

# THE IMPACT OF TRADE LIBERALIZATION: TURKEY'S EXPERIENCE WITH THE CUSTOMS UNION

**Orhan MORGİL**

*(Professor, Department of Economics, Hacettepe University, TR- 06532 ANKARA  
e-mail: orhan@hacettepe.edu.tr)*

*(Prof. Dr., Hacettepe Üniversitesi, İktisat Bölümü)*

## **Abstract:**

In this article the static and dynamic effects of the Customs Union between Turkey and the European Union are discussed. The static effect of the Customs Union, namely trade creation and trade diversion, has been developed in favor of the European Union. The Customs Union has generated limited trade creation for the Turkish economy. However, Turkey has partly benefited from the dynamic effect of the Customs Union. On the other hand, it was found that the Turkish import and export is quite sensitive to the exchange rate policy.

## **Özet:**

### **Dış Ticaretin Serbestleşmesinin Etkileri: Türkiye'nin Gümrük Birliği Deneyimi**

Bu makalede Türkiye ile Avrupa Birliği arasında gerçekleştirilen "Gümrük Birliği" nin statik ve dinamik etkileri tartışılmıştır. Gümrük Birliği'nin ticaret yaratma ve ticaret sapma şeklinde ortaya çıkan statik etkilerinin esas olarak Avrupa Birliği lehine geliştiği görülmektedir. Gümrük Birliği'nin Türkiye açısından sınırlı bir ticaret yaratma etkisi

**Keywords:** European Union, Customs Union, trade creation, trade diversion, free trade agreement, Copenhagen economic criteria, common trade policy, common competition policy.

**Anahtar Sözcükler:** Avrupa Birliği, Gümrük Birliği, ticaret yaratma, ticaret sapırma, Serbest Ticaret Anlaşması, Kopenhag ekonomik kriterleri, ortak ticaret politikası, ortak rekabet politikası.

olmuştur. Gümrük Birliği'nin dinamik etkilerinden Türk ekonomisinin kısmen yararlandığı anlaşılmaktadır. Diğer taraftan Türkiye'nin ithalatının ve ihracatının kambiyo kuru politikasına hassas olduğu belirlenmiştir.

## I. INTRODUCTION

The framework of the Customs Union between Turkey and the European Union was drawn with the Ankara Agreement of 1963, and details were laid down by the Additional Protocol which entered into force in 1973. During the process of negotiations the Association Council adopted a resolution in which Turkey and European Union reaffirmed their decision to complete the Customs Union in November 1993. After completion of the negotiations, the Association Council decided in March 1995 that the Customs Union agreement would enter into force on January-1-1996, pending a prior approval of the European Parliament. The European Parliament gave its assent in December 1995. The Customs Union covers only industrial products and processed agricultural products. The services sector and the agricultural sector are not included in the Customs Union.

In addition to the Customs Union agreement, the European Union made a Declaration concerning the financial assistance to be provided for Turkey. According to the Financial Declaration, Turkey will receive three and a half billion dollars of aid within five years. This financial aid has not been realized.

Before turning to the impact of the Customs Union on the Turkish economy I will briefly indicate the size and the structure of the Turkish economy. On the purchasing power parity basis, the total Turkish Gross Domestic Product is 420 billion dollars and the per-capita income is 6200 dollars. When the structure of the GDP is considered, the share of the agricultural sector is 15 per-cent, the share of the industrial sector is 30 per-cent and the share of the services sector is 55 per-cent. Turkey is the 16<sup>th</sup> largest economy in the world, and is the member of the G-20 which consists of 18 countries.

At this point I will summarize the economic policy that has been implemented by Turkish governments. The basic aim of the economic policy has been to create an open market economy which is based on the private sector and is fully integrated with the world economy. Basic properties of the economic policy can be summarized as follows:

- Financial markets has been liberalized. As a result, money and capital markets has developed rapidly and has been integrated with global financial markets.

-Turkey has one of the most liberal foreign exchange system in the world. Almost all restrictions on foreign exchange have been removed. In addition, the Turkish currency has been made convertible in both current account and capital account transactions. These developments encouraged Turkish firms to invest abroad, especially in Central Asia, Balkans and the Black Sea Region.

- In order to create a competitive economy, 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 and Czech Republic, the Turkish economy is completely opened to the world economy and foreign competition.

## II. THE FRAMEWORK OF THE CUSTOMS UNION

The basic aim of Turkey in forming the Customs Union with the European Union has been to create a competitive market economy and to benefit from the globalization of the world economy. At this point I should indicate that following basic measures that have been implemented in the framework of the Customs Union to create a competitive market economy.

- Turkey abolished all customs duties and all other equivalent charges for the member countries of the European Union for industrial and processed agricultural goods. Thus, the Turkish economy has been completely opened up to the competition of the European Union.

- Turkey adopted the Common Customs Tariff of the European Union for the third countries. Thus, the Turkish economy has been largely opened to the competition of the third countries.

- Turkey adopted the Common Commercial Policy of the European Union. In this respect, Turkey signed free trade agreement with EFTA, Israil, Bulgaria, Romanian, Hungary, Czech Republic, Estonia, Latvia, Poland, Slovakia, Lithuania, Slovenia, and Macedonia. In addition, free trade agreement with Tunisia, Egypt, Jordan and Morocco are being negotiated. Therefore, Turkey became a part of a very large free trade area,

which creates important trade and joint investment opportunities for Turkish business companies. At the same time, those countries can benefit from large Turkish market with 420 billion dollars of Gross Domestic Product on the basis of purchasing power parity.

- Turkey adopted the Common Competition Policy of the European Union; Competition and Consumer Protection Bills were enacted. The harmonization of Turkish legislation and regulation to the European Union with respect to intellectual, industrial and commercial property rights and state aids were largely completed. Thus, integration with the European Union to a large extent has been provided in these respects.
- Turkey has started to adopt the European Union mechanisms that are related to standardization, quality, calibration, testing and certification.

### III. THE DYNAMIC AND STATIC EFFECTS OF THE CUSTOMS UNION

The dynamic effects of the Customs Union have been the rationalization of Turkish economy and more efficient allocation of resources. In fact, the Turkish economy adjusted very rapidly to the Customs Union and became a competitive economy, despite some people's fears that the Customs Union would bring negative shock to the Turkish economy. No industrial sector had any serious problem in adjusting to the Customs Union.

The static effect of the Customs Union is measured by trade creation and trade diversion.

In first year there were strong trade creation and trade diversion effects of the Customs Union in favor of the European Union. In fact, Turkey's import from the European Union increased from 16.9 billion dollars in 1995 to 23.2 billion dollars in 1996. Then, it levelled around 24 billion dollars in 1997 and 1998. Turkey's import from the European Union went down to 21.4 billion dollars in 1999 as a result of the recession in the Turkish economy. There has been continuous but small trade creation effect of the Customs Union for the Turkish economy. In fact, Turkey's export to the European Union went up from 11.1 billion dollars in 1995 to 14.3 billion dollars in 1999. The share of the European Union in Turkey's total trade went up from 48.7 per-cent in 1995 to 53 per-cent in 1999. At the beginning of 2000 Turkey has started to implement a three year stabilization program. According to the stabilization program the exchange rate policy has been used as anchor to control inflation. As a result of

this policy Turkish lira has gained value by 12 per-cent over foreign currencies. On the other hand the Turkish economy overcame recession and expanded by 6 per-cent in 2000. The Turkish overall import increased by 35 per-cent due to overvaluation of Turkish lira and 6 per-cent of economic growth. However, the Turkish import from the European Union increased only by 26 per-cent. It seems that the Turkish import is quite sensitive to exchange rate policy and economic growth rate rather than trade liberalization. On the other hand the Turkish export stagnated in 2000 as a result of overvaluation of the Turkish lira. The expected dynamic effect of the Customs Union, namely to increase capital inflow to Turkey from the European Union, has not been realized. Actually, capital inflow to Turkey from the European Union has decreased, the share went down from 85 per-cent in 1996 to 70 per-cent in 1999. It is obvious that political and economical instability in Turkey largely contributed to this result. On the other hand, the European Union has not fulfilled its obligation to provide financial aid to Turkey for the adjustment of the Turkish economy to the Customs Union due to Greek veto and the European Parliament's hostile attitude towards Turkey.

It should be indicated that Turkish and European Union economies have strong complementary properties. Thus, there are large economic potentials to be utilized for the benefit of both sides. Lately there are positive developments to realize these economic potentials to improve economic and trade relations mainly due to the following reasons:

- Political stability has been achieved in Turkey.
- Turkey has implemented comprehensive stabilization program which includes structural reforms to control inflation and to provide economic stability.
- Turkey was accepted as candidate for full membership at the Helsinki European Council meeting.
- The European Union has started to meet partly its financial obligations to Turkey.

After Turkey became candidate for full membership, Turkey's relation with the European Union have gained new dimensions. For this reason economic criteria of Copenhagen for the accession to the Union need to be examined with respect to Turkey. Two economic criteria laid down at the Copenhagen European Council for the accession to the European Union:

- First the candidate countries should have fully functioning market economy. Turkey has already a well functioning market economy, which is largely integrated to the world economy. However, Turkey needs to accelerate privatization to decrease direct government intervention in the economy.

- Secondly the candidate countries should have the economic ability to compete within the European Union. Five years passed since the establishment of the Customs Union. Turkish companies have countinously increased exports of industrial goods to the European Union. As I indicated before, none of the sectors have had any serious problem to compete in the framework of the Customs Union within the European Union markets. In fact, Turkey wants to enhance the Customs Union to include the services sector. With Turkey's strong demand, negotiations have started to include the 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. There has not been enough cooperation between Turkey and the European Union in this respect. The cooperation needs to be developed between both sides with respect to the integration on the agricultural sector.

#### IV. CONCLUSION

The Customs Union between Turkey and the European Union created limited diversion effect for the European Union. There has not been large change in Turkey's trade with the third countries. The trade creation effect has been largely in favor of the European Union. Turkish manufacturing sector also benefited from the trade creation effect of the Customs Union even though in a small scale. On the other hand, it was found that the Turkish import and export is quite sensitive to the exchange rate policy.

Turkish economy has benefited from the dynamic effects of the Customs Union. There has been fundamental institutional changes in the Turkish economy. Turkey has enacted a wide range of reforms in foreign trade policy, competition policy and intellectual property rights. Institutional changes, reforms and increased competition as a result of the Customs Union contributed to the rationalization of the Turkish economy and brought about more efficient allocation of resources. As a result, the competitive power of Turkish economy and companies has increased.

## REFERENCES

- Avrupa Birliği, Avrupa Komisyonu Türkiye Temsilciliği, 2000 Yılı Genişleme Stratejisi, Ankara, 2000.
- Fritz F., *Approaches To Industrial Policy Within The EC And Its Impact On European Integration*, London, 1982.
- Hazine ve Dış Ticaret Müsteşarlığı, *Avrupa Topluluğu ve Türkiye*, Ankara, 1993.
- Orhan M., "Gümrük Birliği'nin Türkiye'nin Üçüncü Ülkelerle İlişkilerine Etkileri" *Gümrük Birliği Dergisi*, Sayı 17- 18, Mayıs - Haziran, 1995
- Orhan M., "The Euro - Mediterranean Partnership And The Customs Union Between Turkey and the European Union", *Information Commercial Espanola*, Num. 759, December, 1996.
- Orhan M., "Avrupa Birliği'nde Sanayi Politikası ve KOBİ'ler" *Hacettepe Üniversitesi İktisadi ve İdari Bilimler Fakültesi Dergisi*, Cilt:18, Sayı 1, 2000.

