CHAPTER VI
ECONOMIC ISSUES: GENERAL

A-ECONOMIC INTEGRATION

Economic integration is the lever to the political integration of Western Europe. However the objective is to be achieved by stages through a dynamic development of the Community. The founding Treaties reflect not only a programme in that direction but also the means of achieving it. The EEC is the centrepiece of this design. Article 2 of the EEC Treaty states that:

"TheCommunity shall have as its task, by establishing a common market and progressively approximating the economic policies of member states, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stabilitiy, an accelerated raising of the standard of living and closer relations between the States belonging to it".

This statement summarizes the objectives and emphasizes the benefits of membership of the Community as a means of closer relations between the member states (political objective) and of improved well-being of their populations (economic and social objectives). It also underlines the role of the state in the organization of integrated economy.

The overall objectives are to be achieved through the implementation of policies which are defined in the Treaty but, for practical purposes, have to be converted into legally binding obligations. This process, involving sovereign states, entails continuous negotiations and delays resulting therefrom.

B-STAGES OF ECONOMIC INTEGRATION

The layout of the EEC Treaty indicates the stages of the development i.e. first the common market, then economic union leading to a political union. The definition of policies in detailed or general terms reflects the priorities.

However, in the process, intermediary stages have emerged. Thus the common market ought to be completed through the completion of the internal market by the end of 1992. In conjunction with the completion of the internal market intergovernmental conferences on the political, monetary and economic union have been active and the results embodied in the Treaty of Maastricht.

In a technical sense stages of the economic integration are chartered through the definition of policies, i.e. the common market, Treaty policies and consequential policies. Each stage contains a message for Turkey and we shall examine the position in that order.

C-THE COMMON MARKET

The main task of the Community[1] is to set up a Common Market based on the principles of the free movement of goods and persons, the right of establishment of liberal professions and bodies corporate, the freedom to provide services and the freedom of movement of capital. These principles are laid down in the Treaty. They are further elaborated in Community legislation and case law. An applicant for membership has to implement the development of the Treaty provisions.

Following the Commission's White Paper of 1985 and the Single European Act of 1986 the internal market of the Community has to be completed by 31 December 1992. The White Paper presented the Community with a list of unaccomplished tasks and paved the way for implementing legislation whilst the Single European Act amended the legislative process, provided for a greater involvement of the European Parliament and accepted the programme of action as a legally binding obligation. The resulting volume of Community legislation has increased the burden thrust upon the applicants for membership.

D-THE MONETARY AND ECONOMIC UNION

Parallel to the completion of the Common Market the Community has embarked on the evolution towards a monetary and economic union. Both required amendments of the Treaties. These amendments are embodied in the Treaty of Maastricht.

The move towards the monetary union began with European Monetary System (EMS) launched in 1978. It is based on the following principles:

1-In the centre of the EMS there will be a European Currency Unit (ECU) initially identical in value with the European Unit of Account (EUA).

2-The ECU will be used:

(a) as the denominator for the exchange rate mechanism;

(b) as the basis for a divergence indicator;

(c) as the denominator for operations in both the intervention and the credit mechanism; and

(d) as a means of settlement between monetary authorities of the Community.

3- (a) Each national currency will have an ECU-related central rate which will be used to establish a grid or bi-lateral exchange rates.

(b)Fluctuation margins of ±2.25% will be established around these exchange rates but countries with floating currencies may opt for a margin up to ±6% on the understanding that these margins shall be reduced gradually.

4-Adjustments of central rates will be subject to mutual agreement between the participating countries.

5-(a) In principle intervention will be made in participating currencies;

(b) It will be compulsory when the intervention points defined by the fluctuation margins are reached.

6-(a) An ECU basket formula will be used as an indicator of divergencies between national currencies.

(b) A 'threshold of divergence' will be fixed at 75% of the maximum spread of divergence for each currency;

(c) When a currency crosses its 'threshold of divergence' the authorities concerned will correct the situation by any of the following measures:

(i) diversified intervention;

(ii) measures of domestic monetary policy

(iii) changes in central rates,

(iv) other measures of economic policy.

7-To serve as a means of settlement, an initial supply of ECU will be provided by the European Monetary Co-operation Fund (EMCF) against the deposit of 20 % of gold and 20 % of dollar reserves currently held by Central Banks.

8- Initially the existing credit mechanisms will be maintained but these will be consolidated into a single fund in the final phase of the EMS.

9-In the international context the EMS shall require co-ordination of exchange rate policies vis a vis non-participating countries.

10-European countries may participate in the exchange rate and intervention mechanism, their participation being based upon agreements between Central Banks.

In consequence of the EMS the value of the unit of account used by the European Monetary Co-operation Fund was changed[2] and by Regulation 3181/78[3] the European Monetary Co-operation Fund was authorized to receive monetary reserves from the member states and to issue ECU against such assets. By agreement between the Central Banks[4] the operating procedures for the EMS were laid down and officially the EMS came into force on 13 March 1979 originally between eight member states of the Community. The United Kingdom refused to participate but has joined in 1990 and, following the "Black Wednesday" of 16 September 1992, had to leave the system.

The next stage, envisaged by the Treaty of Maastricht is the creation of the Economic and Monetary Union (EMU) including a single currency and a European Central Bank. In view of its opposition, the United Kingdom negotiated a special Protocol which enables it to opt out of both to single currency and the Central Bank, with the right, however, of joining at a later date.

E- IMPLICATIONS FOR TURKEY

The implications for Turkey aspiring to membership of the Community can be summarised as follows[5].

The provisions laid down in the Maastricht Treaty on the Economic and Monetary Union (EMU) have both internal aspects, namely to promote the present integration to the creation of a single currency, common centralbank and common monetary policies and external aspects, namely the new convergence criteria to be fulfilled by candidate countries that wish to join the Community.

The convergence criteria enabling countries to join the EMU are:

-Inflation: not to exceed the average inflation rate of three member countries having the lowest rates by more than 1.5 %.

-Interest rates: not to exceed the average interest rate (for bonds or treasury bills) of three member countries having the lowest rates by more than 2 %.

-Budget deficit: not to exceed a 3 % threshold of the Gross Domestic Product (GDP).

-Public Debts: not to exceed a 60 % threshold of the GDP.

-Stability of the national currency: National currency's central parity within the Exchange Rate Mechanism of the EMS will be kept within the fluctuation band of ± 2.25 % without being subject to any parity realignments in the last two years.

If more than half of the EC members can fulfill these convergence criteria at the end of 1996, the Council can decide to move onto the third stage of the EMU. If not, then this third and last stage will automatically enter into force in 1999 regardless of the number of the member countries that fulfill these criteria. Though this provision is laid down in the Treaty it will be, in reality, hardly possible to enter into the system if the strongest economy, namely Germany, which already has reservations on replacing the D-Mark with the ECU, will be reluctant to do so.

As can be seen, these criteria, which are seemingly designed to adapt to the performances of strong economies in the EC will pose major difficulties for some member countries as well as for non-member but candidate countries. In fact these criteria are, apart from the conditions laid down in the Treaty of Rome, new requirements for countries that wish to join the ECU to be fulfilled, possibly before admission, if the EMU has been completed before further enlargement of the Community.

At this moment, one needs to look at the economic performances of the present member countries as shown in the following Table.

Economic Indicators of the EC Countries and Turkey (by the end of 1991)

Countries	Inflation rate(%)	Interest rates (For Treasury bills-bonds)	Ratio of budget deficit to GDP (%)	Ratio of public debts to GDP (%)
France	2.6	8.8	-1.5	47
Luxembourg	2.4	8.1	2.0	7
Denmark	1.8	8.8	-1.7	67
U.K.	3.7	9.7	-1.9	44
Germany	4.1	8.1	-3.6	46
Belgium	2.8	8.9	-6.4	129
Ireland	3.5	9.3	-4.1	103
Netherlands	3.5	8.6	-4.4	78
Italy	6.2	12.6	-9.9	101
Spain	5.5	11.7	-3.9	46
Greece	17.6	20.8	-17.9	96
Portugal	9.8	14.1	-5.4	65
Required Averages	3.7	10.3	-3	60
TURKEY	55.3	74	5.5	60

As can be seen from the above Table, at the end of 1991, only three countries, namely France, Luxembourg and the U.K.have fulfilled all of the four criteria. But British Pound fell in terms of currency stability while the British currency, which was within the exceptional fluctuation band of ± 6 % of the ERM, had to leave the ERM on 16 Sept. 1992 upon unbeareble pressures of depreciation. On the other hand, Denmark and Ireland fail in terms of public debts, Belgium in both public debts and budget deficit, Germany in inflation, budget deficit and public debts. Italy, Greece and Portugal fulfill none of the five criteria while Spain is successful only in public debts.

As for Turkey's position the EMS and the EMU are in fact, very much interlinked. Only member countries can be a member of the EMS. Hence if Turkey joins the Community, as all other new entrants have done so it will just sign the EMS Agreement, thus officially joining the System. But taking into consideration her economic structure and performance when she will join the EMS will depend on her own decision.

After signing the EMS Agreement, Turkish Central Bank will be able to swap 20 % of its gold and foreign currency reserves with the European Fund for Monetary Cooperation (in fact with the Bank for International Settlements that fulfills EFM's functions) and run these swap operations every quarter of a year. Furthermore, when the composition of the ECU will be subject to five-year reviews, Turkish Lira will be given a certain weight and a fixed amount in the ECU basket in proportion to the Turkish economy's strength, GDP and foreign trade values. In case Turkey joins the EC soon it will be impossible under the present conditions and in the medium term to keep her parities within the ERM, the backbone of the EMS, within the narrower fluctuation band of± 2.25 %, nor exceptionally the wider band of ±6 %, because the chronically high inflation rate of about 70 % a year (by the end of October 1992) and the accompanying depreciation of the Turkish Lira by the same or a little less rate make the Turkish Lira's entry into the ERM impossible, so far.

Moving on from here to the adaptation problem with the EMU, the picture does not seem to be different. As can be seen from the preceding Table, one should admit the fact that Turkey is far from fulfilling the convergence criteria to join the third stage of the EMU; in more specific and explicit terms, by the end of 1991. Turkey does not fulfill three of the four criteria, with her inflation rate of 71 % (Community's present threshold is 3 %), and finally 73.3 % devaluation against the US Dollar. Turkey, with her 60 % rate, fulfills only the criterion of 60 % of public debts to GDP.

This negative picture is due to Turkey's chronically high inflation which has plagued the national economy for the last 15 years. Unfortunately, high public deficits, due to insufficent revenues and excessive expenditures on the budget and the State Economic Enterprises (SEES), constitute the main reason behind this stubbornly high inflation. In a chain reaction high budget deficits lead to a higherPSBR (Public Sector Borrowing Requirement) and a higher borrowing, thus to the need of higher interest rates for bonds and Treasury bills.

At present, Turkey does not seem to have a disciplined mechanism of the economic policy objectives and performance indicators. In order to reduce inflation, a new and shock-therapy type of stabilization measures should be introduced, giving the highest priority to price stability. Also, public deficits should be drastically reduced through decreasing public expenditures, the curbing of the burden of SEES, and increasing tax revenues. The growth in money supply should be limited, too.

However Turkey, like Italy and Spain can fulfill only one criterion (public debts) while Portugal and Greece fulfill none of the four criteria.

Apart from that, the ERM goes through a turbulent and crisis -ridden period with the British Pound and Italian Lira having had to leave it, Spanish and Portuguese currencies having been subject to devaluation. Hence, it is not certain yet whether these criteria can be put into force in the member states concerning the merits of the single currency and a common central bank and there are also potential deflationary imports of these convergence criteria on the growth ambitions of some member countries (a point which concerns Turkey as well) leading to scepticism about the whole idea.

NOTES

1 EEC Art.2

2 Reg.3180/78, OJ 1978, L.379/1

3 OJ 1978, L.379/2

4 Bull. 3/79, item 2.1.1.

5 Dr. Ömer Bolat