

Europe@Risk

A Report by the Global Risk Network



This work was prepared by the Global Risk Network of the World Economic Forum.

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Introduction

The relationship between Europe and Turkey is driven by three factors: historical experience and memory, perceptions of immediate interests and assessment of long-term strategic options. These three elements are in constant interplay, permanently rebalancing each other, giving the relationship with Europe and Turkey both its complexity and vitality.

First, in the space of historical experience and memory stand a number of issues which form the historical and psychological backdrop for the relationship between Europe and Turkey: historical conceptions of “Europe”, the nature of the break-up of the Ottoman Empire and the common experience of an alliance spanning decades against the Soviet bloc under the auspices of NATO. Turkey and European states are products of history; common episodes of that history are key shapers of the current relationship.

Second, of immediate interest are the questions that will drive the relationship over the next 12 months: How can Turkey maintain its path to accession to the European Union? How should Turkey respond to different political conditions in major member states? How can the European Union manage its commitments?

Finally, relevant to long-term strategy are the crucial issues of the next decades: How can Europe and Turkey deal with the global risks that face them both, from the proliferation of weapons of mass destruction (WMD) and climate change, to the coming fiscal crises caused by demographic shift, fears around energy security and possible retrenchment from globalization?

This report focuses firmly on the last of these three spaces: the long-term perspective offered by an understanding of global risks to Europe, and Turkey’s possible role in mitigating them. Turkey is often perceived as a source of risk to Europe; this report suggests that Turkey may, in fact, be able to play a proactive role in helping Europe mitigate some (but not all) of the global risks to its prosperity and security over the next 10 to 20 years. Overcoming the perception of risk associated with Turkey may be a key aim for Turkish and European leaders.

Whatever the short-term outcome of current negotiations on accession to the European Union, Europe and Turkey are bound to each other in the wider global context. They have overwhelming strategic interests in maintaining mutual security and prosperity.

In this context, a key question for the future of the relationship between Europe and Turkey is how much long-term strategy will trump both immediate interests and historical experience – or, conversely, to what extent perceptions of immediate interests and historical experience will present obstacles to the creation of a stable, secure and prosperous relationship in which global risks can be dealt with collectively.

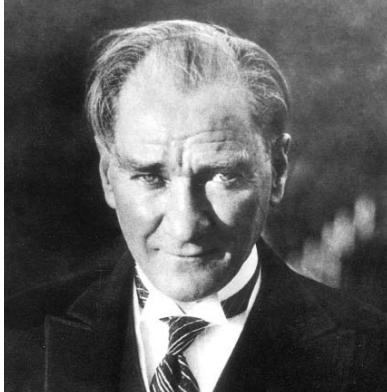
The intention of this report is to promote fresh thinking about Europe’s relationship with Turkey, allowing a space for strategic dialogue which recasts the relationship in terms of long-term global risks – as opposed to historical experience or the short-term management of events. The purpose is not to intervene in current debates, but to provide a framework for discussion and, hopefully, a platform for forward-looking action with mutual benefits.

This report seeks to help decision-makers form answers to three main questions:

- What are the major global risks facing Europe?
- How might these global risks play out over a 10-20 year period?
- What, if anything, is Turkey’s role in mitigating these risks?

One major part of the picture can be found in the Europe@Risk matrix on pages 13-17, which applies the global risk framework to the relationship between Europe and Turkey. This simple matrix summarizes how a select number of defined global risks may impact Europe over the next 10-20 years – and suggests whether and how Turkey will play a mitigating role.

A further part can be found in Turkey: Risk or Risk Mitigator?, an introduction to the context of this report, an exploration of European perceptions of risk and, particularly, the perception of Turkey as a source of risk, and a brief overview of three areas where Turkey can present itself as a mitigator of



Mustafa Kemal Atatürk, Founder of the Turkish Republic

three of the major global risks facing Europe – the risk of “oil price shock/energy interruptions”, the risk of “coming fiscal crises caused by demographic shift” and the risk of “interstate and civil war”.

Two workshops led to this report – the first was held in Istanbul in July hosted by Sabanci University, and the second held in Brussels in October, with the cooperation of the Centre for European Reform. The notes of these workshops give an overview of the discussions, built around the key risk elements in the relationship between Europe and Turkey. They are not a consensus view of participants, but an account of dialogue and debate, and are available on the World Economic Forum’s website as background information.

The final part of this picture is in the contributions to this report of Turkish and European experts (pages 18-28), helping us explore the strategic issues confronting both Europe and Turkey over the coming years. Their insights, more than anything else, demonstrate the salience of discussing the relationship between Europe and Turkey in the context of a wider picture of global risks. Their conclusions suggest the opportunities ahead for Turkey and Europe to collectively mitigate global risks, the obstacles to this and the possible consequences should the relationship regress.

Dr Argüden argues that Europe is facing a struggle between values and interests, protectionism and leadership – and that only a path that puts values and leadership at the core of Europe will allow it to overcome the risks facing it. He suggests that the way in which Europe manages its relationship with Turkey will be a key indicator of which path is chosen.

In his contribution, Sinan Ülgen rejects the fatalism of a “clash of civilizations” with Europe at its epicentre. Instead he shows how Turkey can play an active role in helping mitigate Europe’s social risks and how its stock of social capital, necessary to confront wider global risks, can be boosted.

Chrysostomos Sfatos explores the way in which attitudes to Turkish strength and weakness have changed in Greece over the last few years, and shows how the multilateralization of dialogue has heralded a shift in Greek thinking about Turkey – from risk to opportunity.

Ahmet O. Evin provides an insightful overview of Turkey’s role in the geopolitical landscape. He argues that Turkey has a major risk mitigation role to play, and sets out some of the near-term obstacles to Turkey fulfilling that role. Above all, he makes an appeal for what he suggests is an increasingly rare commodity – leadership.

In a piece of dense analysis, Katinka Barysch and Charles Grant ask what would happen if Europe and Turkey disconnected in a more fundamental way over the longer term. Understanding the way a break-up might play out in the future may help us conceptualize the risk mitigation role Turkey plays in the present, and avoid a sharpening disconnect. Barysch and Grant suggest that Turkey’s fundamental western orientation may not be at risk – but that a break-up would cause increased uncertainty, greater instability and reduce Europe’s and Turkey’s collective ability to face up to common global risks.

Our thanks go to all those who have contributed directly or indirectly to the making of this report, to Professor Ahmet Evin for hosting the first workshop in Istanbul in July, and to Katinka Barysch and Charles Grant of the Centre for European Reform for their assistance and advice in organizing the second workshop in Brussels in October. Our hope is that this report will provide a useful framework for discussions surrounding Europe’s and Turkey’s relationship and will draw out the salient long-term global risks that both will have to face in the coming years.

Managing Global Risk: The Global Risk Network

This report builds on the global work undertaken by the Global Risk Network (GRN) of the World Economic Forum.¹ The purpose of the Global Risk Network is to promote a better understanding of global risks, and seek to facilitate mitigation. The GRN was set up in 2004 in response to concern that the international community and the global business community were not yet able to respond adequately to a radically changing global risk landscape.

The seven elements of the changing landscape of global risks are:

- **Interconnectedness:** opportunities for contagion across geographies and across categories make risks harder to manage and their consequences harder to predict.
- **Asymmetry:** partly as a result of contagion, risks can have disproportionate effects.
- **Time compression:** some risks can develop within the decision cycle of decision-makers; “just-in-time” processes can leave little built-in resilience.
- **Risk extension:** other risks develop in time periods outside the decision cycle of decision-makers, giving rise to the “NIMTOF” (Not-In-My-Term-Of-Office) phenomenon where mitigation costs are immediate and known, and the benefits are either long term or not fully clear.
- **Need for multistakeholder response:** different appreciations of individual and group interest make global risks difficult to mitigate; they typically require multistakeholder responses.
- **Noise:** salient facts are not noticed at the time.
- **Rise of “infodemics”:** rapid spread of inaccurate information can skew responses, generating information-driven impacts greater than those of the primary risk event itself.

Through a number of activities in conjunction with its partners, over the last two years the Global Risk Network has engaged a wide range of experts in the economic, geopolitical, environmental, societal, scientific and technological fields in exploring the nature of the risk landscape facing governments, societies and businesses. The Global Risk Network has produced a number of outputs, including high-level overview reports published at the World Economic Forum Annual Meeting in Davos.²

“Today, the relations between institutions and nations, in a constant state of change and uncertainty, have become extremely complex. In this regard, it has emerged that governors have to implement a more careful and thorough style of governance. In addition to change in social life, there have been bewildering developments in means of communication. Such an environment necessitates the identification and implementation of an institutional “risk management” mechanism which includes the prediction, evaluation and decrease or elimination of negative effects of risk scenarios that may be met in the future. Don’t forget that the healthiest way to predict the future is to create it.”

- **General Yasar Büyükanıt**, 2006-2007
Academic Year Opening Ceremony of the
Turkish Military Academy, 2 October 2006

This report is the first to give a regional dimension to this global work.

Turkey: Risk or Risk Mitigator?

The immediate context of this report is difficult.

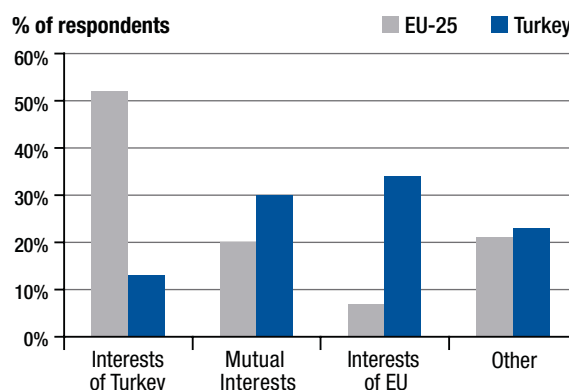
The relationship between Europe and Turkey is under strain. At the same time, the historically strong strategic relationship with the United States has been under pressure since Turkey declined to be a platform for the invasion of Iraq. A number of specific incidents since then, such as the arrest of Turkish special forces near Sulaymaniyah in northern Iraq in July 2003³ and ongoing concerns over the risk of US support for a highly decentralized Iraq with a de facto independent Kurdish state, have not helped. Within Turkish public opinion, support for both the US and the EU has fallen. One much-cited article asks whether, in years to come, Western strategists will have to ask the question, “Who lost Turkey?”, in recognition of a previously unthinkable risk of Turkey pursuing alternative geostrategic options now available to it.⁴

Long taken for granted as a pillar of geopolitical risk mitigation, Europe and others may need to reassess Turkey’s role as a risk or risk mitigator in the context of a wider range of emerging global risks.

The chief immediate cause of strain as regards Europe concerns Turkey’s accession process to the EU. Public support in the European Union for enlargement – and for enlargement to Turkey in particular – has fallen dramatically since the “euphoria” of December 2004. Just 13% of Austrian respondents, 27% of respondents in Germany, and 39% in France, favour enlargement of the European Union to Turkey.⁵ The intensity of public support for the European Union has declined in Greece – from 74% to 56% between Autumn 2005 and 2006 – ascribed by some to the accession of neighbouring Bulgaria and Romania in 2007 and intensifying debates around Turkey’s candidacy.

More surprising is that the decline in public support for enlargement within the EU-25 has been reflected in Turkey itself. Public support in Turkey for EU enlargement fell from 52% in Autumn 2005 to 45% in 2006. Over the same period, trust in the European Union declined from 50% to 35% – just above the levels of the United Kingdom.

Disconnect between EU-25 and Turkish views of who would gain from Turkey’s eventual accession



But perhaps the most interesting disconnect of public opinion in the EU-25 and in Turkey is over the question of who would benefit from eventual Turkish membership in the European Union. In the EU-25, 52% believe Turkish entry primarily benefits Turkey, whereas 20% believe the benefits are mostly mutual and 7% believe the benefits are primarily to the European Union. In Turkey, the picture is almost completely reversed, with 34% believing Turkish accession to be primarily in the interests of the EU, 30% believing the benefits are mutual and only 13% believing that the primary benefit is to Turkey itself. In sum, the popular perception in the EU-25 is that Turkey’s accession would be of benefit to Turkey; the popular mood in Turkey is that accession would benefit the EU.

Overcoming this disconnect – a difference in risk perception – may be a key goal for European and Turkish political leaders over the next months and years. It is not necessarily new; a senior Commission official speaking at the Brussels workshop suggested that, in 2004, the argument was not sufficiently well made that enlargement is in Europe’s interest and that net gains were to be expected. But this disconnect is of fundamental importance – it is the difference between Turkey being seen as a source of risk for Europe, or as a risk mitigator for Europe. Exploring the ways in which Turkey is, or can become, a mitigator of global risks for Europe may be a first step in understanding how that disconnect may be open to change.

European Perceptions of Risk

There is a growing concern that Europe is becoming risk-averse – and that risk aversion may make Europe unable to capitalize on opportunities presented to it.

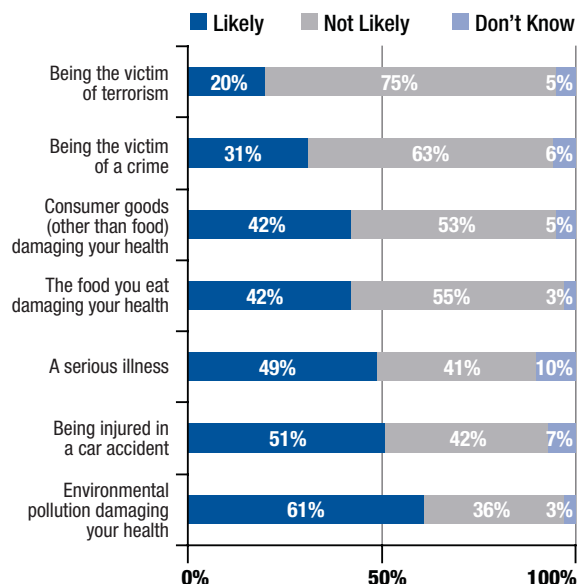
A number of Turkish participants in workshops in Istanbul and Brussels drew attention to an apparent lack of leadership in Europe, and difficulty in adapting itself to a more open and flexible environment created by globalization. One participant said that “Europe has no motivation and nothing to sell.” Another suggested, simply, that “Europe does not ‘get’ globalization.”

At the level of those governing Europe, the argument was made that Europe’s increasing inability to see (or seize) opportunity in place of risk may speed its decline and prevent it from playing the positive role in world affairs that remains open to it.

At the level of public opinion, most Europeans’ assessments of their own individual exposure to risks include a combination of classic risks – such as that of being injured in a car accident – to a number of risks that connect to the global risk landscape.

Their assessment of the most important issues facing their country is similarly a mix of classic issues – crime, healthcare, taxation – and a number of issues which, indirectly or directly, are connected to a wider external landscape of global risks – unemployment, economic situation, immigration, inflation and terrorism.

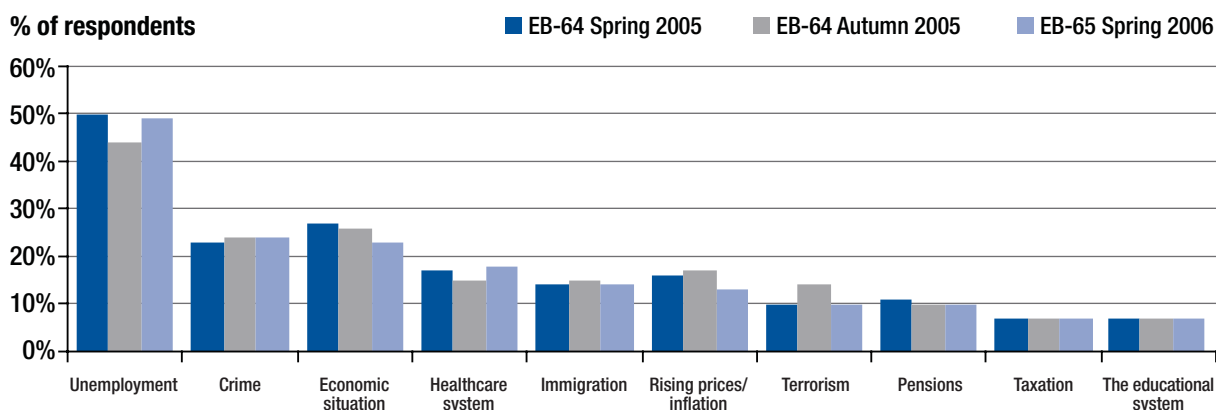
European attitudes to risk - risks which EU-25 citizens believe most likely to impact on them personally



Source: Risk Issues, Eurobarometer, February 2006

To the extent that Turkey can present itself as a mitigator of risks to Europe, it will have to be able to bridge both the individual and strategic perceptions of risks to Europe.

The two most important issues facing (our country) at the moment



Source: Eurobarometer 65, July 2006

Perception of Turkey as a Source of Risk

The perception of Turkey as a source of risk is based on a number of issues.

First, as one participant put it in the October workshop, Turkey is in a “difficult neighbourhood”. Turkey has land borders with Iraq, Iran and Syria. Continued violence in the south-east of the country has both sparked cross-border tensions with the Kurdish authorities in northern Iraq and, in turn, caused tensions with the United States. In addition to these, Turkey has been subject to Islamist terrorism, suffering major bombings in Istanbul in 2003. Turkey’s position on what some see as a potential cultural fault-line increases its perceived risk to Europe.

Second, Turkey has a large and growing population, with a relatively high rate of unemployment. The fear of large-scale immigration contributing to European unemployment – the top issue of concern to EU-25 citizens – may be misplaced, but it is real. As one participant in the Brussels workshop pointed out, this is a major “fear factor” in European public opinion. Meanwhile, economic growth in Turkey needs to remain consistently high to provide employment to its workforce.

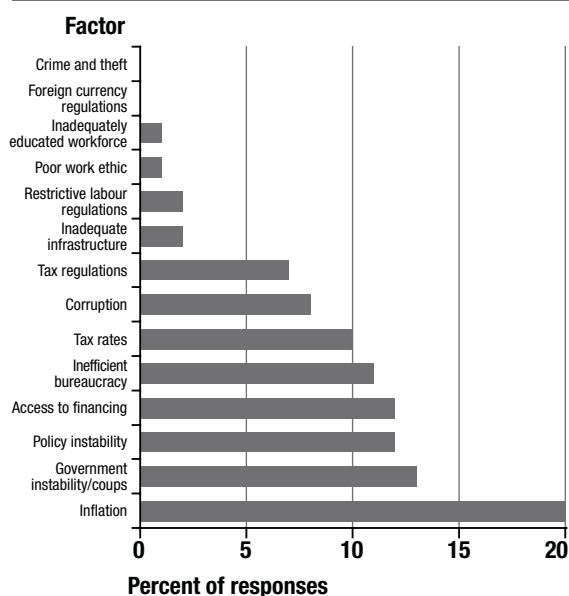
Third, policy and political instability in Turkey has been a major risk consideration in the past and

continues to be one in the present. The following two graphs, drawn from *The Global Competitiveness Report (GCR) 2003-2004* and 2006-2007,⁶ show a major change in the make-up of respondents’ views on problematic factors for doing business. The perception of government instability and coups – along with inflation – has sharply declined, but an impression of policy instability remains.

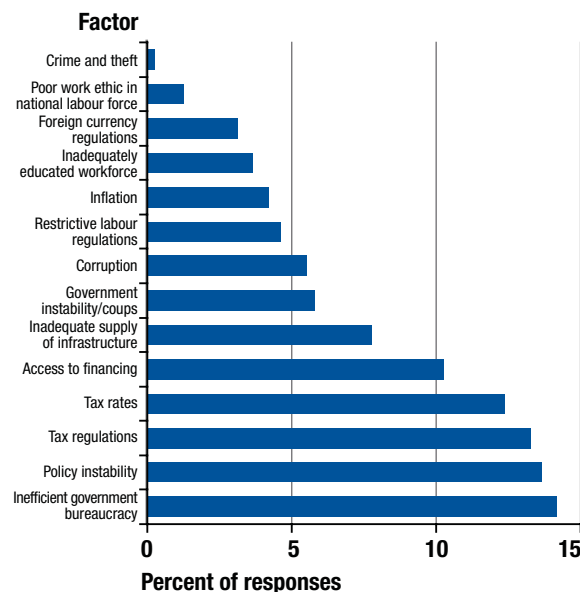
Fourth, Transparency International’s Bribe Payers Index (BPI) placed Turkey 27 out of 30. In the Corruption Perception Index (CPI) Turkey is 65 out of 158, well down the table, though still above both European Union member Poland and candidate country Croatia, both tied at 70. The respondents to the 2006-2007 GCR ranked Turkey at 70 for the impact of organized crime, one position behind Romania; on the perception of the soundness of its banks, Turkey ranked 99 out of 125.

Fifth, Turkey is on a major seismic fault-line. That said, in the 2006-2007 GCR Turkey is ranked surprisingly low – 51 out of 125 – in terms of the impact of natural disasters on business operations and decisions. This suggests that however real the risk, it is not a major factor in determining companies’ decisions to expand local business activities. This could rapidly change in the wake of a major earthquake.

The most problematic factors for doing business in Turkey: 2003-2004



The most problematic factors for doing business in Turkey: 2006-2007



Finally, the Turkish economy has suffered long-term macroeconomic instability. In the last 20 years, Turkish GDP growth has swung from over 8% in four of those years, to less than -4% in three of those years. Consumer price inflation was above 40% in 15 of the last 20 years. Over the last 15 years, overnight interest rates have been extremely volatile, going beyond 50% on several occasions. Domestic gross national saving as a percentage of national income has tended to be the same as countries with far higher per capita income (such as the United States or current member states of the European Union), while inward investment has been considerably lower than in the transition economies of Eastern and Central Europe.

Political instability and economic volatility have been seen to be responsible for up to half of the productivity shortfall in the Turkish economy, distorting business decisions, reducing the ability to manage strategically and reducing the intensity of competition.⁷

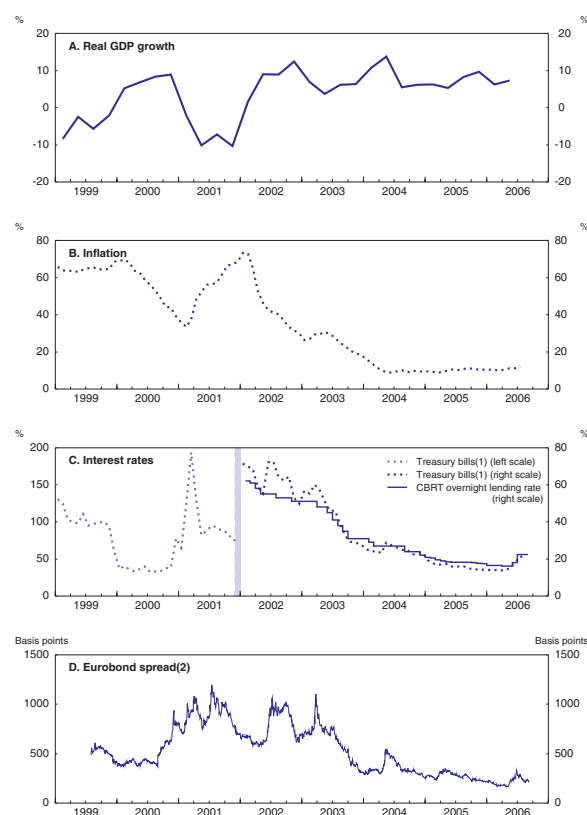
Much has changed in recent years, particularly since the 2001 financial crisis. The independence of the central bank has been a major advance – one workshop participant suggested that the real risk for the future is either inaction on the part of the central bank to combat inflation, or creeping undermining of its independence. The 2002 election of a stable Islamist-led government has led to the continuation of orthodox fiscal policies. Much has also been ascribed to the “EU effect”, not only in the sense of the specific reforms which the EU accession process has required, but in terms of the long-run strategic aims which the path to accession entails. Exports have grown quickly, and interest rates have been rapidly converging with those of the transition economies of Eastern and Central Europe. Net debt peaked at over 90% of GDP in 2001 and is now around 55%.

The results are clear. Foreign Direct Investment (FDI) totalled US\$ 9.8 billion (7.8 billion) in 2005; by mid-2006 Turkey was already close to passing that figure. FDI into the financial sector has been particularly pronounced. Productivity growth has been high (though unbalanced between the informal and formal sectors); structures of financial regulation have been largely updated (although, according to a

recent OECD report, there is a need for continued fiscal discipline and transparency).⁸ The “risk premium” attached to Turkey has declined markedly. The fourth graph on this page, showing Turkey's secondary market bond spread over US Treasuries, demonstrates clearly both the decline in volatility and the convergence and the overall reduction in the “risk premium”.

The current account deficit remains high, with much of the gap covered by short-term funds, leaving Turkey structurally vulnerable to external shocks and to the decisions of outside investors. The Turkish economy was significantly affected by the reduced risk appetite of international financial markets in May 2006. Turkey was not the only economy affected – the impacts were shared across a number of emerging markets – and the lessons are mixed:

Positive macroeconomic fundamentals



1. Primary market treasury bill interest rate (compound) (weighted by net sales).

2. Turkey's secondary market bond spread over US Treasuries.

Source: JP Morgan, Central Bank of Turkey and OECD.

Source: *OECD Economic Surveys: Turkey* – © OECD 2006

continued vulnerability combined with improved resilience. One representative of the financial services industry at the Brussels workshop suggested that “expectations were that this would be bad – it wasn’t; the system is more resilient than we had thought.”

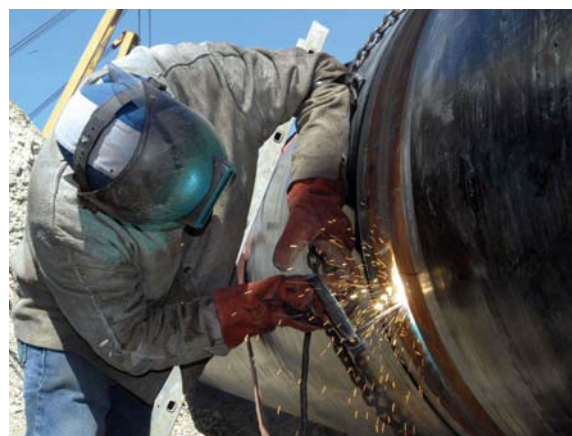
However, as another participant in the Brussels workshop asked – how do you sell a success story? The productive success of the Turkish economy may tend to increase fears in Europe over the risks of delocalization of employment. Moreover, “the better the economy performs, the more that Turks may feel that we don’t need Europe.”

Three Possible Risk Mitigation Roles for Turkey

Overall, a major challenge for Turkey is to present itself as a risk mitigator to many of the global risks facing Europe over the next decades. A major part of this is in the Europe@Risk matrix on pages 13-17. The aim here is to focus briefly on three of the main areas where Turkey can present itself as a risk mitigator to the impacts of Europe’s exposure to global risks.

I. Global Risk: “Oil Price Shock/Energy Interruptions”

Europe’s sense of vulnerability to the risk of interruptions in the supply of energy, a spike in hydrocarbon prices or a prolonged period of weakness vis-à-vis major energy suppliers has increased. This is partly a function of higher global prices for hydrocarbons, fears over supply-chain weaknesses, increasing geopolitical competition for resources and growing debate over “peak oil”. It is also partly due to local considerations – the increasing dependence of Europe on hydrocarbon imports (expected to rise from 50% to 70% over the next 20-30 years) and the Ukraine-Russia gas dispute in 2005-2006, which had knock-on effects in the European market. The European Council has called for an Energy Policy for Europe to be adopted in early 2007. While supporting global energy markets is seen as key to energy security, Europe has also set aims to diversify supplies, help Turkey make full use of its potential as an energy transport hub and create a “common regulatory area with



Construction of the BTC pipeline in 2004

shared trade, transit and environmental rules”. There has been a renewed push to secure ratifications of the Energy Charter Transit Protocol, and promote Turkey’s rapid integration into the Energy Community Treaty. At the same time, Turkey has expressed willingness to become a “fourth artery of Europe’s energy supply security”.

Turkey can play a strong risk mitigation role over the long term. The essential fungibility of oil makes Europe subject to global, rather than regional, oil markets. Nevertheless, the opening of the 1 million bpd Baku-Tbilisi-Ceyhan (BTC) oil pipeline is a historic connection to the Caspian basin (essentially Azerbaijan and, from 2007, Kazakhstan), despite security concerns surrounding the pipeline. When the security situation is improved, Turkey may

become a key transit supplier of oil from Iraq. There are a number of Bosphorus bypass projects intended to reduce the risks of shipping oil through the straits.

Turkey's mitigation role as a transit country for Caspian basin and Iraqi oil may be outstripped by its role in ensuring the supply of gas – from Russia, the Caspian basin and, eventually, Iran and the Gulf. In addition to the Bluestream gas pipeline from Russia, there has been European agreement on the construction of the 3,000 kilometre Nabucco pipeline (due to open in 2011), with eventual connections to Azerbaijan's Shah Deniz field through the BTE pipeline. Turkey has further been discussing an energy deal with Iran – partly to renegotiate current terms of supply, but also to possibly set up a framework for the export of Iranian gas through Turkish pipelines to European markets. There are discussions for a Bluestream-2 pipeline from Russia. A Turkish gas transit role cannot supplant Russian supply, but it can complement it and provide leverage.

Much depends on investment in infrastructure, Turkey's willingness to integrate into the European energy security architecture, Turkey's own energy demands, and overall regional security – but Turkey has the potential to mitigate a major global risk to Europe.

II. Global Risk: “Coming Fiscal Crises Caused by Demographic Shift”

The current demographic structure of Europe's population entails an in-built shift in dependency ratios over the next decades. A recent report on the sustainability of European public finances confirmed the overall scale of the problem, and divided European countries into high-risk (Greece and others), medium-risk (France, Germany, Italy, Spain, the UK and others) and low-risk (including Denmark and Austria).⁹ However, all countries will have to engage in major budgetary consolidation. A number of European countries (such as Italy) are already under considerable fiscal strain. The fiscal problem may be accentuated by an estimated financial wealth shortfall of 34% in the UK, 25% in Germany and 39% in Italy – in terms of the difference between a simple historical extrapolation and a projection from 2003-2024.¹⁰

Increasing workforce participation rates, improving fiscal balances and raising retirement ages may offer some mitigation of the risks. A further element to mitigation may include increased immigration. A final element to mitigation may be improved asset allocation to higher return assets.

Turkey has a relatively low retirement age, given its demographic profile. Labour force participation, at around 49%, is lower than in some European countries. While it has savings rates that are comparable to European savings rates, expected growth in population and its demographic structure mean that the consequences of this on its medium-term fiscal position is not as serious as in Western Europe.

Closer ties between the economy of Turkey and Europe may allow Turkey to play a strong risk mitigating role – by creating a secure market for higher return investments, an excellent base for European business profitability, by contributing dynamism to the European economy and by providing workers to supplement a declining European workforce.

However, there are a number of problematic issues surrounding the last element of the mitigation role. One participant in the workshop in Istanbul asked two particularly acute questions: Do Turks have the right skills to take up jobs in Europe? and How much of a workforce will Europe really need in 2020 (the earliest possible year of accession to the European Union's single labour market)? A further issue may be in terms of Europe's choice of immigration policies, with options ranging from “fortress Europe” to “managed immigration” and “phased immigration”.

III. Global Risk: “Interstate and Civil War”

Major interstate war is largely thought anachronistic as a result of international law, norms and trade. However, the small risks of large-scale interstate conflict over the long term need to be considered prudentially. Turkey inhabits a region key to many of the possible small-scale and large-scale conflicts of the next century: the Middle East, Central Asia and

the Caucasus. Turkey can be a major security provider in a region vital to European (and global security), contribute credibility to European military force-projection capabilities and, more widely, to Europe's Common Foreign and Security Policy (CFSP) and European Security and Defence Policy (ESDP).

Part of this mitigation role results from Turkey's geographical position in Sir Halford Mackinder's "Eurasian heartland" – bordering Iran, Syria, Iraq and the south Caucasus, controlling the Bosphorus and the upstream waters of the Tigris and Euphrates, and sharing an inland sea with Russia and the Ukraine. One workshop participant suggested that geographic location has required Turkey to maintain a strategic military culture which many European countries have lost.

Part of the role stems from European experience of Turkey as a valued security partner for 50 years through NATO, historically as a key block to any southern strategy manoeuvre by the Soviet Union, more recently as contributor and force commander in the International Security Assistance Force (ISAF).

A further part of this mitigation role results from Turkey's network of relationships across a wider region on which European states depend but over which they have relatively little direct influence. Turkey has emerged as a possible intermediary between Europe and Iran. Turkey has maintained good relationships with both Israel and Syria. Though historically turned away from the Arab world, it is playing an increasing diplomatic and military role in the wider region – for example, as a contributor to peacekeeping in Lebanon.

This demonstrates not only that Turkey's strategic options and horizons are increasing – but it points to the influential role that Turkey can play in helping Europe to ensure regional security. Much depends on reforms of the Turkish army itself – one participant pointed to its low "usability rate" despite two commands of ISAF – the willingness of Europe to integrate Turkey more fully into its security architecture and, crucially, Turkey's willingness to opt for a European security option rather than a regional one. Turkey will have to be encouraged to maintain and expand its role of European regional security provider.

Europe@Risk Matrix

The following Europe@Risk matrix draws on the major global risk issues identified by the Global Risk Network for 2006 and explores the trends to watch, impact on Europe and the potential mitigation role for Turkey. The 12 risk issues selected here are a subsection of a broader set of risks affecting the global risk landscape; the risks selected are those considered the most pertinent and interesting for this report, either because they have a particular impact on Europe or because Turkey can play a strong mitigation role. This are not intended to be a ranking of risks or a complete list. The full set of 23 risk issues will be discussed in the global context by the Global Risk Report 2007, to be released in January of next year.

Risk	Description	Trends to watch
Oil price shock/ energy supply interruptions	In the short term, a hydrocarbon price spike sparked by geopolitical tension or terrorism - <i>disruption</i> to secure energy supply. In the longer term, a plateau of high hydrocarbon prices as the supply of products fails to keep up with demand, particularly from emerging markets – <i>unsustainability</i> of secure energy supply.	Rapidly expanding demand, 80% driven by BRICs; fears that underinvestment in capacity will mean production shortfall. Increasing concentration of hydrocarbon resources driving geopolitical attempts to “lock in” future supplies. Debate over possible “peak oil”; growing awareness of androgenic climate change. Integrated energy systems improving market efficiency, but leaving them vulnerable to sudden supply contractions from exogenous shocks (e.g. Hurricane Katrina).
US current account deficit/fall in US\$	Unsustainability of the US current account deficit, triggering a major fall in the US dollar, with impacts throughout the financial system.	Changing global picture of high US current account deficit sustained by Asian saving. US dollar remaining the global reserve currency; other currencies (e.g. euro) playing an increased portfolio role however. <i>See The US Current Account Deficit and Global Ramifications, Global Competitiveness Report 2006-2007</i>
China’s hard landing	Sharp slow-down of China’s economy – potentially as a result of protectionism, internal political or economic difficulties.	Debate around the long-term sustainability of China’s current growth given infrastructure constraints, environmental concerns and political risk. Evidence of some backlash against Chinese exports (in the form of anti-dumping duties); concerns about the stability of the Chinese financial system and the extent of potential defaults.
Coming fiscal crises caused by demographic shift	A demographic shift in developed economies leading to higher taxes, deterioration in the fiscal position and long-term economic stagnation.	Attempt in a number of countries to boost participation rates and retirement ages. Improved global asset allocation allowing developed economies to manage adverse demographic ratios through higher returns on savings.
Blow-up in asset prices/excessive indebtedness	Collapse in house prices and other asset prices pushing consumers into negative equity and causing recession.	A correction in house prices eventually under way in US; questions over the particularities of the US market (high personal expenditure and indebtedness) compared to other markets. Trend of increasing number of households possibly mitigating short-term declines by supporting long-term demand.
Climate change	Increasing frequency of extreme weather events from man-made climate change, with severe impacts on critical infrastructure, agricultural yields and human lives.	Consensus around climate change moving to a debate around impacts, possible mitigation or adaptation measures. Impacts of climate change possibly causing population movements, tension within countries and between countries.

Impact on Europe

Turkish mitigation role

Europe is already a major importer of oil and gas; and a declining producer. Over one trillion euros will need to be invested over the next 20 years.

Over the next 20-30 years, the share of energy needs derived from imported sources will rise from 50% to 70%, leaving Europe more vulnerable to external supply interruptions.

Europe's geopolitical position may be undermined if it is unable to improve diversity of energy supply.

The energy-intensity of European GDP is falling; rising hydrocarbon prices have not yet had adverse growth impacts – but a spike in global hydrocarbon prices may ultimately feed inflation.

High: Turkey is already a major transit country for hydrocarbon resources; this role will become increasingly vital as Caspian basin production increases and as Gulf gas resources seek appropriate export routes.

Turkey could become a “fourth artery” for European energy supplies, improving diversity of supply, reducing Europe's dependence on one or more major suppliers (particularly in gas supplies) and therefore improving European leverage with other suppliers.

For Turkey to play this risk mitigation role, Turkey must be securely anchored in European energy frameworks, infrastructure and transit agreements.

See further explanation on page 11.

A major fall in the US dollar would have mixed impacts in Europe – reducing export competitiveness while cutting the price of US imports.

The longer-term appreciation of euro denominated assets – sparked by a US dollar fall – might increase the reserve currency role of the euro, and thereby enhance the European position in international financial system.

None: Turkey's position in the global economy is not sufficient to impact the management of the US current account deficit or manage consequences of its possible long-term unsustainability.

Europe is a major trade partner and investor in China. Should its economy face a sharp slow-down, European companies with major investments in China would see declining profitability.

Limited: Turkey's position in the global economy is not sufficient to replace the impact of a severe slow-down in Chinese growth. However, over the longer term, the Turkish consumer market might help mitigate the loss of European export markets, while the Turkish manufacturing potential might offer an alternative platform for exports to the Middle East and West/Central Asia in particular.

The US, Japan and China all face a demographic shift. Europe's particular vulnerabilities are heightened by population structure, social security commitments and attitudes to large-scale immigration.

Medium: Turkey has a young demographic profile. In addition to offering potential investment opportunities to support European retirees, Turkey may offer a major European workforce addition, contribute to European dynamism and act as a major provider of retirement services.

See further explanation on page 12.

Some European economies (e.g. UK and Ireland) are considerably more exposed to the downside of asset price collapse than others (e.g. Germany) through higher gearing, ownership rate and price-to-income ratio.

In the more exposed economies, asset price collapse would lead to consumption decline; contagion effects across economies could cause recession.

None: Turkey's property prices have been increasing rapidly – opportunity and risk are matched at high levels. While the underlying trends (population growth, urbanization) are positive, the market is highly cyclical. Turkey would not mitigate a European blow-up in asset prices, but might itself suffer from it.

Climate change is necessarily a global phenomenon. No region can escape impacts – either primary (e.g. increased frequency of extreme events) or secondary (e.g. consequences of extreme weather events through vectors of migration, disruption, etc.).

Europe's primary exposure to climate change may be less than other world regions; but much depends on system interactions which cannot be fully modelled or predicted (such as possible changes in the Gulf Stream).

61% of EU-25 citizens say they believe it “likely” that environmental pollution will affect their health.

Medium: There are three levels to Turkey's mitigation role:

- Reducing GHG emissions (Turkey's emissions are currently set to rise rapidly, but there are large potential efficiency gains in transmission, etc., – per capita energy consumption has risen 25% over the last 15 years);
- Supporting European policy on climate change in international arenas;
- Assisting in dealing with the possible secondary impacts of climate change.

continued

Risk	Description	Trends to watch
NatCat: Earthquakes	Earthquakes in built-up areas or areas of vital economic importance with the capacity to cause large-scale human suffering and major economic dislocation.	Earthquake hazard: not subject to human intervention and knowable likely frequency of events; however uncertainty as to the consequences given the unpredictability of the event, the role of geographical specificity, the scope for triggering other risks (principally financial) and loss-sharing issues.
International terrorism	Acts of terrorism (both internationally organized and inspired, and local) with the capacity to cause extensive physical damage, spread terror (and aversion to perceived risk) and to undermine the cohesion of society.	Discussion of the management of secondary impacts (disruption) of terrorism. Evidence of the emergence of increasing numbers of home-grown “cells” with network links to Al Qaeda. Changing nature of terrorist threat in south-east Turkey. Debate around the role of foreign policy in managing domestic threats, and questions of privacy and civil liberty domestically.
Proliferation of WMD	Proliferation of Weapons of Mass Destruction and the likelihood of their use, inviting major retaliation, further global insecurity and threatening globalization.	Key short-term issue: the management of Iran’s alleged attempt to build a nuclear device. Key long-term issues: future of Nuclear Non-Proliferation Treaty, expansion of Proliferation Security Initiative and prevention of weapons’ capacity while allowing the spread of nuclear power.
Interstate and civil wars	Major interstate war – or equally significant civil war.	Likelihood of major interstate war largely thought anachronistic as a result of international law, norms and trade. However, small risks of large-scale interstate conflict over the long term to be considered prudentially.
Retrenchment from globalization	A two-way risk: a protectionist impulse in developed countries and rising nationalism in developing countries (and evidence of global inequality), driving both to attempt to slow or reverse globalization.	Failure to achieve agreement in discussions on world trade; growth of multilateral trade agreements. Increasing use of anti-dumping measures in the developed world; spread of nationalizations in vital industries in developing countries. Rise of populisms in both the developed and developing world.
Pandemic	Pandemics in history. Typical pandemics: illness in 30% of the population, with low mortality; occasionally, emergence of new viruses with considerably greater lethality. Estimated deaths from the Spanish flu: 40-50 million.	The HN51 virus not yet a full-blown global pandemic; may yet be displaced by an as yet unidentified possible virus. In case of a pandemic, much dependent upon the rapidity of provision of effective vaccines, the speed of accurate information about the geographical extent of the pandemic and the extent of control over possible channels of contagion.

Impact on Europe

Turkish mitigation role

Most seismic activity in Europe is in south and south-east Europe (Italy, the Balkan region and Turkey). Most earthquakes have negligible effects; few are catastrophic - the 1755 Lisbon earthquake was credited by some with altering European attitudes towards risk.

On one level, rising population density and the prevalence of industrial infrastructure have made Europe more vulnerable to the impacts of earthquakes than in the past.

Europe remains a major target for internationally-inspired terrorist activity; threat levels are estimated to have increased over the last year.

There was no major successful terrorist attack to November 2006; but major disruption and financial costs occurred as a result of the failed London plot.

The impact of a specific attack would depend largely on the nature of the target, location and timing.

Any attack would raise risks to social cohesion, and possibly enhance the emergence of home-grown terrorist cells.

Fully 20% of EU-25 citizens say they believe it "likely" that they will be the victim of terrorism.

The limited spread of WMD would lead to a reassessment of European security structures and strategy, and a possible restructuring of deterrent options.

Widespread proliferation of WMD would impact Europe's world view and might encourage retrenchment from globalization.

Europe's ability to conduct out-of-area military operations remains limited - constrained by underinvestment and force structure.

The impact of a specific war would depend largely on the nature of the war, its location, timing and Europe's involvement (if any).

Any major interstate war would increase economic uncertainty and threaten global security and trade structures.

Europe is already affected by populist currents calling for retrenchment from globalization.

A spread of such currents could lead to Europe's retreat from global commitments; at its extreme, centrifugal tendencies could lead to the decline of Europe's single market.

Disinvestment from Europe, a fall in European investment abroad - a reduced rate of return for European investments could make demographic crisis more intractable.

In the long-term, an acceleration of continental decline and a reduced ability to influence global events would be possible.

To consider the full impact of a pandemic is speculative. Europe has high quality health systems and well-developed public information, but the virulence of the virus itself is crucial.

However, one can reasonably suggest that short-term economic impacts would include the severe impairment of service industries, as well as supply chains of manufacturing and retail industries. Over the longer term, deep shifts in social, economic and political relations would be possible.

Limited: Istanbul is the major European city most at risk from a major earthquake (estimates of likelihood of 60-70% over the next 30 years). The North Anatolian Fault is 20km south of the city. Retro-fitting, construction of new homes and city redesign may mitigate the impact of an earthquake on potential high-risk areas.

High: Turkey's role for mitigation of the terrorism risk is complex. Turkey's experience of terrorism, including the 2003 Istanbul bombings, gives it a crucial insight into counter-terrorism operations.

On the security level Turkey's police, intelligence and military cooperation are major additions to European capability. Over the medium term, enhanced judicial cooperation might further strengthen common counter-terror initiatives.

Turkey's continued good relations with the European Union and as a secular state undercut extremist arguments that Islam(ism) and democracy are mutually exclusive.

High: Turkey's diplomatic links with Tehran and other Middle Eastern powers offer a potential channel of communication and influence over the future direction of proliferation.

Police, judicial, intelligence and military cooperation may boost Europe's capability to prevent proliferation. Turkey hosted a PSI interdiction exercise in May 2006.

High: Turkey's military capabilities and geopolitical location provide a significant contribution to Europe's capacity to prevent, respond to and manage the risks of major interstate and civil war.

Turkey's firm anchoring in Europe's security architecture allows an enlargement of the security space; particularly in the Middle East, Turkey can contribute to regional stability on Europe's southern and eastern borders.
See further explanation on page 12.

Medium: Turkey's ability to present itself as a globalizing dynamic partner to Europe may allow Europe to avoid both the cause of a potential retrenchment against globalization and some of its worst consequences.

Much will depend on whether European perceptions of Turkey can be changed from source of risk, to source of risk mitigation.

Dependent on the specific nature of the pandemic: Anatolia is crossed by two major bird migration routes - if the vector of the animal form of the disease is birds, then effective and transparent identification and control mechanisms in Turkey could give critical time to slow the spread of disease and allow for the development of possible vaccines.

If the disease became transmissible from human to human, cooperation on regulating population flows would become a vital mitigation measure.

Europe's Dilemma: Values vs Interests and Protectionism vs Leadership

Dr Yilmaz Argüden¹¹

For decades European development has been guided by a number of key values: human rights, democracy, freedom of thought and belief (and of the press), free trade, the rule of law, laicism (in most countries) and multiculturalism.

Generations have been raised in an environment promoting these values. And these values have been central to helping Europe achieve historically unprecedented prosperity and stability. Yet Europe now faces a number of serious risks for the future: an ageing population, eroding competitiveness, limited military credibility and limited access to key natural resources. Global institutions seem inadequate to the range of global risks facing the world, from terrorism to climate change.

The true test of values is whether they can be maintained when they run counter to the short-term interests of these risks and challenges.

Already some conflict is emerging. Some key European values – such as free trade – are beginning to hurt. Globalization has the potential to make some people in Europe relatively poorer, even if it helps global growth. Will Europe continue to open its markets, and enable cross-national mergers, regardless of the nationality of new owners?

A similar question applies to transforming global institutions along universalist lines which may run counter to Europe's interests. For example, it is difficult to defend Europe's two vetoes in the UN Security Council when India has none. Will Europe be able to accept the limits on its voting power that would stem from embracing a more democratic governing principle for global institutions?

Ultimately, trying to sustain unsustainable agricultural or high social security subsidies and to limit international M&A, or even freedom of speech,¹² will not only cause potential conflicts with some key European values but will fail to protect Europe from the risks facing it.

Protectionist tendencies – economic or cultural – are likely to delay, and therefore raise the costs, of

“The true test of values is whether they can be maintained when they run counter to short-term interests...”

subsequent structural reform. Enlargement fatigue will surely cause Europe to lose momentum as a model for global governance.

Europe should adopt an offensive, not defensive, approach: continuing enlargement to export its values and systems and at the same time clearly demonstrating its commitment to these values by its actions, avoiding double standards for short-term interests.

The EU has the potential for global leadership, not by virtue of size or strength, but by being an example. However, the EU must orient itself towards improving the world in line with its own values, instead of its current self-centred, protectionist approach. Only in such a way can Europe deal with the risks it faces itself – let alone help the process of mitigating global risks.

Taking Opportunity

There is an **opportunity** for the EU for global leadership. Since 9/11 the world has been subjected to unilateralist policies; global sentiment has moved against the accumulation of power in a single country. There is a growing wish for an alternative approach to global leadership, one not based on power, but on values.

Building Power

But in order for the EU to exercise leadership, it also has to have sufficient power, defined in five dimensions: political, economic, sociological, technological and military.

As a **political** project, the EU is an innovation where countries, without recourse to force, agree to share sovereignty. However, it has become clear that both the efficiency and legitimacy of EU decision-making needs to be improved. Both administrative systems and individual perspectives need a more global dimension to deal with future global and European risks. The EU can be a global model, but only if the

“Europe should not be about protecting... interests, but creating a structure by which European values become a global norm.”

efficiency of decision-making takes precedence over protection of the existing power equilibrium.

The EU is the premier global **economic** bloc, but competitiveness must be enhanced. Can the EU's present welfare mentality be maintained? From the point of economic development, the Lisbon goals carry a lot of weight.¹³ Failing to reach them will pose a major threat to aspirations to global leadership.

Sociologically, much store is set in Europe by “unity in diversity”. But tolerance and understanding are too often only for current citizens; nationalism and rejection of “the other” are growing trends, as witnessed by immigration policies and attitudes to enlargement.

Technologically, there are a number of constraints. The EU has collectively made some significant advances – adopting the GSM standard or implementing common projects in the 7th Framework Programme. But financing for innovation and the spirit of entrepreneurialism remain weak.

Militarily, Europe lags well behind. Even in an era when world leadership depends less on military prowess, it is vital to share more significant military responsibility in conflict regions of the world. The EU itself is a successful peace project and should focus on exporting this idea.

Creating Vision

In addition to **opportunity** and **power**, leadership demands vision. One very important message should be conveyed to Europe's people: Europe should not be about protecting narrowly-defined interests, but creating a structure by which European values become a global norm.

And this requires consistency between words and deeds in all EU actions. “European” values as democracy, human rights, rule of law, multiculturalism, protection of minorities and laicism have to be applied consistently to gain the trust of

global citizens. Defence of self-interest – narrowly defined – alienation of “the other”, fears over migration, worries over innovations such as GM foods and protection of low working hours will not allow the EU to maintain its existing prosperity, let alone attain global leadership to deal with global risks.

A True Test of Values: Approach to Membership of Turkey

To the surprise of many, after forty years of courting, Turkey successfully completed many reforms and secured negotiations for accession to the European Union. However, recent developments in the negotiations are failing to create an impression of mutually trusting future partners, but one of European reluctance to accept Turkey as an equal partner. Unless this changes significantly, it will be difficult to proceed on a win-win basis. This process will turn into one side establishing ever changing goal-posts and the other feeling alienated.

Yet Europe and Turkey have a historical opportunity to throw out the prejudices of ages, discredit the “clash of civilizations” and establish a stronger EU. Turkish membership presents the potential to mitigate some of the key risks for Europe, and help the EU to be a role model for global governance.

While the European population is ageing, Turkey is entering a “golden demographic period” similar to what East Asia experienced in the 1980s. The continuation of reforms in Turkey will not only increase investments in Turkey, but make Turkey indispensable. In contrast to European worries about inflows of migrants, Turkey, with her renowned hospitality, quality of medical care and pleasant climate, may become “Europe's Florida”, in terms of attracting and caring for European retirees. While the immigration of Turkish people will be limited, immigration of jobs will make up for Europe's declining population. Automotive production has started to move to Turkey – where the most profitable Ford and Fiat plants are located.

“Turkey may become ‘Europe's Florida’ in terms of attracting and caring for European retirees.”

Only a few emerging markets in the world have the potential to be able to create a “virtuous investment cycle” of exports and domestic demand. This is true not only for products, but also for young managers. Young Turks are being employed by global firms throughout the world. The Chairman of Pfizer said recently that their most important export from Turkey was qualified managers.

Overcoming regional political risks can only be achieved if economic development spreads. And throughout the region, Turkey is likely to be an engine of growth. As one observer put it, “Turkey will be the ‘viagra’ for Europe” by becoming the key agent to help improve European and regional competitiveness.

A win-win approach on Turkey will be the key to addressing European risks, and making the EU a values-based global leader. Managing Turkey’s relationship with Europe relies on navigating the (sometimes false) dilemma in the title of this essay.

Good governance requires wisdom. Sufist philosophy, which has an important place in Anatolian tradition, gives important advice. This philosophy, based on “tolerance” and “harmony”, defines good governance as self-management. Good governance is to free ourselves from our fears, opening our eyes and hearts to new perspectives, to “regard others, as we regard ourselves.” Individuals, civil society, political statesmen, business people and managers of international organizations have critical roles in accomplishing that goal.



Lebanese Prime Minister Fouad Siniora shakes hands with Turkish Foreign Minister Abdullah Gul, following talks on the deployment of international peacekeepers in Lebanon - 16 August 2006

Risk Mitigation: Conditions and Prospects for Turkey's Potential Role

Ahmet O. Evin¹⁴

Energy, security and regional stability are among the several areas in which Turkey can potentially play a significant role in mitigating risks for Europe. Because of its geopolitical significance, historic connections, familiarity with the major actors and influence in the region, Turkey is a natural partner for addressing Europe's security needs.

First, concerns over energy. Risks associated with Europe's dependency on Russian gas came to the forefront last winter when on 1 January 2006 Russia suspended delivery of natural gas to the Ukraine on account of the outstanding Ukrainian debt for energy imports from Russia. Given high EU dependency on Russian natural gas (as high as 80%, for example, in the case of Germany), Russia's sudden stoppage of deliveries raised serious doubts about Russia's dependability as the EU's major energy supplier.

Diversification of both energy sources and supply routes are essential for the EU. Positioned strategically between key energy-producing regions and energy-consuming Europe, Turkey is the key actor to provide effective diversification of both sources and routes, in terms of oil and, more importantly, natural gas. Over the past several years, Turkey has focused on the challenge of developing into a major energy delivery centre. Caspian crude now flows into Ceyhan; in the future, it is possible that part of Kazakh oil might be shipped across the Caspian to Baku for Ceyhan, circumventing Russian control over its delivery. In addition, Ceyhan, which is the terminal for the Kirkuk pipeline, may also receive Russian crude through the proposed Samsun-Ceyhan pipeline.

Similar infrastructure development has been achieved regarding natural gas: the Blue Stream connecting Russia under the Black Sea completed in 2003; direct connection from Iran since 2002; and the more recent Baku-Tbilisi-Erzurum pipeline that connects Shah Deniz gas field in Azerbaijan.

For Turkey to play an effective role in risk mitigation, however, the necessary infrastructure has to be completed. Two essential projects have been moving too slowly: one is the Nabucco pipeline that will be connected with the Tebriz (Iran) - Erzurum

pipeline, and with the South Caucasus pipeline, connecting to the planned Trans-Caspian Gas pipeline. Once completed, this would allow transportation of natural gas from producers in the Middle East and Caspian region such as Iran, Azerbaijan and Turkmenistan to Western Europe via Austria. Although included in the EU Trans-European Energy Network programme, the Nabucco pipeline is expected to begin only in 2008 and is planned to be finished by 2011. The second is the Turkey-Greece-Italy interconnector of the Nabucco pipeline that will run across Greece and under the Adriatic Sea. Recently, US officials have also admonished Turkey to move faster and support the construction of both the Nabucco pipeline and its interconnector to Greece.

Second, the security issue flows from this last point. Since World War II, the US has viewed Turkey not merely as ally but as an integral part of the Western security family. For that reason, despite the serious current strains in its relations with Turkey on account of the Iraq war, the US continues to actively promote (sometimes to the chagrin, even exasperation, of its European allies) Turkey's EU membership. The current transatlantic tensions resulting also from the Iraq war notwithstanding, the maintenance of a coherent and sustainable European security area is consistent with long-term US interests, even if the US is in the course of shifting the focus of its strategic interests from Europe to other parts of the world.

Although precipitated by nearly the same reason, the current tensions between the US and Turkey on the one hand, and most Western European countries on the other, have not had the effect of moving Europe and Turkey closer to one another. The cumulative effect of sustained US advocacy of Turkish membership, however, has not been negligible, at least as far as its impact on European policy-makers is concerned. Turkey is recognized as a security asset in both Europe and the US, but in the EU, issues relating to the Security and Defence Pillar are separated, institutionally and politically, from those pertaining to Enlargement.

While it is a key actor, Turkey ought not be perceived as a potential glue to mend Euro-Atlantic relations: transatlantic mediation is highly unlikely to be

channelled through Ankara. It is only sensible to expect a gradual convergence of the EU and US positions regarding Turkey, leading to the realization among European leadership that Turkey would be a greater security asset as an EU member state than otherwise.

Third, the question of regional stability constitutes a crucial independent variable concerning Europe's security. As a result of the failure to stabilize Iraq, US and UK troops are likely to be withdrawn from there much faster than the White House or Downing Street would like to admit. In the continued absence of order, Iraq, now engaged in a civil war, poses the threat of becoming an incubator for terrorist networks. Anarchy in Iraq, moreover, is likely to bring into the fray uncouth and unpredictable actors, threatening further regional destabilization.

In the near future, the Middle East (both the greater and the classic, narrower, definitions of that construct) is expected to pose an increased security threat to Europe. With its understanding of regional political cultures, Turkey is a natural interlocutor and remains a stabilizing influence, despite its own problems with renewed terrorist activity resulting also from the prevailing chaos in Iraq. Turkey can help mitigate these security threats as an integrated part of a broader zone of stability that only an enlarged EU will be successful in achieving.

In assessing Turkey's ability to achieve its potential to mitigate risks (and project an effective stabilizing influence), three factors need to be taken into account.

1. 2007 is an election year during which both parliamentary (general) elections will be held and a new president will be voted by the parliament. As a big country, Turkey has a tendency (somewhat like the US) to place priority on domestic issues, particularly during times of electoral contest. There remains the possibility that, over the next 12 months, Turkey's political agenda might be shaped by issues of overriding domestic concern, while relations with Europe are left to simmer.

2. Turkey's regional and international weight and influence are directly correlated to the size of its economy as well as its macroeconomic stability. Thanks to both the reforms following the 2001 crisis, and the lessons learned nationally, Turkey has achieved high growth rates while bringing down inflation and scoring success among the emerging markets. However, growth and the increased value of the currency have fuelled consumption resulting in growing current account deficits, which are offset by inflows in several categories: hot money buying sovereign debt or company shares, sale of assets through privatization, and foreign direct investment. Only the latter form of inflow contributes to the economy in a stable and sustainable fashion. If, however, populist economic policies are avoided in this double election year, Turkey is likely to emerge as an even more influential actor and a more desirable candidate for Enlargement.

3. Most import is the fact that Turkey's progress towards establishing itself as an energy hub puts it into the midst of political rivalries and competing agendas of powerful global actors vying for control over energy supplies. Energy interests and needs (and the powerful leverage that stems from the control of energy assets) pose an unstructured problem for which there exist no simple equations or solutions. Helping to provide diversified energy sources and supply routes to mitigate Europe's risk, for example, does not change or challenge Russia's overriding power and control over the production and distribution of oil and gas from the Urals to the Pacific.

Exposed to the crosswinds generated by US objectives, Russian ambitions and EU interests converging on the Euro-Atlantic area's energy assets, Turkey cannot avoid being a key diplomatic actor on the centre stage. The challenges facing Turkey, as well as the economic and political rewards these challenges entail, require the kind of sophisticated leadership capable of implementing and orchestrating policy that is becoming increasingly hard to find, given the populist domination of the political arena in today's world.

Turkey's Role in Mitigating Europe's Social Risks

Sinan Ülgen¹⁵

In the post-9/11 world, the relationship between Islam and the West is among the most serious challenges to global stability. Recent episodes – from the publication of cartoons considered blasphemous by some, to the recent speech given by the Pope at Regensburg university quoting a 14th century Byzantine emperor – have made for a series of crises portrayed by many as vindication of the notion of a clash of civilizations.¹⁶

For the West, the challenge has an internal as well as external dimension. Internally, Western societies are compelled to address the problem of integration of their Muslim communities into the mainstream. Islam is now Europe's second religion, with some 13 million Muslim European citizens. At the same time, externally, Europeans are increasingly aware of the need to establish a harmonious relationship with Europe's neighbourhood, including the wider Mediterranean basin.

Turkey's relationship with the West in general, and with the EU in particular, should be viewed against this backdrop. Indeed the evolution of this crucial relationship stands to have a significant impact on both these challenges, internal and external.

Turkey has been a secular republic since 1924 and a multiparty democracy since 1950. It has embraced free market economics and ensured the rule of law. As such, Turkey provides a rare example of a predominantly Muslim country where the application of what can historically be termed as the values of western civilization are well established. Yet beyond the obvious choice of Turkey as a role model for the political development of other states in the region, what is even more important from a European perspective is its creation of a unique political culture. Indeed, Turkey demonstrates the possibility for a Muslim community to fully embrace the fundamental European values of democracy, tolerance, rule of law and liberal economics.

It is this dimension which is the essence of Turkey's role in assisting future social integration in Europe, and helping mitigate a number of risks to Europe's future. It demonstrates that there are no insurmountable barriers to integrating Muslim communities into European societies, if we define

“Present tensions and difficulties [in the relationship between Muslim communities and European societies] can be viewed as the consequences of the naïve or misguided integration policies of the past, rather than as the necessary by-product of some more fundamental obstacle to integration... Turkey is well placed to play a more active role in the future in ensuring improved integration...”

integration as a process of mutual understanding based on the sharing of a set of fundamental values. Present tensions and difficulties can be viewed as the consequences of the naïve or misguided integration policies of the past, rather than as the necessary by-product of some more fundamental obstacle to integration.

This observation has important consequences for Europe in terms of what immigration and integration policies it should adopt – and ultimately for social peace.

First, as long as Turkey's journey towards deeper integration into European institutional structures remains on course, Turkish political culture should continue to evolve in the right direction, creating an ever more solid basis for demonstrating the compatibility of Islam with the fundamental values of European civilization. This constitutes one of the most potent rebuttals of the thesis of civilizational incompatibility championed by religious fundamentalists and radical politicians alike in Europe and beyond.

Second, Turkey is well placed to play a more active role in the future in ensuring the improved integration of Muslim communities into European societies. Thus far, Turkey's ability to act in this manner had been limited due to the past nature of most immigration policies in Western Europe, where migrant communities were often viewed by their host countries as a temporary phenomenon needed to fill jobs, with the immigrants set to return to their countries of origin at some future point in time. In Germany, where citizenship laws were based on blood-ties and the Turkish-origin population was referred to as “Gastarbeiter”, the temporary nature of such migrant communities was explicit.

However, with more proactive integration policies now in place in many of those countries, Turkey could contribute much more extensively to the integration process through its official and institutional capabilities as well as its dynamic civil society organizations. It should be recalled that Turkish institutions are already quite active in battling the rise of religious extremism in the form of the Wahhabi branch of Sunni Islam in such places as Bosnia or Macedonia. Turkish civil society organizations are already establishing partnerships with their counterparts formed by Turkish migrants in Western European societies to assist with their political, economic and social integration into their host countries. This has been particularly the case in Germany.¹⁷



Schoolchildren in Turkey; Turkey's demographic profile may help Europe cope with its own ageing population

The potential role of the Turkish media can also be underlined here. Turkey boasts a rich and diverse media landscape. Technological developments such as the advent of the Internet and satellite broadcasting have massively extended the reach of media across national borders. The footprint of Turkish TV broadcasts covers the whole of Europe, the Middle East, northern Africa as well as Central Asia. These images, reflecting contemporary Turkish culture, arguably have a strong influence on the evolution of the political culture of the Turkish-origin Diaspora in Europe, Turkic-language cultures and beyond.

The future social well-being of European societies will depend on the ability of European governments to deal sensitively and intelligently with the impact of past and current immigration. Failure would strengthen tendencies towards polarization and alienation, creating an environment conducive to the rise of political extremists, further undermining Europe's social fabric and hampering its ability to face up to the landscape of global risks with which it is confronted.

The risk of such a failure is real. But through its accumulated experience and growing capacities, Turkey can help prevent it. Indeed, Turkey can make a major positive contribution to the establishment of the right conditions in Europe for the lasting social peace necessary for Europe to confront together the long-term risks to its prosperity and security.

From Risk to Opportunity: How Multilateralization Has Changed Greek Attitudes to Turkey

Chrysostomos Sfatos¹⁸

The bilateral relationship between Greece and Turkey has improved dramatically in the past 10 years since Turkey has shown an active interest to move forward with her bid to enter the European Union, and Greece started endorsing the process, concluding with full support for Turkey's accession. In the past, Greek-Turkish relations were often seen as a zero-sum game: the strength of one implied the weakness of the other. Individual strength, therefore, became a risk; today mutual strength is understood as an opportunity. A similar transformation of wider European perceptions of Turkey – from risk to opportunity – may be needed.

Greek elites understand that a stable and predictable Turkey complying with European Union law is a desired neighbour with whom Greece can develop further ties on the foundation of common values and principles. Somewhat surprisingly, this attitude has gained support very quickly among the broader public, with some opinion polls in Greece in 2006 showing support for Turkey's entry into the European Union rising to 45%.

This new era of Greek-Turkish rapprochement was triggered by so-called earthquake diplomacy, whereby earthquake recovery assistance from both sides after two catastrophic earthquakes in Istanbul and Athens in 1999 was followed by warm political and business exchanges.

But the main reason behind this rapprochement was the integration of the bilateral relationship between the two countries into the multilateral context of Turkey's talks with the European Union. Throughout the Cold War, Greece felt itself to be the weaker party, given the perceived higher importance placed on Turkey as a strategic ally of the West confronting the Soviet Union, and the losses and trauma of the Cyprus conflict.

In the late 1990s, however – nearly 20 years after Greece joined the EU – the country felt leverage for the first time, and committed to using it constructively. In an improving relationship, Turkey would have to comply with a set of requirements dictated by the European Union, not as a result of a bilateral and bitter give-and-take negotiation. The

"In the past...relations were often seen as a zero-sum game....Today, mutual strength is understood as an opportunity. A similar transformation of wider European perceptions of Turkey – from risk to opportunity – may be needed."

thorny issue of a resolution of the Cyprus conflict was recast in the multilateral context of the European Union (and the United Nations, although without a successful outcome).

Given this new environment, successive Greek governments were freed to develop the bilateral relationship in a new direction, primarily the economic relationship, by consigning some of the most difficult issues to the dialogue between the EU and Turkey, and thereby circumventing any risk of a public opinion backlash for having ignored Cyprus or other territorial disputes.

This approach has created considerable room for collaboration both in the public sphere and for the private sector. Moreover, the approach has generated tremendous forward economic momentum, particularly given Turkey's commitment to applying conditions of fiscal austerity and macroeconomic stability.

One can draw out two main points about the benefits of the existing multilateral dialogue from all perspectives:

1. Multilateral dialogue is based on principles which are considered objective, universal, beyond dispute and bias; and,
2. Multilateral dialogue has allowed bilateral relations to jump ahead and gain momentum by bypassing the sensitive political issues which have been made part of a multilateral agenda.

By extrapolation, one can argue that membership of the European Union for Turkey would allow the creation of novel approaches to the perennial sources of risk, both to Turkey and more broadly to Europe.

To take one major example from the Turkish point of view, the Kurdish issue could become a matter of

“By extrapolation, one can argue that membership of the European Union for Turkey would allow the creation of novel approaches to the perennial sources of risk, both to Turkey and more broadly to Europe.”

regional development. In the future, Kurds living relatively prosperously in south-eastern Turkey with a European Union passport and human rights protected by European legal instruments will have little desire to rebel or to create an independent or autonomous region outside the European Union. By multilateralizing what is currently understood in Turkey specifically as a risk to the Turkish state, the source of the risk may be mitigated.

Conversely, from the EU perspective, energy security could be a key mitigation gain. As a member of the European Union, Turkey will necessarily side with the EU on major geopolitical issues and be constrained to satisfy European demands for energy security. Indeed, multilateral European energy policy would largely dictate national Turkish policy, thus mitigating some of the risks to Europe of a major supply shock.

As Greece has learned, scaling up the relationship from bilateral to multilateral is the best way to smooth out differences and overcome the small-picture details that block the large-picture vital interests.

Such transformations have completely changed the psychological climate of Greek-Turkish relations in the past ten years and allowed the two sides to recognize that they have much to gain from cooperation with the frameworks set out by universal and commonly-accepted rules. Whatever concessions that would affect bilateral or national issues are shielded by broader gains in the multilateral agendas.



Building of a railway tunnel underneath the Bosphorus connecting the European and Asian continents

Dealing with Risk: If Turkey and Europe Break Up...

Katinka Barysch and Charles Grant¹⁹

During the first year of EU-Turkey accession negotiations, one thing has already become abundantly clear: Turkey's path will be rocky. It may even lead to nowhere. Olli Rehn, the EU's enlargement commissioner, famously warned of a "train crash" in EU-Turkey accession negotiations, caused by either disagreements over Cyprus and/or the slowdown of political reform in Turkey.

The EU and Turkey may manage to salvage accession talks in 2006, but the risk that they may fail in subsequent years remains substantial. Even if the EU overcomes hostile public opinion and Greek Cypriot stubbornness, a disillusioned Turkey may decide to turn its back on the EU. What would be the consequences?

The most immediate impact would be on Turkish politics. The goal of joining the EU has helped to glue together an array of political forces, including Kemalists, Islamists, nationalists and liberals. If this glue dissolves, Turkey may return to the bad old days of political instability. "We told you the EU wasn't serious," the nationalists would say, promoting the idea of a sovereign and independent Turkey. The hopes of the Kurdish minority to obtain better rights under the aegis of the EU would dwindle. The more traditional Islamist factions in Prime Minister Erdogan's AKP would feel reconfirmed in their view that Turkey was never going to be a mainstream European country anyway, and they could make a new push to achieve objectives such as changing the rules on wearing the veil in public places. This, in turn, would fuel the Kemalists' suspicion that the AKP's hidden agenda was to undermine Turkey's secular traditions. The liberals – who have seen the EU as an anchor for Turkey's modernization – would be close to despair. The Turkish army would be on stand-by once again, ready to take over if and when the country descended into political turmoil. The positive momentum of political reform would stall.

Political instability would not bode well for economic policy and investor confidence. In less than five years, Turkey has managed to graduate from economic basket case to growth story. Since the last meltdown in 2001, real GDP has expanded by

7% a year on average, inflation is down to single digit figures for the first time in decades, and FDI has risen from next to nothing to €10 billion a year. Jitters in currency markets no longer lead to crises. More responsible policy-making and the prospect of convergence with the EU appear to have put a floor under the lira. Both the IMF and the EU have underpinned these improvements: the IMF by limiting Turkey's traditionally spendthrift policies; and the EU by nudging Turkey to adopt more liberal and transparent rules in competition, telecoms and banking.

The IMF is still holding Turkey's hand until 2008, when the current stand-by agreement runs out. After that, the risk of macroeconomic slippage would increase. With the EU anchor gone as well, microeconomic reforms may also stall. Turkey would presumably maintain its customs union with the EU (although Turks have tended to see this as a preliminary step towards membership). But the government would see little need to make further progress with bringing its business environment in line with EU requirements. As a result, West European businesses would feel less at home in Turkey. The spectre of less foreign investment must be hugely uncomfortable for a country that runs an annual current-account deficit of €20 billion.

German politicians in particular argue that, if EU accession negotiations fail, Turkey could be persuaded to accept a "privileged partnership" instead. For those opposed to Turkish membership, this represents the best possible outcome: Turkey would still be closely aligned with the EU but it would not have a seat at the decision table. Nor would it get much money. But this view may be too sanguine. An angry and disappointed Turkey will probably say "No thank you" to any close EU relationship that falls short of full membership. Many Turks would argue a mixture of close economic ties (in the shape of the custom union) and arms-length political relations are better than being fobbed off with a "privileged partnership".

Political and economic instability in Turkey would not only be bad news for Turkey itself. It would also be bad for Europe. There would be opportunity costs for the European economy: Turkey's fast-growing economy adds a degree of dynamism. And Turkey's

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young and fast-growing workforce could help other European countries mitigate their demographic problems.

An end to accession talks would also have a negative impact on EU foreign policy. It would damage the EU's ability to influence the Middle East, and would not help its role in the Islamic world. Turkey's accession process has provided Europe with an invaluable commodity in the Islamic world: credibility. An EU that rejects Turkey could be seen as a Christian club; its potential to play a leading role in the Middle East peace process would diminish.

And then there are implications for wider Europe. An end to accession would not be good for Turkish-Armenian relations. Turkey knows that if it wants to join the EU, it will need to reopen its frontier with Armenia. Take away the goal of EU membership, and Turkey has few incentives to do that. Continuing poor relations between Turkey and Armenia would ensure that Turkey had little influence over the Nagorno-Karabakh peace process, and would minimize its influence over the Caucasus region generally.

Rejected by the EU, Turkey might turn its attention to other potential allies. Russia has already taken steps to woo Turkey. Trading and political ties have burgeoned. Many senior figures in the Kremlin argue that both countries are outcasts from the European mainstream and should therefore stick closely together. There are other similarities as well, for example the two countries' tendency, in difficult times, to resort to nationalist posturing or paranoia.

Russia is not only looking for friends. It is also worried that a more European Turkey would undermine Russia's hold over European energy markets. At present, most of Europe's gas comes through pipelines that run over Russian territory. But the EU wants to diversify in the name of energy security. Almost all alternative routes for gas from the Caspian and the Middle East would go through Turkey. Turkey cherishes its growing importance as a European energy hub. But if it turned away from the EU, towards Russia, the EU may find it a lot more difficult to decrease its reliance on Russian energy

and pipelines. Closer political ties to Russia, however, are unlikely to undermine the overall western orientation of the economy.

A closer Turkish-Russian alliance could also have implications for Cyprus. Russia has been protecting Cyprus at the United Nations, preventing the UN Security Council from passing resolutions that are critical of Greek Cypriot obduracy. There are some signs that Moscow may be reconsidering. However, a shift in Russian policy would be immaterial if EU-Turkey relations broke down – because this would almost certainly end hopes of reuniting the island. Without the goal of EU accession, Turkey has few incentives to make the concessions required to get the Greek Cypriots to compromise and accept a revised version of the Annan plan. Northern Cyprus would in the long term head towards gradual integration with Turkey – even if the “Turkish Republic of Northern Cyprus” claimed to be an independent state.

A disappointed Turkey would look around its neighbourhood for allies. At various times since the break up of the Soviet Union, Turkish politicians have talked of reviving their country's ancient cultural ties with the Central Asia states (all of which speak Turkic languages, bar Tajikistan). But little has come of it, and Central Asia does not provide a serious alternative to Europe, given the small size of the Central Asian economies. Russia and China will remain the dominant countries in the region. The AKP government has taken a closer interest in the Islamic world than earlier secular governments. Turkey has become an active participant in meetings of the Organization of Islamic Conference. If talks with the EU collapsed and AKP stayed in power, these ties would probably deepen.

Nevertheless, even if EU talks collapse, Turkey's overall orientation – both in trade and politics – would remain westward. Turkey would continue to modernize and open its economy, and consolidate its democracy. However, progress would be much slower and more patchy than it would be if Turkey stayed on the EU accession path.

Footnotes

- ¹ More information on the Global Risk Network can be found at www.weforum.org/en/initiatives/globalrisk/
- ² The 2006 *Global Risk Report* released at the Forum's Annual Meeting in January 2006 can be found at www.weforum.org/pdf/CSI/Global_Risk_Report.pdf. An extensively updated report will be released ahead of the Annual Meeting 2007 in January.
- ³ Later turned into a blockbuster film, "Valley of the Wolves Iraq", this single issue has been part of a major repositioning of Turkish popular attitudes regarding the United States.
- ⁴ Philip Gordon and Omer Taspinar, "Turkey on the brink", *Washington Quarterly*, Summer 2006.
- ⁵ *Attitudes towards European Enlargement*, Eurobarometer, July 2006.
- ⁶ More information on *The Global Competitiveness Report 2006-2007* can be found at www.weforum.org/en/initiatives/gcp
- ⁷ McKinsey Global Institute, *Making the Productivity and Growth Breakthrough*, 2003.
- ⁸ Economic Survey of Turkey 2006, OECD, published 18 October 2006. Available at www.oecd.org/turkey
- ⁹ *The Long-Term Sustainability of Public Finances in the European Union*, European Commission Directorate General for Economic and Financial Affairs, October 2006.
- ¹⁰ *The Coming Demographic Deficit: How Ageing Populations Will Reduce Global Savings*, 2005, McKinsey Global Institute.
- ¹¹ Dr Yılmaz Argüden is Chairman of ARGE Consulting, Senior Adviser and National Representative of Rothschild Investment Bank in Turkey, a columnist, and an Assistant Professor of Strategy at the Bosphorus University and the MBA programme of Koç University. He was selected as a "Global Leader for Tomorrow" by the World Economic Forum.
- ¹² Such as the recent law passed by the French parliament.
- ¹³ A status report on Europe's progress towards the Lisbon goals by the World Economic Forum's Global Competitiveness Network will be released on 23-24 November at the World Economic Forum in Turkey.
- ¹⁴ Ahmet O. Evin is Professor at Sabanci University in Istanbul.
- ¹⁵ Sinan Ülgen is Chairman of the Centre for Economics and Foreign Policy Studies (EDAM), based in Istanbul.
- ¹⁶ Samuel Huntington's article, "A Clash of Civilizations?", appeared in *Foreign Affairs* in the Summer 1993 edition. His thesis was expanded upon in a 1996 book, *The Clash of Civilizations and the Remaking of the World Order*. That book describes an "emerging alignment" of civilizations, with the considerable degree of conflict in the civilizational relationship between "Western" and "Islamic" civilizations.
- ¹⁷ According to a recent survey (October 2006) conducted for the German magazine Stern, 71% of German Muslims of Turkish origin feel "strongly" or "very strongly" integrated. 73% choose Germany as the place they most want to live; 19% in Turkey. However, 46% expressed the view there is some incompatibility between the rules of Islam and the rules of German society.
- ¹⁸ Chrysostomos Sfatos is Director of International Relations at Intralot in Greece.
- ¹⁹ Charles Grant is Director of the London-based Centre for European Reform. Katinka Barysch is Chief Economist at the Centre for European Reform.

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The World Economic Forum thanks those who participated in the two workshops leading to this report, in Istanbul in July and in Brussels in October.

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