

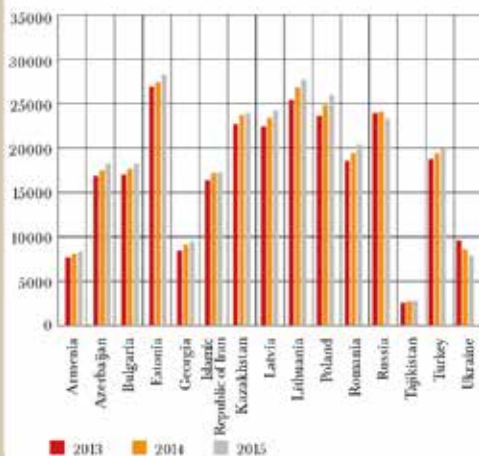
GEORGIA AND TURKEY

LONG JOURNEY ON THE SHORT ROUTE TO EUROPE

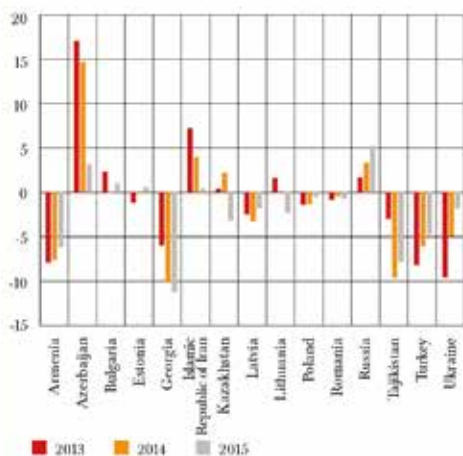


IMF WORLD ECONOMIC OUTLOOK

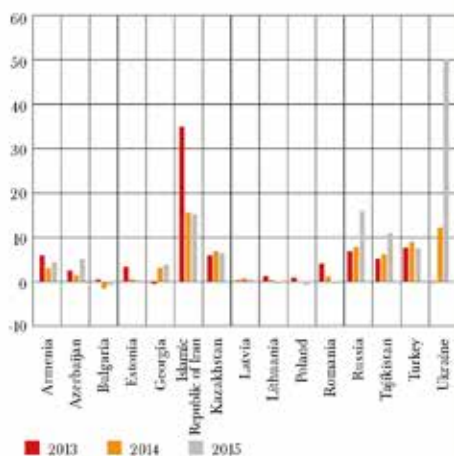
GDP per Capita, PPP Dollars



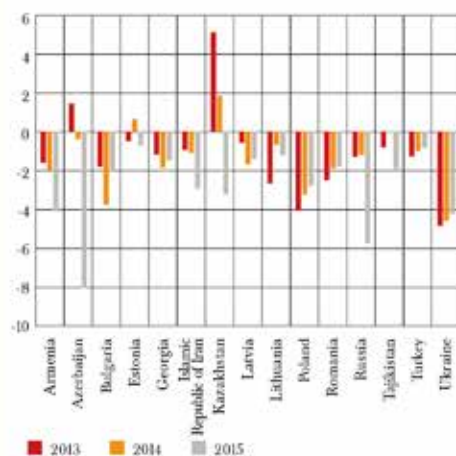
Current Account Balance, % of GDP



CPI Inflation, %



Budget Deficit, % of GDP





GEORGIA AND THE NEIGHBORS is an analytic periodical covering economic, financial, and business trends in Georgia's neighboring countries and in the major trade partners. The aim of the brief is to scrutinize the potential implications of the key political and economic developments taking place within the region or in the world. Georgia's policy and business community are the primary audience of the brief. The analyses and projections made by the Georgia and the Neighbors are based on the extensive research and consultations in Georgia and in the countries in-focus. It is being compiled by the EPRC's in-house experts and the outsourced consultants.



Armenia



Azerbaijan



Belarus



Bulgaria



Estonia



Georgia



Iran



Kazakhstan



Kyrgyzstan



Latvia



Lithuania



Moldova



Romania



Russia



Tajikistan



Turkey



Turkmenistan



Ukraine



Uzbekistan

GLOBAL COMPETITIVENESS INDEX

Rank	Country	Value
1	Switzerland	5.7592335
2	Singapore	5.6766692
3	United States	5.6129673
4	Germany	5.5285691
...		
51	Turkey	4.3722501
52	Costa Rica	4.3336764
53	Romania	4.3239356
54	Bulgaria	4.3194091
55	India	4.3108237
56	Vietnam	4.3012696
57	Mexico	4.294407
58	Rwanda	4.2928482
59	Slovenia	4.2844126
60	Macedonia, FYR	4.2810519
61	Colombia	4.2782079
62	Oman	4.2472135
63	Hungary	4.2455023
64	Jordan	4.2334002
65	Cyprus	4.2297352
66	Georgia	4.2220696
...		
139	Chad	2.9646368
140	Guinea	2.8411147

GLOBAL INNOVATION INDEX

Rank	Country	Score
Rank	Country	Score
1	Switzerland	68.3
2	United Kingdom	62.4
...		
58	Turkey	37.8
59	Bahrain	37.7
60	South Africa	37.4
61	Armenia	37.3
62	Panama	36.8
63	Serbia	36.5
64	Ukraine	36.5
65	Seychelles	36.4
66	Mongolia	36.4
67	Colombia	36.4
68	Uruguay	35.8
69	Oman	35
70	Brazil	34.9
71	Peru	34.9
72	Argentina	34.3
73	Georgia	33.8
74	Lebanon	33.8
...		
140	Togo	18.4
141	Sudan	15



GEORGIA AND TURKEY
LONG JOURNEY
ON THE SHORT ROUTE TO EUROPE

Issue #5, July 2016
Tbilisi, Georgia

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TURKEY – EUROPEAN COUNTRY WITH ASIAN FLAVOR

One of the handful of transcontinental countries¹, Turkey is a natural bridge between East and West. While prior to the First World War the relations between Ottoman Porta, as Turkish Empire was known then, and Europe were strained at best, the modernization reforms carried out by Mustafa Kemal Atatürk – founder of the Republic of Turkey – became the foundations of the Westernization of the country and an Asian country with European conquests became an European country with Asian flavor. As a result of these reforms, Turkey became one of the leading emerging markets in the world, firmly in the top-20 richest countries and steadily moving from the agricultural country to a service-based economy.

When discussing Georgia-Turkey relationship, word strategic is the best “single word” description of it. As one of the biggest countries, biggest economies and biggest military powers in the Black Sea region and in Europe, indeed makes Turkey one of the most important strategic partners for Georgia. Turkey's European identity and Asian flavor and geopolitical location makes this relation even more complex and exciting.

Current state and future prospects of Georgia-Turkey relationship should be analyzed and modeled within the framework of the following dimensions: (a) Global geopolitical context, regional context and domestic context; (b): social, economic, political, security; (c) bilateral and multilateral.

After the dissolution of the Soviet Union, Eurasian supercontinent has reconnecting by several driving factors: trade, energy, military, logistics. Geopolitical process has been labeled as the revival of the ancient Silk Road. As the result of this process complex network of trading routes, pipelines, communications, hub infrastructures connecting South Asia to Europe and the Greater Middle East, as well as Europe with East and Southeast Asia has been creating and rapidly developing. This process of reconnection is of great strategic significance for the US – world's leading superpower.

In this global context, Turkey plays significant strategic role not only within the Black Sea region but also as the connection across regions, especially in the vast spaces between Europe, Asia and Middle East.

It is a pivotal country between the regions such as South Asia, Southeast Asia, the Greater Middle East, and the former Soviet space. All this together comprise a highly dynamic and diverse multipolar environment.

¹ Unless Eurasia is defined as a single continent

Turkey as the NATO member and EU aspirant country exercises very active foreign economic and security processes driven by some of its domestic political, economic and security challenges as the European secular Muslim democracy.

This geography generates both major security concerns, especially vis-à-vis Russia, and economic opportunities for Georgia. Georgia's foreign and security policy goal for recent decades has been to maximize security and economic benefits through mutually-beneficial engagement on trade, transit, and energy issues while fostering security ties to minimize space for Russia's aggressive revisionism.

Significant aspect of Georgia's relation with Turkey has increasingly trilateral nature of with Azerbaijan. This trilateral economic, energy, security and logistical bridge itself represents key component of the New Silk Road.

Though trilateral cooperation, in particular on trans-Caucasian energy projects, extends back to the early 1990s, the Trabzon Declaration, a joint statement issued by the foreign ministers of the three countries following a summit in Trabzon, Turkey in June 2012 that grew out of Georgia's conflict with Russia in 2008 and the slow pace

of EU and (in Georgia's case) NATO integration, has provided the structure for this relationship moving forward.² The Declaration emphasizes the further development of relations "in every field, especially in the field of trade, energy, transport, finance and banking, [and] environment," placing particular emphasis on energy and transport-related projects, such as the Southern Gas Corridor and the Transport Corridor Europe-Caucasus-Asia (TRACECA), that envision the South Caucasus and Turkey as a major player in transcontinental trade.³ This strongly supports Georgia's broader economic policy priority to acquire the function of trade and logistical hub in the region.

This function has been materialized largely due to major pipelines and transport routes including most notably the Baku-Tbilisi-Ceyhan (BTC) crude oil pipeline, the South Caucasus Pipeline (Baku-Tbilisi-Erzurum, BTE), and the Baku-Tbilisi-Kars (BTK) railway project. It is important to note that the projects outlined have the potential to tie Turkey through Georgia to Central Asia, allowing them to enhance their value to global energy markets.⁴ This region, besides purely economic interests has significant political importance for Turkey's foreign policy.

2 http://www.jamestown.org/single/?tx_ttnews%5Btt_news%5D=42079&no_cache=1#.VYRVpPIViko

3 http://www.mfa.gov.tr/trabzon--declaration-of-the-ministers-of-foreign-affairs-of-the-republic-of-azerbaijan-georgia-and-the-republic-of-turkey_-08-june-2012_-trabzon.en.mfa

4 http://www.jamestown.org/single/?tx_ttnews%5Btt_news%5D=42079&no_cache=1#.VYRVpPI

Security and defense cooperation has also become a major pillar of the Georgia-Turkey. NATO member Turkey has also consistently strongly and vocally supported Georgia's quest to become a full member of the alliance. Bilateral defense cooperation is mostly directed to support Georgia's NATO integration; development of interoperable capabilities, education and training, participation in NATO led military exercises. NATO Warsaw summit communiqué underlined "evolving challenges in the Baltic and Black Sea regions, the North Atlantic, as well as in the Mediterranean, which are of strategic importance to the Alliance and to our partners"⁵. In this context Georgia-Turkey defense and security cooperation has significant value for the Euro-Atlantic community. Wider bilateral security cooperation is covering fighting terrorism and organized crime as well.

Besides comprehensive bilateral defense and security cooperation agenda, trilateral format has gained significant momentum. Georgia, Turkey, and Azerbaijan have stepped up mutual military aid in the form of joint military exercises oriented towards pipeline defense and security, joint technological development, and cooperation

in officer education.⁶ Georgia, Turkey, and Azerbaijan held their first joint military exercises in 2013; subsequent military exercises between the three countries have focused on the defense of regional energy transit infrastructure.⁷

While Georgia and Turkey enjoy strategic partnership, some areas of friction in these relationships remain. Georgia's ties with Turkey have been strained, in particular, over the issues of Turkey's engagement with the separatist government of Abkhazia. Although Turkey does not recognize Abkhazia's de facto independence, in practice Ankara maintains limited political and economic relations with the breakaway region, and is its second-largest trade partner after Russia. The strength of this relationship rests on the fact that Turkey hosts the largest population of diaspora Abkhaz.

Summer of 2012 witnessed the outbreak of protests in Batumi over government-endorsed plans to rebuild an Ottoman mosque.⁸ There have been subsequent marginal anti-Turkish sentiments as the reelection campaign issue.

The Georgian government has intercept-

5 http://www.nato.int/cps/en/natohq/official_texts_133169.htm

6 <http://www.eurasianet.org/node/69646>

7 <http://www.eurasianet.org/node/69646>

8 <http://www.eurasianet.org/node/66929>

ed more than 60 Abkhazia-bound Turkish freighters between 1999 and 2009. As a solution, in the spirit of strategic partnership, joint customs regime between the two countries to monitor Turkish trade in and out of Abkhazia, has been offered.

The key strategic question for Georgia and Turkey is how to maximize economic and security effect in the Black Sea region and further to the Caspian Sea region through fostering bilateral and multilateral relations with regional and global powers?

TURKEY TODAY

Turkey is one of the largest economies in the world, 17th by the PPP GDP and 18th by nominal GDP at current exchange rates.⁹ Similarly to Iran – subject of our previous essay – Goldman Sachs Asset Management chairman, Jim O’Neill, names Turkey as another one of the Next-11, emerging markets coming after BRIC countries and having high potential of becoming among world’s largest economies in the 21st cen-

ture. O’Neill places Turkey among MIST nations – Mexico, Indonesia, South Korea and Turkey – four biggest markets in the Goldman Sachs N-11 Equity Fund.¹⁰

At the moment Turkey is an importer of both gas and petroleum, however, reports indicate that the country has significant potential at least in gas, with the ability to even be a future source of energy for the Western Europe.¹¹ Nevertheless, until these reserve estimates are proven correct, Turkey’s strength in natural resources lies elsewhere – borone (Approximately 61% of the world’s boron reserves are in Turkey, with the Kirka deposit at Eskisehir reported to be the largest boron deposit in the world¹²), chromite (with around 11% of world production in 2013¹³ and 3rd in the world exports of chromite with a share of 12.5%¹⁴), bauxites and copper.¹⁵ Nevertheless the share of minerals in the Turkish exports is very low – 1.56% of total exports in 2011, with most of it going to China and European Union.¹⁶

9 <http://www.imf.org/external/pubs/ft/weo/2016/01/index.htm>

10 <http://www.bloomberg.com/news/articles/2012-08-07/goldman-sachs-s-mist-topping-brics-as-smaller-markets-outperform>

11 <http://www.wallstreetdaily.com/2014/09/24/turkey-oil-fields/>

12 <http://minerals.usgs.gov/minerals/pubs/commodity/boron/mybl-2014-boron.pdf>

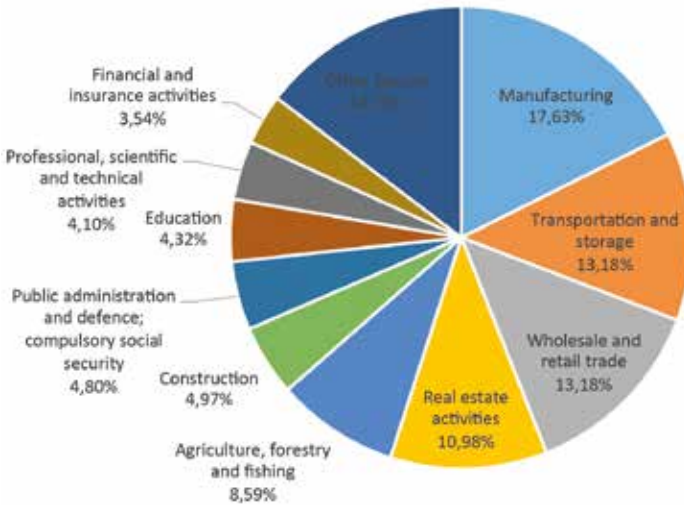
13 <http://minerals.usgs.gov/minerals/pubs/commodity/chromium/mybl-2013-chrom.pdf>

14 <http://www.economy.gov.tr/portal/content/conn/UCM/uuid/dDocName:EK-021135>

15 http://www.photius.com/countries/turkey/economy/turkey_economy_mineral_resources.html

16 <http://www.economy.gov.tr/portal/content/conn/UCM/uuid/dDocName:EK-021135>

GDP of Turkey in 2015



On the whole the economy of Turkey is quite diversified, with manufacturing, transportation and trade being the leading sectors, with the total of 34% of GDP in 2015. At the same time, shares for manufacturing and agriculture have been steadily declining from 24.4% and 12.9% respectively in 1998 to current 17.6% and 8.6%.

Despite the declining share and relatively low productivity¹⁷ of agriculture in the economy, Turkey is self-sufficient in food

production and net exporter of food for past several decades. It is the largest producer of hazelnuts, cherries, figs, apricots, quinces, and leading producer of tomatoes, eggplants, onions, cucumbers, etc.¹⁸ Nevertheless, Turkish government has removed agriculture from its priorities, focusing instead on industry and innovation.¹⁹ The Tenth Development Plan for 2014-2018 specifically lists acceleration of industrialization process, raising innovation production capacity and integrating innovations

¹⁷ The rural population of Turkey is around 27% (World Bank), whereas the employment in agriculture is 23.6% (FAO)

¹⁸ <http://faostat3.fao.org/browse/Q/QC/E>

¹⁹ <http://www.mod.gov.tr/Lists/RecentPublications/Attachments/75/The%20Tenth%20Development%20Plan%20%282014-2018%29.pdf>, page 27

into production structure as important steps in ensuring reaching “higher, stable and sustainable structure” and increasing “competitiveness and welfare level” of Turkey.²⁰

Turkey is an important producer of consumer electronics and appliances, with Vestel being the largest European producer of TVs,²¹ selling about 20% of all TVs purchased in Europe and Arçelik (owner of brands like Beko, Grundig, etc.) – one of the largest producer of white goods in Western Europe.²² Yet another important Turkish industry is textile production, accounting for around 7% of GDP, and being 3rd largest exporter to EU and 6th largest worldwide.²³ Turkey is an important shipbuilding nation as well as one of the leaders in automotive industry, being 15th largest producer of motor vehicles in the world and 6th in Europe.²⁴ In addition to having its own car industry,²⁵ Turkey has attracted global car-makers like Fiat, Renault, Hyundai, Toyota and Honda, who have their own production

plants in Turkey. Finally, Turkey has one of the world’s largest construction/contracting sectors, with 43 out of 250 largest contractors coming from Turkey, making it the second most important contracting industry (after China).²⁶

Service-wise Turkey is one of the most attractive tourist countries, being the sixth most-visited country in the world in 2014 (after France, US, Spain, China and Italy) with almost 40 million visitors per annum.²⁷ Share of tourism in Turkish GDP was 12.9% in 2015 and had been above 10% ever since 2000.²⁸

Turkish banking sector is one of the strongest in the Europe outside EU, behind only Switzerland and Russia in volume of assets.²⁹ “Turkish banking sector is well-regulated, monitored and governed by two primary regulatory authorities; the Banking Regulation and Supervision Agency (BRSA) and the Central Bank of Republic of Turkey (CBRT).”³⁰

20 Ibid.

21 <http://www.forbes.com/sites/larrymagid/2014/04/27/ceo-of-europes-largest-tv-maker-on-curved-4k-and-3d-tvs/#2c8e836936b0>

22 http://www.arcelikas.com/page/841/Slovenia_Press_Meeting

23 <http://www.fibre2fashion.com/market-intelligence/countryprofile/turkey-textile-industry-overview/index.asp>

24 <http://www.oica.net/category/production-statistics/>

25 Mostly buses, trucks and military vehicles

26 http://www.enr.com/toplists/2015_Top_250_International_Contractors1

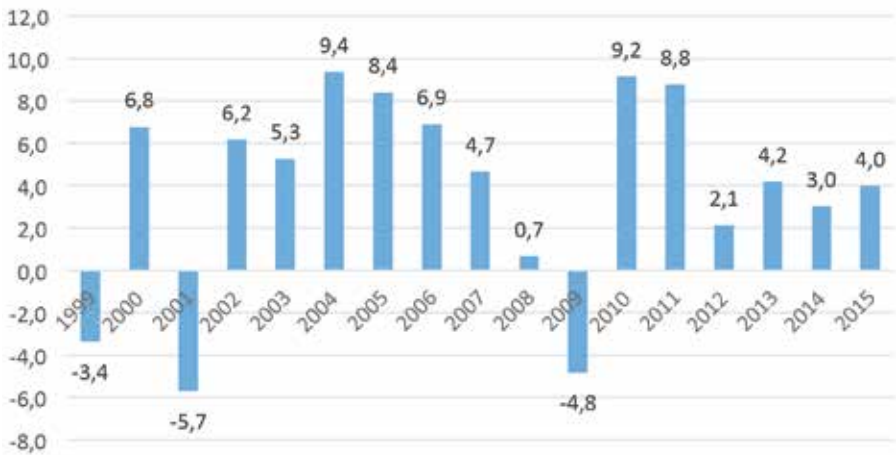
27 <http://data.worldbank.org/indicator/ST.INT.ARVL>

28 <https://knœma.com/atlas/Turkey/topics/Tourism/Travel-and-Tourism-Total-Contribution-to-GDP/Total-Contribution-to-GDP-percent-share>

29 European Banking Sector, Facts & Figures 2014, p. 141

30 <http://www.garantiinvestorrelations.com/en/financial-information/detay/Turkish-Banking-Sector-in-Brief/55/41/0>

Real GDP Growth in Turkey (%)



Since late 1990-ies economic growth in Turkey has been somewhat uneven, averaging 3.9% in 1999-2015, with three recession years (1999, 2001 and 2009), and high and low growth periods. In the past 4 years the growth rates have decreased from the peak values of 2010/11 and has been 3.3% on average in the last 4 years. However, 4% growth in 2015 has been unexpectedly high, given the political turbulence within the country, rising security threats and overall dire economic situation in the region.³¹

In late XX century Turkish economy was quite unstable, with the growth rates fluctuating between -5.5% and 9.3%. At the same time inflation was very high, often

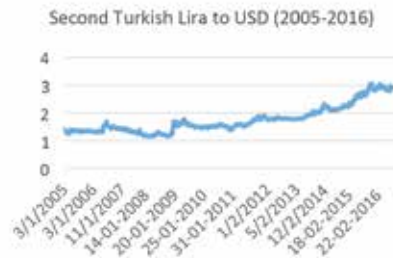
exceeding 80%, since the public policy was characterized both by high monetary financing and large budget deficits. This in turn caused the inflation rate to be quite volatile and despite attempts to peg Lira to USD, Turkish currency continuously lost its value (e.g. from 45,000 per USD in 1995 to 1,650,000 in 2001). The Asian crisis of 1997 and Russian crises of 1998 shattered investors' confidence in Turkey, resulting in sudden stop of capital inflows which along with the devastating earthquake in 1999 seriously undermined Turkish economy, pushing it into recession. Despite the disinflation program starting in late 1999, with the pre-announced crawling peg, large-scale privatization program and improved

31 <http://www.wsj.com/articles/turkish-economy-defies-political-chaos-with-further-growth-1459441506>

regulation of the financial system³², the inflation did not decline as fast as expected and since the vulnerabilities in the banking sector had not been addressed, in 2000-2001 Turkey experienced a severe banking crisis.³³ The banking and ensuing economic crisis undermined the trust in the incumbent government and in 2002 the Justice and Development Party (AKP³⁴) led by Recep Tayyip Erdogan won convincingly taking 66% of seats. The AKP immediately implemented important structural reforms, which included incentives for foreign investment to pour in, tax code simplification and significant tax cuts, finalization of privatization program, etc. As a result the Turkish economy recovered quite strongly, whereas the inflation rate dropped to most-

ly single-digit figures (virtually never exceeding 12%)³⁵. Another important reform, carried out in 2003, was the redenomination – removal of six zeros – of the old Turkish lira, which by early 2000s became world’s least valuable currency.³⁶

During its time in power AKP³⁷ has overseen a number of economic reforms, including those started by the previous coalition government, and the political stability it brought (at least in the 2000s) “improved the business climate in Turkey, strengthened the positive perception of international investors towards the Turkish economy and contributed positively to its economic success”³⁸. This economic success in turn brought political success to the



32 From the long-term macroeconomic stability point of view the most important reform, probably, was giving the central bank independence, allowing it to focus on the monetary policy (with the price stability explicitly declared to be the main goal of monetary policy) and prohibiting it from extending credit to Treasury and/or other public institutions and agencies.

33 <https://economics.rabobank.com/publications/2013/september/the-turkish-2000-01-banking-crisis/>

34 Adalet ve Kalkınma Partisi

35 Although it should be noted that the 5% inflation target has rarely been met

36 http://www.turkeyforyou.com/turkey_money_history

37 In 14 years the party only lost once – in June 2015, however regained power in November of the same year

38 Ayşe Aylin Bayar, Öner Günçavdi - Economic Reforms and Income Distribution in Turkey, materials of Economic Research Forum 2016 Annual Conference - Towards a New Development Agenda for the Middle East, March 19, 2016, Cairo, Egypt (<http://erf.org.eg/events/towards-a-new-development-agenda-for-the-middle-east/?type=project&tab=>)

Annual Inflation in Turkey



AKP, which has been in power since 2002, and in general the “economy has been the government’s greatest success”³⁹, according to many.

However the success story mostly pertained to the early period of AKP rule, rather than later. Since 2011 the slowing growth, depreciation pressure on exchange rate, problems with the unemployment (in particular among the youth), exposed the vulnerabilities and weakness of the economy,⁴⁰ in spite of the reforms adopted in the beginning of the millennium. According to critics, Turkish economy requires addition-

al fundamental reforms, and some of the aforementioned problems are of the AKP’s making. In particular, pressure on the central bank, requiring it to keep expansive monetary policy, while providing results in the short term is unsustainable and might cause long-term problems, not the least loss of independence of and confidence in the central bank.⁴¹

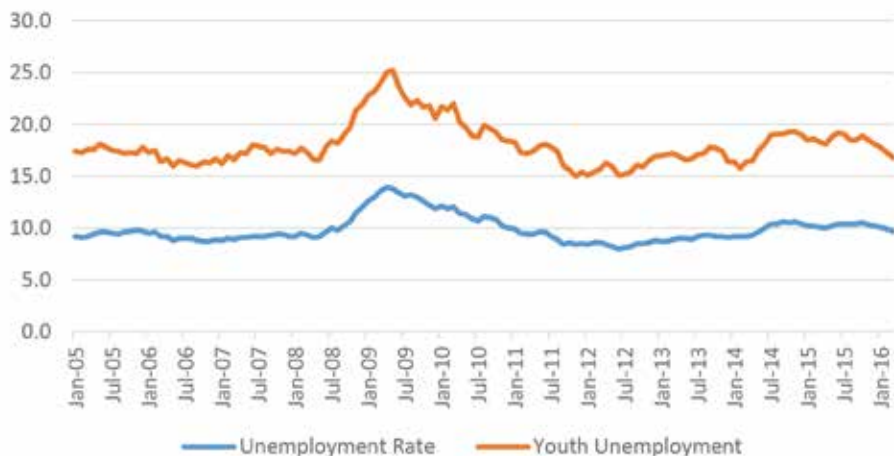
Furthermore, since 2012 Turkey slipped down in Corruption Perception Index from 54th to 66th in 2015, whereas Freedom House downgraded Turkey from Partly Free to Not Free in 2014 and the

39 https://next.ft.com/content/692061c0-f988-11e4-ae65-00144feab7de?siteedition=intl&iab=barrier-app&i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F0%2F692061c0-f988-11e4-ae65-00144feab7de.html%3Fsiteedition%3Dintl%26iab%3Dbarrier-app&i_referer=&classification=conditional_standard&iab=barrier-app

40 <http://foreignpolicy.com/2015/04/03/whos-going-to-save-turkeys-economy-erdogan-akp/>

41 <https://next.ft.com/content/c0eaf6a0-c287-11e4-ad89-00144feab7de#axzz3W03JjDOx>

Unemployment in Turkey



ranking has not changed since. While these are political, rather than economic issues, this certainly is a bad signal to the outside investor and might affect Turkey's long-term prospects.

Turkey has definitely been trying to reform its economy and according to the World Bank Doing Business, the reforms initiated by Turkish government in the last 8 years mostly made it easier to do business, with only a handful of changes being essentially anti-business.

DB2016	
✓ Dealing with Construction Permits	Turkey made dealing with construction permits easier by streamlining the process to obtain the fire clearance.
DB2015	
* Starting a Business	Turkey made starting a business more difficult by increasing the notary and company registration fees.
* Paying Taxes	Turkey made paying taxes more costly for companies by increasing employers' social security contribution rate.
✓ Enforcing Contracts	Turkey made enforcing contracts easier by introducing an electronic filing system for court users.
DB2014	
* Starting a Business	Turkey made starting a business more difficult by increasing the minimum capital requirement.
✓ Dealing with Construction Permits	Turkey reduced the time required for dealing with construction permits by setting strict time limits for granting a lot plan and by reducing the documentation requirements for an occupancy permit.

✖ Registering Property	Turkey made transferring property more costly by increasing the registration and several other fees.
✓Protecting Minority Investors	Turkey strengthened investor protections through a new commercial code that requires directors found liable in abusive related-party transactions to disgorge their profits and that allows shareholders to request the appointment of an auditor to investigate alleged prejudicial conflicts of interest.
✓Getting Electricity	Turkey made getting electricity easier by eliminating external inspections and reducing some administrative costs.
DB2013	
✓Dealing with Construction Permits	Turkey made dealing with construction permits easier by eliminating the requirement to build a shelter in nonresidential buildings with a total area of less than 1,500 square meters.
✓ Enforcing Contracts	Turkey made enforcing contracts easier by introducing a new civil procedure law.
DB2012	
✓Starting a Business	Turkey made starting a business less costly by eliminating notarization fees for the articles of association and other documents.
✓Paying Taxes	Turkey lowered the social security contribution rate for companies by offering them a 5% rebate
DB2010	
✓Getting Credit	Turkey's private credit bureau added firms to its database, improving access to credit information.
DB2009	
✓Protecting Minority Investors	Turkey strengthened investor protections by requiring that an independent auditor assess related-party transactions before approval.
DB2008	
✓Trading Across Borders	Turkey made trading across borders easier by introducing an electronic data interchange system, improving information technology infrastructure and training some 2,500 customs officers and 14,000 traders.
✓Paying Taxes	Turkey made paying taxes less costly for companies by reducing the tax rates on corporate income and on interest.

Nevertheless, despite these reforms, Turkey still lags behind many emerging markets in the Doing Business index in 55th (e.g. Georgia is 24th, Armenia - 35th, and even Russia is ahead of Turkey in 51st place) indicating the need for deeper structural reforms.

2016 AND PROBLEMS IN TURKEY

For a country quite dependent on tourism, Turkey is facing significant problems in 2016. On November 24 2015, Turkish air forces shot down a Russian warplane,

which crossed Turkey-Syria border and disregarded numerous warnings and requests to change direction.⁴² As a result the diplomatic and economic relations between the two countries were severely damaged, with President Putin signing a decree which called for banning/limitation of Turkish imports, work of Turkish companies in Russia and work of Turkish citizens in Russia.⁴³ Since January 1, 2016 Russia ended visa-free visits of Turkish nationals in Russia, canceled charter flights and called on its citizens not to go to Turkey (the latter essentially meaning prohibiting Russian tourists visiting Turkey; given that for Turkey Russia is the source of the second-largest number of tourist arrivals after Germany, the impact was disastrous).⁴⁴ As a result, Turkish economy took a significant hit, with Aydin Sezer, a former trade official saying that “Russia’s sanctions are costing Turkey 12 billion USD a year, 4 times what was first projected”.⁴⁵ In May 2016

tourist arrivals in Turkey declined 34.7% y-o-y, mostly due to the stark decline in the number of Russian tourists – 91.8%.⁴⁶

However the decline in tourists was not due only to the severed relations with Russia. A number of terrorist attacks since October 2015, claiming lives of nearly 250 people,⁴⁷ significantly diminished the attractiveness of Turkey as a tourist destination. Holiday bookings fell by 50% on 2015, hitting the tourism industry hard and forcing hundreds of B&Bs, hotels and boutique resorts’ owners to put their property on sale.⁴⁸ Possibly the problems in the economy were behind President Erdogan’s decision to apologize for the downing of Russian warplane on June 27 2016.⁴⁹ However the very next day three terrorists assaulted Istanbul’s Ataturk airport, killing more than 40 people and wounding 200,⁵⁰ an attack which doubtless will add to the alms of the tourism sector in Turkey.

42 <http://www.bbc.com/news/world-middle-east-34912581>

43 <http://en.kremlin.ru/events/president/news/50805>

44 <http://www.al-monitor.com/pulse/originals/2015/12/turkey-russia-steep-costs-of-downing-of-russian-jet.html>

45 <http://vovworld.vn/en-US/Current-Affairs/Thawing-RussiaTurkey-relations/449314.vov>

46 <http://www.tradingeconomics.com/turkey/tourist-arrivals>

47 <http://www.economist.com/news/leaders/21701489-how-turkey-has-made-itself-soft-target-turkeys-agonny>

48 <https://www.theguardian.com/travel/2016/mar/23/turkey-tourism-industry-summer-holiday-bookings-fall-50-percent>

49 https://www.washingtonpost.com/world/turkey-apologizes-for-shooting-down-russian-warplane-last-year/2016/06/27/d969e0ea-3c6d-11e6-9e16-4cf01a41dec_story.html

50 <http://www.economist.com/news/leaders/21701489-how-turkey-has-made-itself-soft-target-turkeys-agonny>

TURKEY AND GEORGIA – EXTENSIVE COOPERATION

The relation between Georgia and Turkey had been mostly hostile throughout history, with Georgia having a handy geopolitical location and Turkey realizing its imperial ambitions. However, once Georgia declared independence, Turkey was one of the first countries to acknowledge its independence and establish diplomatic relations with us.

At present there are 76 bilateral treaties and agreements between Georgia and Turkey, which cover virtually all possible issues.⁵¹ Most important of those are related to the cooperation in energy and transport as well as to the trade and economic relations. Notably, the travel between the two countries is extremely simplified, with only an ID card necessary to cross the border. At the moment there are more than 3200 Turkish or Turkish-Georgian joint companies operating in Georgia.⁵²

TRADE

Turkey is one of the most important trading partners of Georgia. In the first four months of 2016 Turkey was the second largest export destination, with 10.5% of exports (second only to China), and second largest importer in Georgia as well, with 15.3% of imports (second only to Canada, with 15.7%, although it should be mentioned that this large number is almost entirely due to Hepatitis C medications). The importance of Turkey is seen from long-run data as well – in 2000-2015 Turkey was responsible for 11.5% of all exports and 16.4% of all imports in Georgia.

Unsurprisingly, Turkey is a significant import destination for a number of various goods. E.g. in 2000-2015 95.6% of all t-shirts, singlets, tank tops etc, knit or crochet exports, 80% of ferrous waste & scrap, remelt scrap iron/steel ingot, 58.6% of semifinished products of iron or nonalloy steel, 46.25% of aluminum waste and scrap and 41.5% of electric energy exports went to Turkey.⁵³

51 <http://www.mfa.gov.ge/MainNav/ForeignPolicy/BilateralRelations/%E1%83%97%E1%83%A3%E1%83%A0%E1%83%A5%E1%83%94%E1%83%97%E1%83%98%E1%83%A1-%E1%83%A0%E1%83%94%E1%83%A1%E1%83%9E%E1%83%A3%E1%83%91%E1%83%9A%E1%83%98%E1%83%99%E1%83%90.aspx>

52 <http://4liberty.eu/turkish-georgian-economic-relationship-as-an-example-of-good-will-and-successful-cooperation/>

53 Only goods with total export in 2000-2015 exceeding \$100 mln were chosen for this comparison.

Trade with Turkey in 2000-2016			
Export (1000 USD)		Import (1000 USD)	
Ferrous waste & scrap, re-melt scrap iron/steel ingot	793239.7	Medicaments nesoi, mixed or not, in dosage etc fm	409499.1
Ferroalloys	315265.2	Structures nesoi & parts thereof, of iron or steel	306672.6
Mineral or chemical fertilizers, nitrogenous	154323.5	Tubes, pipes & hoses & their fittings, of plastics	284956.9
T-shirts, singlets, tank tops etc, knit or crochet	139277	Insulated wire, cable etc, opt sheath fib cables	234863.2
Electrical energy	102424.3	Organic surf-act agents, preps & cleaning preps	225693.3
Aluminum waste and scrap	86611.61	Tubes, pipes & hollow profiles nesoi, iron & steel	218972.5
Semifinished products of iron or nonalloy steel	86603.97	Sanitary towels (pads) and tampons, napkins and napkin liners for babies and similar articles, of any material	215269.8
Motor cars & vehicles for transporting persons	71430.01	Monofil, cr-sect ovimm, rods, sticks etc, plastics	203875.9
Wood sawn or chipped length, sliced etc, ov 6 mm thick	70019.98	Refrigerators, freezers etc, heat pumps nesoi, pts	200171.8
Women's or girls' suits, ensemb etc, not knit etc	66234.22	Containers (boxes, bags etc), closurers etc, plast	193406.2

The dominance of various scrap metals in the top exports to Turkey is obvious, with just the iron scrap constituting 30.9% of all exports to Turkey in 2000-2016. However, if we consider only period since 2013,

when the export of scrap metals started to dwindle down (most likely, since it is an unrenewable resource), the composition of exports to Turkey has drastically changed.

Exports to Turkey in 2013-2016		
Goods	Value (in 1000 USD)	Share in total exports
T-shirts, singlets, tank tops etc, knit or crochet	113,767.5	16.9%
Mineral or chemical fertilizers, nitrogenous	92,839.2	13.8%
Semifinished products of iron or nonalloy steel	85,228.2	12.6%
Flour, meal etc of meat etc, not for human: greavs	46,169.7	6.9%
Electrical energy	35,281.3	5.2%
Bars & rods, iron & na steel nesoi, h-r etc	35,102.2	5.2%
Men's or boys' suits, ensembles etc, knit or croch	25,783.5	3.8%
Ferroalloys	23,214.9	3.4%
Women's or girls' blouses, shirts etc not knit etc	19,544.7	2.9%
Fats & oils, their fractions, fish & marine mammal	17,765.8	2.6%

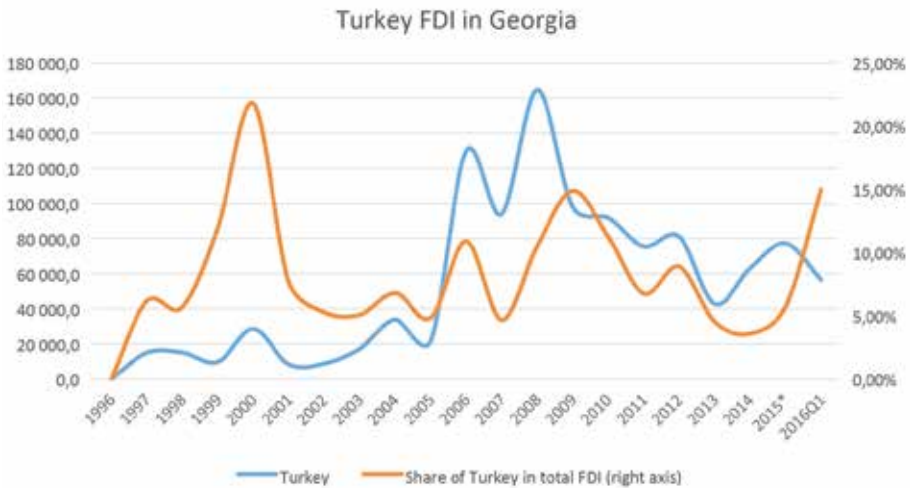
Despite various metals still being an important export goods, the dependence on scrap is virtually gone and export to Turkey has become much more diversified, including textile, foodstuffs and electricity. Turkey is also a major export destination for a number of goods,⁵⁴ with 95.6% of t-shirts, 39.7% of sawn wood, and 13.7% of nitrogen fertilizers going there in 2000-2015.⁵⁵

Imports from Turkey are dominated by various plastic and construction goods, with the medicaments being the most important Turkish import in 2000-2016. As for the comparative importance of Turkey as a source of specific imports, out of goods with the total import into Georgia exceeding \$100 mln in 2000-2015, many are dominated by Turkish imports – e.g. 88% of monofilms, 77% of wood boards, 76% of

made-up textile articles, 76% of sanitary pads, etc. come from Turkey, once again confirming significance of Turkey for Georgian economy.

FDI, TOURISM AND REMITTANCES

Turkey has never dominated the FDI flowing into Georgia in the same way as it dominated trade. Since 1996 Turkish FDI constituted only 7.6% of total investment inflows in the country and beginning on 2012 Turkish FDI was 320.8 mln USD, being 6.01% of total; in the same period FDI from Turkey mostly went to transport and communication (108.3 mln USD; 7.5% of total FDI in the sector), construction (57.3 mln USD; 10.3% of total), processing industry (42.3 mln USD; 7.5% of total), and hotels and restaurants (24.1 mln USD; 11.5% of total).



54 Again, omitting various scrap metals

55 This only includes goods with high overall volume of imports; there are almost 40 various goods, more than 90% of whose exports goes to Turkey, including various textile products, fibers, etc.

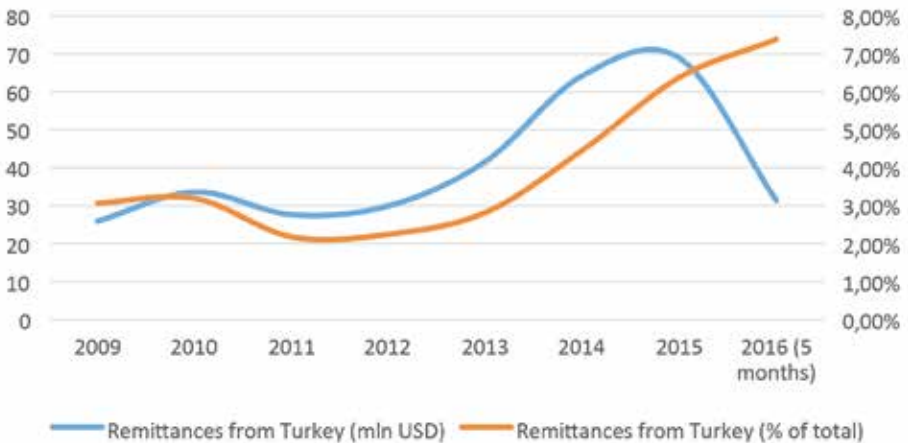
Visitors from Turkey



Turkish visitors constitute important share of tourist coming in Georgia, with around quarter of all visitors coming from Turkey. It should be mentioned that possibly a majority of those are the truck drivers crossing

the country, however the number is quite impressive nevertheless. Only Armenia and Azerbaijan provide similar number of tourists/visitors, while Russia lags behind in the fourth place.

Remittances from Turkey



Regarding the remittances, given the problems in the countries which had been traditional sources of remittances for Georgia, like Russia and Greece, remittances from Turkey started growing in the recent years both in absolute value and as a share of total, reaching 7.4% in the first five months of 2016.⁵⁶ While this is not a particularly high number and Turkey cannot be relied on as a steady source of foreign exchange inflows at the moment, it is still a positive sign.

ENERGY COOPERATION

An important sphere of cooperation between Turkey and Georgia is the oil and gas transportation via pipelines. At the moment two major pipelines connect Turkey and Georgia – South Caucasus natural gas Pipeline (also known as Baku–Tbilisi–Erzurum Pipeline, or Shah Deniz Pipeline) and Baku–Tbilisi–Ceyhan oil Pipeline.⁵⁷

The South Caucasus Pipeline (SCP) has been designed to transport natural gas from the Shah Deniz field as well as other fields of the Caspian basin to Turkey and then from Turkey to the European market. The length of the pipeline is 691km, with 249km in Georgia. On the border the pipeline is tied to the branch line built by the Turkish side, which connects the SCP to the local gas supply system of Erzurum. Construction of the SCP was completed in 2006. First deliv-

eries of natural gas to Georgia through the SCP commenced in early 2007. In Georgia the SCP follows the route of the Baku–Tbilisi–Ceyhan (BTC) crude oil pipeline on the territory of Georgia. The total cost of the project totaled to \$1bl. The pipeline belongs to the consortium where BP, Statoil, SOCAR, LukOil, NICO, TOTAL and TPAO are partners in the project development. BP is the technical operator of the pipeline while Statoil is the commercial operator. After completing additional stages of the pipeline development and working at full capacity, the pipeline will transport up to 21 – 24 bcm of natural gas. According to the project agreement, Georgia is not only a transit country but also a natural gas consumer country. Georgia has an option to purchase 5% of gas transported from Azerbaijan to Turkey for a favorable price. In addition, for 20 years starting from the project functioning date, Georgia will purchase additional volume of gas (about half a million cubic meters), from project investors at a special price.

The BTC oil pipeline is the shortest route to transport oil from the Caspian Sea to the Mediterranean. The total length of one of the longest pipelines in the world is 1768 km; 443 km in Azerbaijan, 249 km in Georgia, and 1,076 km in Turkey. The diameter of the pipeline ranges from 42 to 46 inches. The pipeline has eight pumping stations (two in

⁵⁶ Despite accounting only for 3.6% in 2009-2016

⁵⁷ The information below related to these pipelines is in its entirety taken from the website of Georgian Oil & Gas Corporation at <http://www.gogc.ge/en/saertasoriso-praqtobi>

Azerbaijan, two in Georgia and four in Turkey). The pipeline construction costs totaled to about \$4 bl. The BTC pipeline exports oil extracted from the Azeri-Chirag-Gunshli field to Ceyhan. The owner of the project is International Consortium BTC Co with eleven participating partners. The pipeline is operated by BP and the project was financed by International Financial Corporation and EBRD. After putting the pipeline into operation, the Georgian state budget received \$50 ml as a direct transit fee.

In addition to the aforementioned, Georgia is an important counterparty of the EU Priority corridor Southern Gas Corridor (“SGC”), which is a project of common interest (PCI) cluster “integrated, dedicated and scalable transport infrastructure and associated equipment for the transportation of a minimum of 10 bcm/a of new sources of gas from the Caspian Region, crossing Azerbaijan, Georgia and Turkey and reaching EU markets in Greece and Italy”⁵⁸ including, inter alia, “[g]as pipeline to the EU from Turkmenistan and Azerbaijan, via Georgia and Turkey, [currently known as the combination of “Trans-Caspian Gas Pipeline” (TCP), “Expansion of the South-Caucasus Pipeline” (SCP-(F)X) and “Trans Anatolia Natural Gas Pipeline” (TANAP)]”⁵⁹

CONCLUSIONS AND RECOMMENDATIONS

Short Term

- There is an indirect link between decline in tourists’ (mainly Russian, but also from other countries of the region) flow to Turkey and their increased number in Georgia. Given the risks related to travel to Turkey, Georgia may provide a substitute seaside-tourism destination possibly in the medium-term as well and this opportunity must be utilized.
- Remittances from Turkey are on a rise and we can expect this upward trend to remain unchanged in the near future.
- Number of visitors from Turkey will remain steadily high without a pronounced trend. Given that a large number of those visitors are long-distance truck drivers entering mostly for a short-term, and with the increase in trade volumes and rising importance of Georgia as a transportation and trade hub this number will increase as well.
- In the last 3 years Turkish FDI has been on an upward trend, which can be expected to remain in the near future.

58 At http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2016_019_R_0001&from=EN

59 Ibid.

- The composition of trade with Turkey has significantly changed in the last 3-4 years, particularly in respect to export. Given that Turkish share in Georgian exports has at the same time increased which means that after depletion of our “traditional” exports – scrap metals and such – to Turkey, Georgian exporters took some time to find our comparative advantage with Turkey and the changed composition of exports reflects this advantage. The performance of these sectors could be considered a good example to follow for Georgian exporters as a whole. An unusual advantage that could be used by Georgian exporters (not only for trade with Turkey) is the huge number of empty containers leaving Georgian ports every year⁶⁰ the use of which might significantly lower transportation costs.

Long Term

- The precarious political situation in the region means that Turkish economy might be under significant pressure in coming years. The problems could be exacerbated by the Fed’s interest rate increases, which can increase the said pressure, since the foreign financing is a significant factor in Turkish growth.⁶¹ The effect on Georgia can be ambiguous, leaning to negative: on one hand

Turkey is one of the most important economic partners and decline in its economy will definitely affect Georgian export sector both in goods and services weakening the aggregate demand as a result; on the other hand Georgia can find certain opportunities and fill the niches which will open, e.g. in tourism.

- The completion of Baku-Tbilisi-Kars railway is crucial as an additional leverage to Georgia’s claim to being an important transit country. It also will provide an important alternative to the North-South railway which is actively being promoted by Russia and may even render it useless. At the moment the deadline of the BTK railway completion has been postponed to 2017,⁶² however all feasible efforts must be made to ensure that no more unnecessary postponements will take place.

- Georgia should continue cooperation with Azerbaijan and Turkey on large-scale transit projects, since Georgia provides certain advantages for such transit – there already is a successful experience in this regard, route through Georgia is the shortest way from Caspian Sea to Europe, and from the political viewpoint it is much more expedient to plan a route through a neutral country.

60 Georgian Competitiveness Report 2013, page 56 (at http://iset-pi.ge/images/Projects_of_MPRC/National_Competitiveness_Report_for_Georgia.pdf)

61 <http://www.al-monitor.com/pulse/originals/2015/08/turkey-economy-political-uncertainties-greatest-risk.html>

62 [http://www.jamestown.org/single/?tx_ttnews\[tt_news\]=45159&no_cache=1#.V3pk_FL6Kb8](http://www.jamestown.org/single/?tx_ttnews[tt_news]=45159&no_cache=1#.V3pk_FL6Kb8)

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GEORGIA & TURKEY IN 2015

\$187 mln

EXPORT TO TURKEY

\$1,330 mln

IMPORT FROM TURKEY

2,782,291

VISITORS ENTERED
GEORGIA FROM
TURKEY

\$69 mln

REMITTANCES FROM TURKEY

\$56 mln

FDI FROM TURKEY



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