

## **THE TURKISH-GERMAN ECONOMIC RELATIONS AND THE EUROPEAN UNION<sup>1</sup>**

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### **INTRODUCTION**

When we discuss the Turkish-German economic relations, two developments need to be taken in to consideration. The first development is the signing of the Customs Union agreement between Turkey and the European Union that came into effect on January the first of 1996. The Customs Union covers industrial products and processed agricultural products. The services and agricultural sectors are not included in the Customs Union. However, negotiations have been started to include the services sector in the Customs Union. With the implementation of the Customs Union Agreement, Turkey abolished all customs duties and quantitative restrictions for the member countries of the European Union and put into effect the Common Customs Tariff -for the third countries. Another important point with the Customs Union is that Turkey adopted the Common Competition Policy of the European Union. Turkey has already put into effect all the laws and regulations to protect intellectual and industrial property rights.

The second development is the acceptance of Turkey as a candidate for full membership at the Helsinki European Council meeting. After Turkey became a candidate for full membership, Turkey's relation with the European Union have gained new dimensions. For this reason Copenhagen economic enteria for the accession to the Union need to be briefly examined with respect to Turkey. It is obvious that the process of accession will effect the Turkish-German economic relations.

### **COPENHAGEN ECONOMIC CRITERIA**

Before discussing Copenhagen Economic Criteria with respect to the Turkish economy it will be useful to indicate the size and structure of the Turkish economy. At the purchasing power parity basis, the Turkish Gross National Product was 450 billion US dollars and the Per-capita income was 6400 US dollars in 2000. Since the early 1980s Turkey has been in the process of radical economic change, achieving 6 Percent yearly average growth rate over the period of 1980-2000 which was provided by a dynamic expansion of manufacturing and services sectors and shrinkage of the agricultural sector.

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The gradual opening of the Turkish economy to the world economy has played a key role in this change. The share of exports in GNP stood at 4.3 Percent in 1981, but had risen to 15 Percent in 2000. The share of imports in GNP rose from 11.7 Percent in 1981 to 25.6 Percent in 2000. When the structure of the GDP is considered, the share of the agricultural sector is 15 Percent, the share of industrial sector is 25 Percent and the share of the services sector is 60 Percent. Turkey is the 18<sup>th</sup> largest economy in the world and is the member of the G-20 which consists of 18 countries.

Now, let me turn to the Copenhagen Economic Criteria. Two economic criteria laid down at the Copenhagen European Council for the accession to the European Union.

The first criterion is that the candidate countries should have fully functioning market economy. Turkey has the institutional framework of a market economy. Financial markets have been liberalized and have been integrated with global financial markets. Price setting in the private sector has been almost completely liberalized. However, the state still plays an important role in setting some agricultural prices and energy and transport prices. Thus, Turkey needs to accelerate privatization to decrease direct government intervention in the economy.

Turkey has one of the most liberal foreign exchange system in the world. Almost all restrictions on foreign exchange have removed. In addition, the Turkish currency has convertibility in both current account and capital account transactions. All sectors are open to foreigners and there is no discriminations between foreign and local investors. There are not any major obstacles to entering or leaving the market. Liberal foreign trade policies have been implemented. In addition, with the formation of the Customs Union between Turkey and the European Union and with the signing of free trade agreements with countries such as Israel, Romania, Bulgaria, Hungary, Czech Republic, Slovenia, Poland, Slovakia and Estonia, the Turkish economy is opened to the world economy and foreign competition.

However, Turkey has not attained the necessary macro economic stability which is necessary for the smooth operation of the free market economy. High and volatile inflation has been adversely affected the efficient allocation of resources. The main source of inflation is the public sector deficit which reached to 15.3 Per cent of GNP in 1999 and went down to 10.7 Per-cent in 2000, as a result of implementation of comprehensive stabilization program to control inflation.

The second criterion is that the candidate country should have the capacity to cope with competitive pressures within the European Union. Five years passed since the establishment of the Customs Union. The European Union remains Turkey's leading trading partner. It is important to note that Turkish industry is standing up to full competition from the industries of the European Union. Turkish companies have increased exports of industrial goods to the

European Union. None of the manufacturing sectors have had any serious problem to compete in the framework of the Customs Union within the European Union markets. In fact, exports of transport equipment and capital goods have risen in recent years. This indicates that the Turkish industry is becoming more competitive in more sophisticated sectors.

Turkey wants to enhance the Customs Union to include services sector where Turkey has competitive power. With Turkey's strong demand, the negotiations have started to include services sector into the Customs Union. However, there are some problems for the Turkish agricultural sector to adjust to the Common Agricultural Policy of the European Union.

## **THE TURKISH-GERMAN ECONOMIC RELATIONS**

Let us first to look at the trade relations between Turkey and Germany since the establishment of the Customs Union.

**Table 1: Turkey's Foreign Trade With Germany (Million US Dollars)**

|         | 1995 | 1996  | 1997  | 1998  | 1999  | 2000  |
|---------|------|-------|-------|-------|-------|-------|
| Exports | 5036 | 5187  | 5253  | 5459  | 5475  | 5150  |
| Imports | 5548 | 7814  | 8021  | 7136  | 5880  | 7150  |
| Balance | -512 | -2627 | -2768 | -1677 | - 405 | -2000 |

Source: Turkish State Statistics Institute

First, I should indicate that Germany is the largest trading partner of Turkey. Secondly when we took at the Table 1, we see that in the first year there were strong trade creation and trade diversion effects of the Customs Union in favor of Germany. In fact, Turkey's import from Germany increased from 5.548 million dollars in 1995 to 7.814 million dollars in 1996, an increase of 40.8 Percent. It seems that all the trade creation and trade diversion effects of the Customs Union were realized in the first year. This created huge trade deficit in the Turkish trade account. The trade deficit went up from 512 million US dollars in 1995 to 2.7 billion US dollars in 1996. After 1996 the level of Turkey's imports from Germany was depended on two variables, namely the real growth rate of Turkish economy and the foreign exchange rate.

The growth rates of Turkish economy were 8.0 Percent in 1995 and 7.1 Percent in 1996. When these growth rates are taken into consideration, it can be said that the large increase in Turkey's imports from Germany in 1996 was the result of only trade creation and trade diversion effects of the Customs Union. In 1997 the growth rate of Turkish economy went-up to 8.3 Percent. As a result there was a small increase in Turkey's imports from Germany. In 1998 the

growth rate of Turkish economy went-down to 3.9 Percent. As a result of this decline in growth rate, Turkey's import from Germany decreased by 10.8 Percent. Turkey's trade deficit was 2.8 billion dollars in 1998. It went down to 1.7 billion dollars in 1998 as a result of decline in the growth rate.

The Turkish economy experienced deep recession in 1999 because of economic crises in Russia and Southeast Asian countries and earthquakes. The growth rate was negative 6.1 Percent. Turkey's imports from Germany went-down by 17.6 Percent to 5.9 billion dollars. The trade account deficit of Turkey with respect to Germany was only 405 million dollars.

In 2000 there were two important developments in the Turkish economy. Turkey implemented comprehensive stabilization policy to control inflation. The inflation rate went-down from 63 Percent in 1999 to 33 Percent in 2000. In the stabilization program, the foreign exchange rate was chosen as nominal anchor to break inflationary expectation. As a result the Turkish currency became over valued. Overvaluation of the Turkish currency encouraged imports and discouraged exports of Turkey. Secondly the Turkish economy overcame recession and started to expand in 2000. In fact, Turkey had a healthy 6.2 Percent growth rate in the year of 2000. As a result of these developments Turkey's imports from Germany increased by 21.8 Percent and reached to 7.2 billion dollars in 2000. It should be indicated that about 15 Percent of Turkish imports comes from Germany. The trade account deficit of Turkey in 2000 went up to 2 billion dollars.

At this point we need to examine what are the major products Turkey imports from Germany. The major items Turkey imports from Germany are various machinery and equipment, vehicles, chemical products and plastic products. Since Turkey imports mainly investment goods from Germany, the level of imports strongly depends on the growth rate of the Turkish economy. Whenever Turkish economy expands Turkish imports from Germany rise. Whenever the Turkish economy contracts Turkish imports from Germany decline to a large extent.

When we look at the export side of the Table 1 it can be seen that there has been continuous, but small increase in the Turkish exports to Germany after the establishment of the Customs Union. The only exception is the year of 2000. In that year there was a quite sharp decline in Turkish exports to Germany, namely six Percent. This was the result of the overvaluation of the Turkish currency in that year. As indicated before, foreign exchange rate was employed as a nominal anchor in the stabilization program that was implemented in 2000. This caused the Turkish currency to become overvalued. This development adversely affected Turkish exports.

The major products that Turkey exports to Germany are ready garment, textiles, vegetables and fruits and small amount of machinery and equipment. Turkey mainly exports consumer goods to Germany. The important point is that there has not been any important development in the Turkish exports to

Germany since the establishment of the Customs Union. The share of exports to Germany in total Turkish exports was 23.3 Per-cent in 1995. It went down to 18.7 Percent in 2000. Thus, the share of Turkish exports to Germany actually declined after the establishment of the Customs Union.

There are two aspects that the German economy is important for the Turkish economy. The Germany contributes to the Turkish economy by means of tourism and workers remittances.

**Table 2: Turkey's Tourism Income And Workers Remittances (Million U.S. Dollars)**

|                | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|----------------|------|------|------|------|------|------|
| Total Tourism  |      |      |      |      |      |      |
| Income         | 4957 | 5620 | 7002 | 7177 | 5203 | 7636 |
| German         |      |      |      |      |      |      |
| Tourism Income | 1420 | 1723 | 1814 | 1714 | 918  | 1700 |
| Total Workers  |      |      |      |      |      |      |
| Remittances    | 3327 | 3542 | 4197 | 5356 | 4529 | 4560 |

Source: The Turkish Central Bank

Large part of workers remittances come from Germany. About 20 to 25 Percent of total Turkey's tourism income is provided by German tourists. It seems that workers remittances from Germany plus tourism income from Germany more than offset foreign trade deficit that emanates from Turkey's trade relations with Germany.

However, when we look at the Table 2 we can see that the share of tourism income, coming from Germany, in total Turkish tourism income has been declining and the amount of workers remittances has been staying in the same level in recent years. The share of tourism income coming from Germany in total Turkish tourism income was 28.9 Percent. It went down to 22.3 Percent in 2000. Again, there is not any development in Turkish-German economic relations in these respects.

Another important point is that the expected dynamic effect of the Customs Unions, namely increasing capital flow to Turkey from the European Union and from Germany has not been realized.

## **CONCLUSIONS**

Five years have been passed since the establishment of the Customs Union. The Turkish economy has successfully adjusted to the Customs Union. Turkey became a candidate country for full membership of the European Union. Turkish economy fulfills the economic criteria to a large extent, set by the European Union. These are positive developments. However, there has not

been any important development in the Turkish-German economic relations. I believe that there are large economic potentials to be exploited for the benefit of Turkey and Germany, since Turkish and German economies have certain complementary properties. These complementary properties need to be exploited for the benefit of both Turkey and Germany.

Turkish and German firms can make joint investments in Turkey in certain manufacturing industries to export their products to the Black Sea region and Turkish Republics in the Central Asia. Turkey provides excellent location for these joint investments. There are large investment opportunities in the infra-structure facilities such as transportation and communication in the Black Sea region and the Central Asian region. The Turkish and German private construction enterprises can form joint firms to take part in infra-structure projects. Both manufacturing and Infra-structure investments can get financial funds from the Black Sea Trade and Development Bank and PHARE and Tacit programs of the European Bank. It is obvious that these activities will also develop the trade relations between Turkey and Germany.

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