China-Turkey Relations:
Bilateral Cooperation, Cooperation on Global Issues and Headwinds in Present Relations

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December 11, 2015

Turkey and China share many common interests and goals in the global arena. Both are middle-income countries that are seeking to transit to higher income status, and both seek to navigate financial and trade headwinds present in the global economy today. In the aftermath of the 2008 financial crisis that erupted from the developed economies such as the US and Europe, both Turkey and China managed to maintain high rates of growth. China accomplished this by unleashing a massive fiscal stimulus package worth around $586 billion while Turkey benefitted from low global interest rates and a construction boom. Now, with an imminent rise in interest rates by the Federal Reserve in the US, both also face financial vulnerabilityand a growth slowdown due to external factors and their internal growth mechanisms.

Before we discuss bilateral cooperation and cooperation on global issues, it's useful to present some information about China and Turkey's relative growth performance. Today both countries are termed members of the ***middle-income*** group of nations; see Figure 1. The World Bank categorizes middle-income countries (MIC's) as those that "fall in the middle-income range set by the World Economic Indicators. They account for just under half the world's population"… but "they also cover a wide income range, with the highest income MIC having a per capita income 10 times that of the lowest. The group has grown in number since the mid-1990s, including 10 countries (for example China and Egypt) moving from the low-income to middle-income category."[1] MIC's represent about one-third of global GDP and are major engines of economic growth.[2] Many international institutions expend considerable resources on identifying and coordinating the various development needs of the MIC's.

Figure 2 further shows the behavior of GDP per capita for Brazil, China, India, and Turkey relative to the US, based on the World Bank series that is adjusted for purchasing power parity (PPP). From this figure, we observe that both Brazil and Turkey have higher GDP per capita relative to the US compared to China but that China shows a strong `catch-up' performance. Second, whereas Brazil, Turkey, and China have GDP per capita that is at least 25% of US GDP per capita in 2014 (with per capita GDP in Turkey reaching more than 35% of US per capita GDP by this date) , GDP per capita for India remains around 10%. Third, we observe a temporary decline in GDP per capita relative to the US for Turkey during 2009, reflecting its greater vulnerability to the effects of the global financial crisis whereas the performance of other three countries remains unaffected. Finally, we observe a deteriorating performance for Brazil since 2011, with little progress made towards convergence to higher income levels.

[1] The World Bank, Independent Evaluation Group, "What Are Middle Income Countries?"

[2]http://www.worldbank.org/en/country/mic

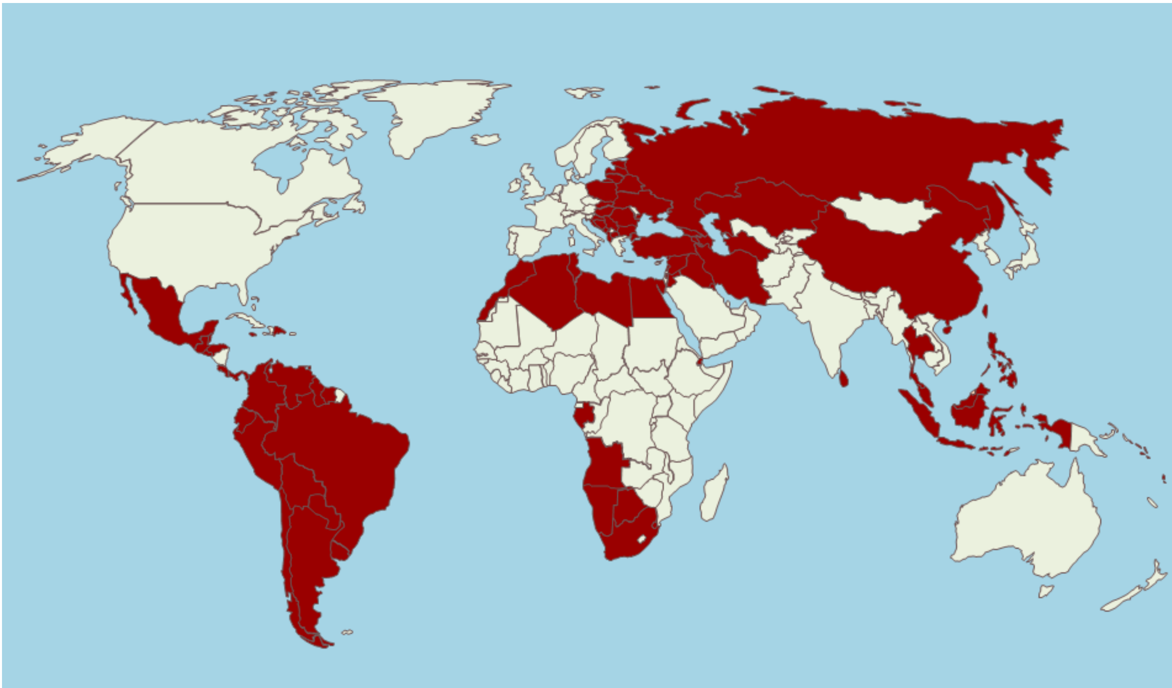

Figure 1: Map of Middle Income Countries
Source: The World Bank, Independent Evaluation Group, “What Are Middle Income Countries?”

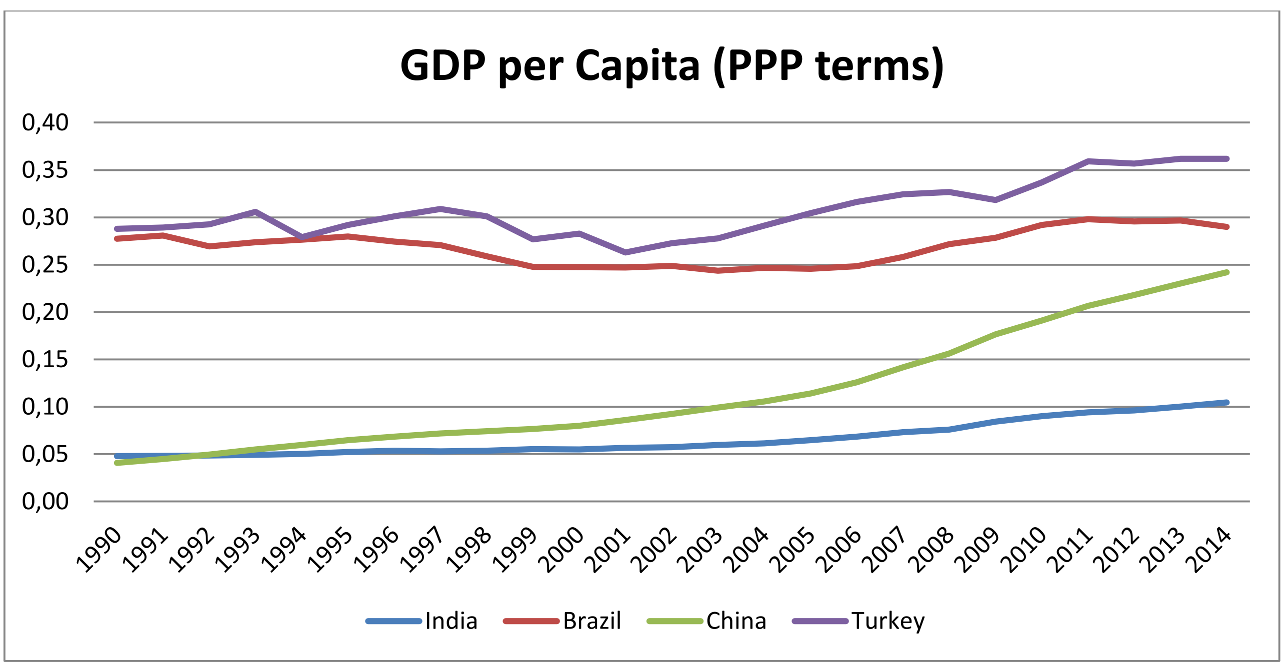

Figure 2: GDP per Capita, PPP adjusted (in current international $)
Source: World Bank

In Figure 3, we also present projections of real GDP per capita relative to the US for the same set of countries. Here we observe that Brazil and Turkey have real GDP per capita that is slightly greater than 20% relative to that for the US in 2015 while the same quantity is measured to be around 12% for China. However, by 2030, all three countries are projected to have converged to a level of GDP per capita that is around 25% to that of the US. For India, some convergence is also expected by year 2030, but this is much more minor compared to the expected performance for the other countries and especially China. Thus, Figure 3 shows not only the strong expected performance for the Chinese economy in the next 15 years, which is expected to nearly double its GDP per capita relative to the US by 2030, but also demonstrates the commonalities in the future growth performance of three key emerging economies.

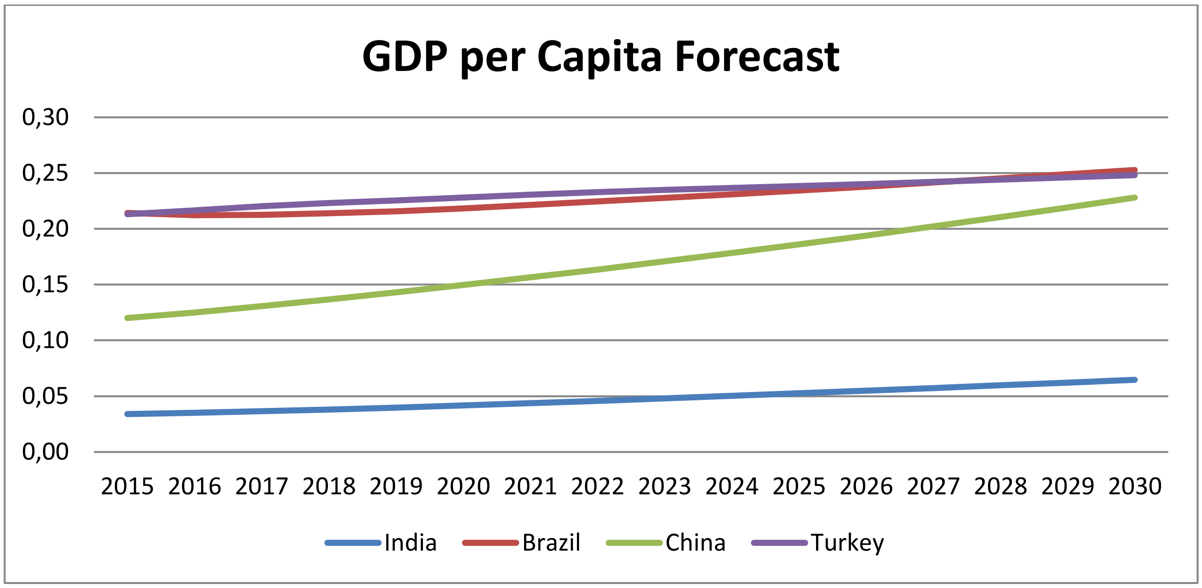

Figure 3: GDP per Capita Forecasts (in 2010 $)
Source: US Department of Agriculture Economic Research Service

Keeping in mind these preliminary observations, we can now address some issues in bilateral and global cooperation for China and Turkey. From a bilateral point of view, China and Turkey, in many ways, face similar types of issues. These include incomplete financial development and in China's case, further financial and capital account liberalization domestically. In many ways, China as a much larger economy is now traversing the path that Turkey embarked upon in the late 1980's, with efforts to develop its stock market, liberalize its capital account, and institute more market-based mechanisms for determining interest rates and credit allocation. Hence, one area of potential bilateral cooperation between China and Turkey is sharing the experience of such opening up in the capital account and further unleashing financial market mechanisms. While many emerging economies faced currency and financial crises as part of this process of financial deepening and reform during the 1990's and early 2000's, China itself has been subject to volatility in its stock markets and unexpected global repercussions from its decision is to further liberalize its exchange rate setting mechanism this past August. Clearly, sharing the lessons of this experience both bilaterally and more broadly among other vulnerable emerging economies seems a key area of potential cooperation.

In common with other emerging economies, a growth slowdown is also occurring for both countries. In China's case, the stimulus program which kept its economy growing in the wake of the global financial crisis and which also contributed positively to global growth has also led to an increase in the ratio of the total indebtedness of the private sector to 140% of GDP in 2014 from 107% in 2007 as well as inducing excess capacity in many key industries such as steel and construction. As China simultaneously seeks to unravel these imbalances and move from aninvestment-led growth to a consumption-led model, its policy choices may be limited and the potential for further volatility and a sharp, unwanted contraction relatively large.A study by PriceWaterhouseCoopers examines the growth effects of an investment slowdown in China on the major economies in the world, including Turkey. Here a 2.5% decline in fixed asset investment in China would lead to a 0.2% decline in growth for countries such as Mexico and Turkey from the baseline scenario. Due to the foreign exchange debt of its private sector combined with the weak lira, such an external shock could be amplified more for Turkey.[3]

In an environment with external risks emanating from the imminent Fed interest rate hike as well as a potential slowdown in Chinese growth, Turkey is also buffeted by geopolitical risks and regional instability. The risk of capital flow reversals and commodity price declines together with domestic political factors also appear to be taking their toll GDP growth on other large emerging market economies such as Brazil and Russia. In an environment with enhanced volatility and recessionary pressures, a second venue for bilateral cooperation lies in seeking mechanisms to reduce alternative sources of volatility for emerging economies by further financial collaboration, the opening up of swap lines, or instigating trade in domestic currencies. Devisingconsultative mechanisms between developed and emerging economy central banks or financial supervisory bodies is also another way to cushion emerging economies such as China and Turkey from the impact of financial shocks originating outside of their economies, as enunciated by the former Governor of the Reserve Bank of India, RaghuramRajan.[4]

A third obvious mechanism for bilateral cooperation lies in increasing investment flows, tourism, and mutually beneficial trade. While trade between Turkey and China increased from $2 billion in 2002 to $28 billion in 2014, it is skewed towards China and would benefit from measures to enable a more even distribution between the imports and exports of the two countries.[5]Other bilateral interests include further collaboration in infrastructure such as high speed rails and nuclear projects. China's biggest bank, the Industrial and Commercial Bank of China (ICBC) became the first Chinese lender to operate in Turkey following its acquisition of 75.5% stake in Turkish Tekstilbank in 2014. Turkey hosts a regional management center for the Chinese network solutions provider Huawei, which also operates a research and development lab in Istanbul.

These joint ventures point to an increasingly fertile field for collaboration in technology-related endeavors, as both Turkey and China seek to move their economies further up the value-chain in production. A study implemented by PWC in 2012 identifies five sectors which could constitute centers of excellence for the Turkish economy in 2041.[6] These include industries that seek to take advantage of

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[3]See "China Unmasked", *PWC Global Economy Watch*, October, 2015. http://www.pwc.com/gx/en/issues/economy/global-economy-watch/china-unmasked.html

[4]. Robin Harding, John Aglionby, Delphine Strauss, Victor Mallet and Amy Kazmin. "India's RaghuramRajan hits out at uncoordinated global policy." *Financial Times*, January 30, 2014. http://www.ft.com/intl/cms/s/0/cc1d171689ac-11e3-abc4-00144feab7de.html

[5] See the comments by RecepTayyip Erdogan, President of Turkey, during the Turkish-Chinese Business Forum held in Beijing, *Star* newspaper, 30/07/2015.

[6] "Turkey in 2041: Looking to the Future," PWC, May, 2012. https://www.pwc.com.tr/tr/publications/arastirmalar/pdf/turkey-in-2041-eng.pdf

Turkey's abundant agricultural and energy resources such as the food and beverage processing, agricultural R&D and services, alternative energy, automobile production, and tourism. When taken into consideration with the rising middle classes of China, specifically, and the Asia region, more generally, and their demand for higher quality foods, services, and recreation, these areas of excellence present themselves as natural areas for bilateral cooperation between China and Turkey. With its priceless cultural heritage, Turkey appears as a natural destination for the tens of millions of Chinese tourists who are already making their way to many foreign venues. The development of the industries, in turn, would entail more short-term collaboration on building the required transport and telecommunications infrastructure.

In summary, China and Turkey are two emerging economies that are rapidly converging higher levels of income per capita and affluence. While China is projected to be the largest economy in the world in a few short years, Turkey is also slated to appear among the top 10-12 economies globally. In the short term, both face formidable reform agendas, the need to implement further infrastructure projects to improve their global and regional interconnectivity, and to obtain a larger say in international institutions and governance forums. As they proceed along their separate paths, sharing lessons from past policy experiences and promoting mutually beneficial investment and trade flows appear to be some key areas for collaboration and bilateral cooperation.