Turkey strives to join the European Union. To qualify for EU membership a number of economic criteria have to be fulfilled.\textsuperscript{1} According to the conclusions of the Copenhagen European Council of June 1993 EU membership requires the existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union.\textsuperscript{2} Special attention is also paid to external relations.

Between 1975 and 2003 the balance of exports and imports of goods and services did not impact Turkey's growth performance. Over the entire period its real gross domestic product (GDP) grew at the same rate, whether the trade balance is taken into account or not. A year-by-year analysis reveals enormous positive as well as negative effects on GDP growth in single years (Figure 1), however. This was particularly the case during the balance of payments crises in 1994 and 2001. Since the mid-1990s real GDP growth was mostly restrained by the negative external trade balance. Without the diminishing impact of the balance of exports and imports, and ignoring the year 2001, Turkey's real GDP would have grown by an additional 1.3 percentage points.

The balance of exports and imports of goods and services is part of the current account, which covers all cross-border transactions of an economy. Against the background of the enormous growth effects documented in Figure 1 this study traces the development of the Turkish current account and presents different, but equally valid interpretations.\textsuperscript{3} This variation results from the fact that the different interpretations are connected by the bookkeeping principles used by the national income accounts and the balance of payments accounts. In addition, the different perspectives on a given current account situation render information not only on the external relations but also on the internal state of an economy. On the whole the current account balance allows a consistent insight into the external and domestic situation and development of a country.

The following study presents several interpretations of the Turkish current account during the period 1975 to 2004. The starting year was chosen because some of the relevant data are only available since the mid-1970s. Figure 2 shows the development of Turkey's current account in billion US dollar and as a percentage of nominal GDP. In all but six years the current account balance was negative. In 2004, the current account deficit reached a record level of $15.6 billion or 6 per cent of GDP. However, current account deficits of 5 per cent of GDP also occurred in earlier years.

Structure of the Turkish Current Account

The current account is part of the balance of payments, which also includes the capital account, reserve assets and net errors and omissions. The current account balance can be separated into four parts:

- the trade balance, which covers exports and imports of goods
- the balance of services, which includes exports and imports of services (e.g. tourism, financial services)
- the balance of income, which covers cross-border capital and labour incomes (e.g. interest payments and returns on foreign direct investment)
- current transfers, which include, for example, worker remittances and official transfers to international institutions.

To simplify matters we add the balance of goods and services and current transfers and call the sum


Michael Grömling

Ways to Interpret Turkey’s Current Account

In order to qualify for EU membership Turkey will have to fulfil a number of economic criteria. With this in mind, the following article examines the Turkish current account in the period 1975 to 2004, in which it has shown a consistent pattern of surplus in transfers and trade in services, and deficits in factor incomes and in trade in goods. Several contradictory interpretations of the facts are then discussed.
primary current account, where $X$ stands for exports and $M$ for imports ($\text{PCA} = X - M$). The current account balance ($\text{CA}$) is defined as:

$$\text{CA} = X - M + r\cdot B_f \left(t-1\right) \quad \text{or} \quad \text{CA} = \text{PCA} + r\cdot B_f \left(t-1\right)$$

$B_f$ stands for the net external position and $r\cdot B_f \left(t-1\right)$ for cross-border net interest payments on the external debt ($B_f < 0$) or external wealth ($B_f > 0$), $r$ representing a uniform lending and borrowing rate. The current account balance is the sum of the two positions ($X - M$) and $r\cdot B_f \left(t-1\right)$. A current account deficit can emerge even if there is a surplus in the primary current account ($X > M$). This is the case when cross-border factor incomes – for example because of high interest payments on high external debt – are higher in absolute terms than the PCA surplus.

Turkey’s current account shows a consistent pattern since the mid-1970s: a surplus in transfers and trade in services, and deficits in factor incomes and in trade in goods.

Trade in goods: During the last four years the deficit in trade in goods markedly increased and amounted to US $24 billion in 2004. Only in 2000 was the level nearly as high. As a percentage of GDP the present trade deficit (9.5 per cent) is less outstanding. Trade deficits of more than 6 per cent of GDP were often realised in earlier years. However, the present deficit emerges in spite of the export boom. In 2004, exports of goods exceeded the level of the previous year by 30 per cent. This can be explained by the improved competitiveness of the Turkish economy as a result of rising productivity, decreasing unit labour costs and, of course, the booming world economy. In particular exports of manufactured goods, which account for 90 per cent of Turkey’s goods exports, soared recently. Exports of electrical machinery and equipment, motor vehicle parts and iron/steel rocketed. More than half of the exports went to the EU. Nevertheless, the export boom was not sufficient to diminish the chronic trade deficit because imports of goods also shot up by 40 per cent in 2004. There are several reasons for this development. One is the strong recovery after the economic crisis in 2001. The corresponding invest-

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Sources: OECD; own calculations.

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Figure 1

Growth Effect of the Turkish Trade Balance

GDP growth with and without the trade balance, difference in percentage points.

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth Effect</th>
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</thead>
<tbody>
<tr>
<td>1975</td>
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<tr>
<td>1980</td>
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<td>1985</td>
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</tr>
<tr>
<td>1995</td>
<td>2.0</td>
</tr>
<tr>
<td>2000</td>
<td>4.0</td>
</tr>
</tbody>
</table>

Sources: OECD; own calculations.

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Figure 2

Turkey’s Current Account Balance

a) in US $ bn.

b) as a percentage of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Current Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
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</tr>
<tr>
<td>1980</td>
<td>-11.0</td>
</tr>
<tr>
<td>1985</td>
<td>-16.0</td>
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<tr>
<td>1990</td>
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<tr>
<td>1995</td>
<td>-7.0</td>
</tr>
<tr>
<td>2000</td>
<td>-2.0</td>
</tr>
</tbody>
</table>

Sources: Central Bank of the Republic of Turkey (CBRT); own calculations.

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4 Jeffrey Sachs, Felipe Larrain, op. cit.

5 See Brazil or Mexico in the late 1980s (ibid.).