund and World Bank have been instrumental as double anchors. Implementing rule-based decision making by founding autonomous authorities independent from political pressure, enacting disciplining laws have been consequences of the process, culminating in high growth and attracting foreign direct investments. Setbacks from reform process, conversely, have given rise to decadence of governance and economic performance. Quality of growth has deteriorated and foreign direct investments have contracted.

In the context of this research, literature on governance and economic performance is analysed, the effect of the relationship between Turkey and the European Union on Turkey's economic performance is evaluated by analysing European Commission's Progress Reports on Turkey and World Governance Indicators data released by the World Bank.

2. Literature Review

Institutions are known as "the rules of the game" as put forth by North. Within this prominent framework, institutions are distinguished as formal and informal institutions. When political, economic and legal rules are the instances of formal institutions; concepts such as norms of behavior, codes of conduct and culture compose informal institutions (North, 1999/2010: 9–13). Works of Acemoğlu and Robinson on institutions that have been mostly debated and assumptions of which are commonly accepted distinguish institutions as inclusive and extractive. While inclusive institutions reflect positively on economic performance and human development, extractive ones pave the way for a poor nation (Acemoğlu & Robinson, 2012). Repercussions of institutions on economic performance bring about the concepts of institutional quality and level of institutional development that lead to the concept of governance. Although there is not a generally accepted definition of governance, common aspects of different definitions that form governance or the elements that are associated with are, rule of law, democracy, and anti-corruption approach, inclusive and participatory governance approach. The basic principles of governance are stated as equitability, accountability, transparency and responsibility. The adoption of those principles are of great significance in the process of establishing inclusive institutions. As revealed by North in a historical perspective, it takes a long historical process for institutions to be established and is affected by cultural, economic, social and legal factors. It is obvious that adoption of those principles in governance has a transforming effect (North, 1999/2010: 97–136). Through establishment of inclusive institutions,

governance encourages democratic and human development as well as economic development. Furthermore, positive effect of governance on human capital and capital investments lays the groundwork for innovation and technology transfer, investment and economic development. In this way, governance capacity of the country is led to translate economic and social resources into development (Hall & Jones, 1999: 83–84). Good governance and high quality institutions ensuring particularly rule of law, accountability and transparency are of great significance to combat corruption, rent-seeking behavior and socially unfair privileges enjoyed by specific groups (Masuch et al., 2018: 15).

International organisations such as World Bank and International Monetary Fund (IMF) have also contemplated governance as a guiding principle in policy making while their own role and transformation have been debated. Kaufmann of Brookings Institution, Kraay and Mastruzzi of World Bank have defined governance as the traditions and institutions determining how authority has been exercised (Kauffman et al., 2010: 1–4). Their research based on data sources starting from 1996 has been mainstreamed in the literature and come up with widely used indicators. We used these indicators in this research to evaluate governance in Turkey. Three areas of governance have been defined concerning the process ensuring the election, monitoring and replacement of governments, the capacity of the government to formulate and implement effective policies, the respect of governments and citizens for the institutions determining their economic and social relations surrounding them. World Governance Indicators (WGI) based on those areas have thus been formulated. Two indicators corresponding to three governance areas have paved the way for six interrelated indicators: voice and accountability, political stability and absence of violence/terrorism, government effectiveness, regulatory quality, rule of law, control of corruption (The World Bank, 2022b).

3. EU Anchor and Governance

Among the organisations or communities of Western states, the European Union (EU) as a regional integration has the leading role to emphasize governance, human rights, democracy, and the rule of law as the main elements of its external partnerships (Börzel et al., 2008: 4).

The EU defines its objective as promoting peace, its values and wellbeing of people. To reach those goals, the Union has established a single market and prioritised sustainable development based on balanced economic growth, price stability, full employment, a highly competitive social market economy, a high level of protection of the environment. (Treaty on EU art. 2–3) From the Union's

point of view, those goals can be reached through good governance. Rule of law that is undeniably an element of good governance is the primary condition that needs to be fulfilled for a country to be admitted to the EU.

Among various external relationships, the EU has set with the outer world such as enlargement, neighbourhood and trade, enlargement is the one that the EU exerts the most influence and exercises transformative power (Öniş & Kutlay, 2019: 230, Yalman & Göksel, 2017). In this respect, enlargement process is the instrument of institutional transformation. The EU has formulated the enlargement process based on Copenhagen criteria that stipulate a country to ensure rule of law and democracy along with a functioning free market economy and the ability to take on the obligations of membership (EUR-LEX, 2022).

3.1. A Brief Review of EU Turkey Relations

Turkey-EU relations can be traced back to the year 1959 when Turkey applied for partnership with the European Economic Community. The most concrete outcomes of this inconclusive relationship with difficulties have been customs union and negotiation process. By signing the Ankara Agreement in 1963, a customs union has been planned to be established between Turkey and the European Economic Community. In case Turkey fulfilled its commitments arising from the agreement, the Community would consider Turkey's membership. Notwithstanding, expansion of the Community's trade relations, Turkey's incapacity to fulfil its commitments that were incompatible with its import substitution development model and derailing from democracy as a result of 1980 coup have ceased the relations. Revival of the relations has been the consequence of Turkey's inclining to free market economy in the aftermath of 1980 coup. Aiming at opening to international markets, attracting foreign direct investment and receiving loans from European countries have been the motives of Turkey to apply for full membership in 1987 (Akman & Çekin, 2021: 300). To this end, tariff cuts that were not made earlier were carried out and customs union was accomplished by the end of 1995. The establishment of the customs union between Turkey and the EU has been the initial step for subsequent developments that have transformed Turkey's governance and economic performance. After Turkey was acknowledged as a candidate country in 1999, the decision to start negotiations was taken in 2004 and negotiations have commenced in 2005. The negotiation process is related to the terms and conditions under which the candidate country will be admitted to the Union. The negotiation process necessitates the candidate country to fulfil obligations of the EU membership and adopt the EU *acquis*. The EU carries out this process

through the model based on Copenhagen criteria that has been formulated in the Central and Eastern Europe enlargement.

3.2. The Effect of Negotiation Process on Turkish Governance

Turkey's negotiation process has started with conditionality under 35 chapters in the context of adopting the EU acquis. From the outset, when Turkey was acknowledged as a candidate country by the end of 1999, the state of affairs can be examined in two periods. The first period which has lasted until 2008 global crisis, corresponds to vivid negotiation process helping to transforming institutional structure and building good governance. On the contrary, the second period beginning thereafter overlaps with the deterioration of the relations, stalling of the negotiation process and institutional decadence. In the first period, institutional transformation has yielded high quality growth; "EU anchor" has attracted foreign direct investments. In the second period, however, decadence of institutions has generated low quality growth and the volume of foreign direct investments has decreased.

3.2.1. The Process from Customs Union to Global Crisis of 2008

In the context of customs union and negotiation process, Turkey has made a great number of institutional arrangements and regulations that have contributed to its institutional capacity. To start with, in the framework of customs union, Turkey had to align with the EU's execution of customs, technical standards, preferential trade regimes, intellectual property rights, competition and state aid policies. Furthermore, regulatory institutions in those areas such as Competition Authority, Turkish Patent and Trademark Office, Turkish Accreditation Agency were established within this framework. Customs union with the EU has meant more than cutting tariffs and applying common customs tariff for the third parties. It has required regulations and establishment of regulatory authorities (Akman & Çekin, 2021: 307).

Along with trade regulations, the structure of the economy has been subject to transformation according to the principles of free market economy. The EU monitors developments in candidate countries through its progress reports that are launched regularly. The first progress report for Turkey was launched in 1998 which stated that Turkey had institutional structure of a free market economy, expressing the need to diminish the size of the public sector in the economy (T.C. Dışişleri Bakanlığı AB Başkanlığı, 2022a: 20). In this context, Turkey has started privatization practices and privatized the sectors of electricity, petrol, tobacco and sugar, established regulatory authorities in the privatized sectors such as

Energy Market Regulatory Authority, Tobacco and Alcohol Market Regulatory Authority (Morgil, 2006: 94–95).

Preparing for the EU membership process has also coincided with the recovery period after two consequent crises of 1999 and 2001. Strong Economy Programme launched in the wake of 2001 crisis under the agreement signed with IMF was prepared in order to restructure banking system, discipline public finance and sustain financial stability. Establishment of Banking Regulation and Supervision Agency, Central Bank independence and amendment of Capital Market Law have been the regulatory reforms implemented in this respect (Acemoğlu & Üçer, 2015: 12–13). Therefore, this process was backed up by double anchors of Bretton Woods institutions-World Bank – IMF, and the EU.

Central Bank independence which came into force in 2001 has explicitly stated that primary objective of the Central Bank of the Republic of Turkey was price stability and prohibited to finance government by transacting in the primary market (The Law on the Central Bank of Republic of Turkey, art. 56). Two important laws regarding public finance were enacted. The Public Finance and Debt Management Law of 2002 and the Public Financial Management and Control Law of 2003. The Law of 2002 has targeted preventing non-transparent borrowing, providing financial accountability, bringing government borrowing, assurances under strict rules, and the obligation to report. The latter has set the framework for financial management. Principles and merits, multiyear budgeting, scope and execution of the budget, performance management, strategic planning and internal control, accounting, monitoring and reporting have been introduced within this framework (Atiyas, 2012: 12–13).

The most significant development came with the enactment of Public Procurement Law of 2002 under the surveillance of World Bank. The aim of this law was assuring effectiveness, transparency and competitiveness in public procurement (Acemoğlu & Üçer, 2015: 13).

Along with regulation in the monetary, fiscal and public procurement areas, by adopting “European model” in the public management area, autonomous authorities have been established in the sectors that have been liberated. Through rule based policy making, as is the case of Competition Authority, power to make decision has been left to autonomous authorities, unlimited power of the executive has been restricted and providing autonomous authorities independent from government influence has been targeted in these terms (Atiyas, 2012: 22).

Autonomous authorities are as follows:

Competition Authority (founded in 1994 and came into operation in 1997 under the customs union.), Banking Regulation and Supervision Agency (founded in 1999 and came into operation in 2000), Telecommunication

Authority (founded in 2000 and renamed to Information Technologies and Communication Authority in 2008), Energy Market Regulatory Authority (2001), Tobacco and Alcohol Market Regulatory Authority (founded in 2002, dissolved and transferred to Ministry of Agriculture and Forestry in 2017), Public Procurement Authority (2002). Revision of Capital Market Board established in 1981. (Yalman & Göksel, 2017: 27).

The reforms and institutional structuring in question played significant role in disciplining public finance and stabilizing financial system. The infamous duty losses have been swept away to a great degree and the rate of inflation has been decreased to one digit number as of 2004 (Akman & Çekin, 2021: 300). Based on Acemoğlu and Üçer's works of 2015 and 2019, Turkey's economy for the period between 2002 and 2006 can be compared to a rising star, with the annual growth rate of %7,6 (see Fig. 1) and the total factor productivity rate around %5.2 for this period. When Gini coefficient for the year 2003 was 42 %, it has fallen to 38 % in 2008 (Acemoğlu & Üçer, 2019: 10–11). It has again risen to 41.9 % in 2019 (The World Bank, 2022a). Recovery in the distribution of income has been supported with the distribution of public services such as education, healthcare and infrastructure. Income has been distributed geographically giving rise to the so-called Anatolian tigers (Acemoğlu & Üçer; 2015: 6).

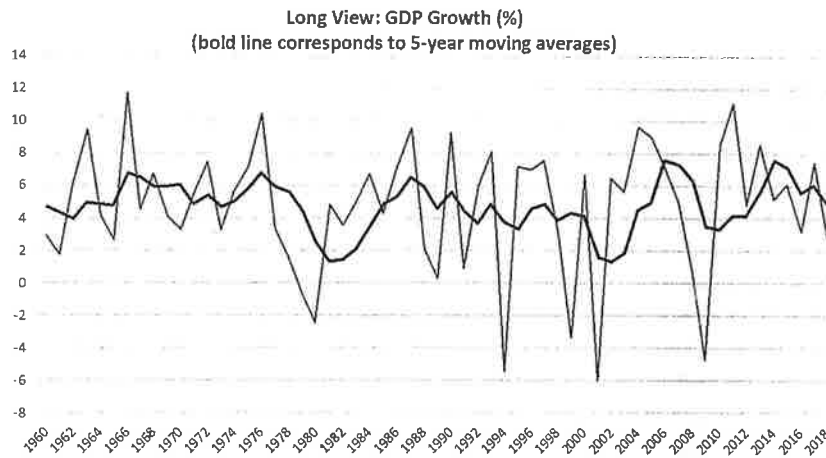


Fig. 1: GDP growth (%) (1960–2018)

Source: Acemoğlu and Üçer, 2019 based on TURKSTAT data.

The decision of 2004 to start negotiations and the commencement of negotiations in 2005 have contributed to inflow of foreign direct investments from European countries. As of 2004, inflow of FDI from European countries has risen drastically and maintained high until the adverse effects of global crisis have hit European countries (see Fig.2) (Akman & Çekin, 2021: 301).

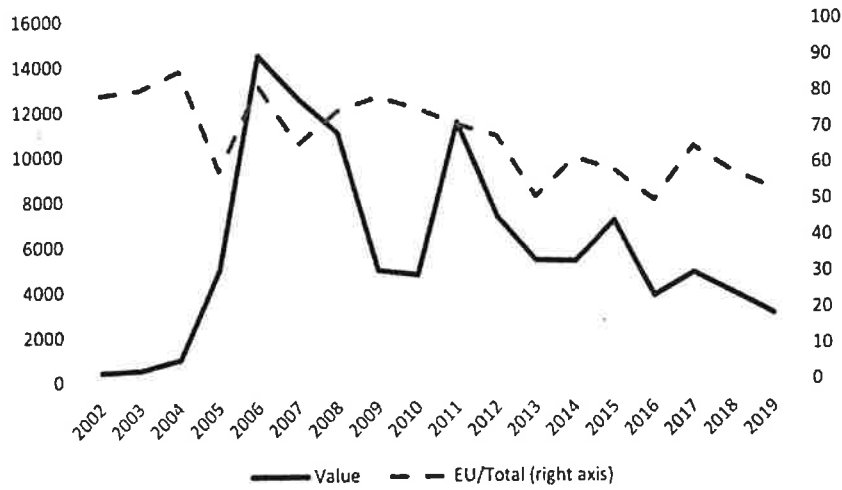


Fig. 2: Value and share of inflows of FDI in Turkey originating from the EU (2002–2019) (in million Dollars and %)

Source: Akman & Çekin, 2021; 301.

3.2.2. The Collapse of the EU Anchor

Reform process in the wake of the crisis of 2001 and EU membership perspective have contributed to Turkey's economy, effects of which have reflected to economic indicators positively. However, the positive atmosphere has started to alleviate due to EU's attitude to design negotiation process in an open-ended framework and declare that the termination of the process could not be assured. Membership of Southern Cyprus without unification and obligation of Turkey to open its ports to Southern Cyprus ships under customs union brought about the issue of declaration by Turkey and counter declaration by the EU. Suspension of negotiations under eight chapters associated with customs union has been the consequence of the developments taking place. Ambivalent nature of the negotiation process as well as blockages coming from EU countries have exacerbated trust (Yalman & Göksel, 2017: 31).

The first signs of the process that can be called de-Europeanisation have appeared in the course of 2008 global crisis and 2010 Sovereign Debt Crisis thereafter. The economic slowdown in EU has reflected to Turkey's economy as narrowing of the market. Deceleration of the enlargement process because of the crisis has also had adverse effects. Stalling of the negotiation process has eventually destroyed EU anchor and EU advantage has lost its impact. Post crisis period has introduced BRICS as new alliances for Turkey and moved away from former allies of the West as EU, World Bank and IMF. In the process of de-Europeanisation, relations with Russia, China and Qatar have gained importance (Akman & Çekin, 2021: 302, Öniş & Kutlay, 2019: 234).

The post crisis period has witnessed not only deterioration of Turkey-EU relations but also the decline of the institutional reform process. Allegations of corruption against four ministers in 2013 have risen perception of risk on Turkey that has reflected to progress report as allegations of political influence on public tenders. A state of emergency has been declared in Turkey after the coup attempt in 2016. It has been criticized in the progress report by emphasizing the worsening of investment environment and warning against setback from economic reforms (Acemoğlu & Üçer, 2019: 31–32).

Modernisation of customs union to rejuvenate relations which came to fore with a declaration by the Commission and Turkey gained approval from the European Parliament on the condition to bring a clause on human rights and fundamental freedoms, however has been subject to objections of some member states led by Germany. Modernisation of customs union has thus been shelved and remained inconclusive (Ülgen, 2017). The latest chapter opened in the negotiation process has been the financial and budgetary provisions in 2016 (T.C. Dışişleri Bakanlığı Avrupa Birliği Başkanlığı, 2022b). From then on, relations have developed in the axes of refugee crisis and security (İktisadi Kalkınma Vakfı, 2017: 41).

EU anchor has been functional in terms of Turkey's economy. Yet, this functionality has served beginning from 1999 until 2008. From this point of view, it can be concluded that negotiation process has been beneficial until negotiations have started. Adverse effects of the Europeanisation and losing of anchors have come into existence in governance, particularly in the field of public tenders. Alterations to the public procurement law and increasing number of exemptions are incompatible with principles of transparency and accountability. Therefore, they are subject to be criticized in progress reports of the EU. Some of the instances of criticisms elaborated are as follows: Turkey has not made progress in the field of public procurement, Public Procurement Authority is not autonomous and local government and infrastructure tenders

are open to corruption (European Commission, 2019: 66–68). Another crucial aspect of public procurement practices is that negotiation procedure (Public Procurement Law Article 21/b) rather than open procedure has turned out to be ordinary procedure although specified in the circumstances of natural disasters and unforeseen situations requiring emergency action (Toker, 2019: 43–45). As for fight against corruption, not setting up anti-corruption bodies and not implementing recommendations of Council of Europe's Group of States against Corruption (GRECO) have been repeatedly covered in progress reports (European Commission, 2022: 70–72).

3.3. Evaluation of World Governance Indicators (WGI) for Turkey

WGI developed by World Bank are widely used in the literature to measure governance quality of a country. Data collected for 200 countries and territories, for the period starting from 1996, indicate a country's rank, 0 corresponding to the lowest and 100 corresponding to the highest. Table 1 displays WGI for Turkey for the period 1996–2021. A glance at Tab. 1 shows a trend of increase in a positive way corresponding to rising quality of governance at the beginning of the table and a decrease at the end of the table corresponding to a setback of governance quality. Considering all indicators, all have evolved differently showing different levels of development; however, there is a similar trend for all indicators staying below where they started. Rising trends generally overlap with the period of institutional and governance reforms. On the contrary, low ranks coincide with the period when institutional reform process has dwindled.

Tab. 1: WGI for Turkey (1996–2021)

Years	Voice and Accountability	Political Stability and Absence of Violence/ Terrorism	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
1996	45,5	10,64	55,74	59,24	47,24	51,61
1998	31,84	12,23	46,11	68,39	48	45,36
2000	40,3	21,16	56,92	64,62	50,5	49,75
2002	42,29	21,69	60,71	58,67	52,48	34,85
2003	45,77	25,13	60,71	56,12	59,41	52,02
2004	49,52	20,87	57,64	56,65	58,37	51,71

Tab. 1: Continued

Years	Voice and Accountability	Political Stability and Absence of Violence/ Terrorism	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
2005	50,96	27,67	58,82	60,78	58,37	56,1
2006	45,67	27,05	59,02	59,31	55,5	58,05
2007	46,15	19,81	64,08	62,14	54,07	59,71
2008	46,15	18,75	63,59	59,22	56,73	60,68
2009	45,5	15,64	63,16	59,81	57,82	60,29
2010	44,55	18,96	64,11	59,81	58,77	58,57
2011	44,13	18,48	65,4	62,09	57,75	58,29
2012	41,78	12,8	65,4	64,93	57,28	62,56
2013	40,85	10,9	64,45	64,93	55,87	61,14
2014	36,45	11,9	67,79	66,35	57,21	52,88
2015	35,47	9,05	62,02	62,5	53,37	53,37
2016	30,05	4,76	54,81	61,06	46,63	50,48
2017	27,59	7,14	55,29	57,21	45,19	49,52
2018	25,12	10	53,85	52,4	42,31	43,75
2019	24,63	10	54,33	54,81	44,71	44,71
2020	24,15	12,74	47,60	50,48	38,46	43,27
2021	23,67	12,26	49,52	49,04	36,54	40,38

Source: (Worldbank, 2022c) WGI, <https://info.worldbank.org/governance/wgi/Home/Reports> (15.10.2022)

4. Conclusion

The most recent approach on the relationship between institutions and economic performance is that of Acemoğlu and Robinson distinguishing institutions as inclusive and extractive ones and emphasizing the role of inclusive institutions on growth and development of a country. The questions of how a country is governed in terms of election, monitoring and replacement of governments, the government's ability to formulate sound policies and both governments and citizens' respect for institutions have paved the way for indicators mainstreamed in the literature to gauge governance in a country. Rule of law, democracy, anti-corruption approach and participatory governance are of great significance for a country to reach its full potential. International institutions have designed their role emphasizing the significance of governance. The EU as a regional integration

has transformative power on countries which it exerts influence on. Enlargement is an instrument of transformative power of the EU. Through Copenhagen criteria, a country is motivated to ensure rule of law and democracy along with a functioning free market economy and the ability to take on the obligations of membership. In addition, practices of good governance are imposed on candidate country.

Turkey and EU have maintained a partnership relationship since 1959 and negotiations have commenced in 2005 in the pursuit of the EU's acknowledging Turkey as a candidate country in 1999. EU candidacy status has accelerated the institutional reform process that had already begun with IMF and World Bank in the wake of two consecutive crises of 1999 and 2001. Double anchors of EU, IMF and World Bank have contributed to the transformation of Turkey's economy and institutional structure. By setting up autonomous authorities and rule-based decision-making, main principles of governance-transparency and accountability have been achieved. Good governance has reflected to economic performance as well. Due to cyclical developments taking place in both the EU and Turkey as well as global crisis of 2008, negotiation process has stalled and institutional transformation has lost pace and collapsed. The negotiation process has been functional until the negotiations have been interrupted. Losing EU anchor has had repercussions on decadence of institutional quality and economic performance verified by the evaluation of WGI on Turkey.

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M. Erkan Üyümez / Canatay Hacıköylü (eds.)

Current Debates on Public Finance

This book covers current issues and debates in the field of public finance, and features contributions from twenty-one academics across eight different universities. It comprises fourteen chapters, with the first eight covering current discussions in various areas of public finance theory and practices while the last six chapters deal with current debates on tax theory and policies. The aim of this book is to present current debates on public finance from different perspectives.

The book titled *Current Debates on Public Finance: Theory and Practice* not only provides the reader with information on different current issues but also shares the data obtained by different methods. Combining these new methods used in social sciences with public finance theory and practices is important in terms of its contribution to the literature. Therefore, the text is expected to provide information for the reader within the scope of future studies. Thus, the way can be opened for new international cooperations.

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