Free Movement of Capital in the Context of Turkey's EU Candidature

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ABSTRACT

The confirmation of Turkey's candidacy by the Helsinki European Council in 1999 has ushered in a new era of relations after forty years of association with the European Union. The freedom of capital movement is one of the four fundamental freedoms, alongside of the freedom of movement of goods, persons and services to assist the operation of the EU internal market. The Turkish regime on the free movement of capital is, to a certain degree, aligned with the EU regulations. However, there are some restrictions on foreign ownership in other sectoral legislation in the areas of civil aviation, maritime transport, radio and television broadcasting, and energy. Moreover, acquisition of real estate is also limited for foreign investors. Removing all restrictions affecting the acquisition of real estate and foreign ownership in Turkey by EU citizens and legal persons was the focal importance in the process of the harmonization of the acquis.

I. Introduction

The freedom of capital movement is one of the four fundamental freedoms alongside of the freedom of movement of goods, persons and services to assist the operation of the EU internal market. There is no doubt that legal and natural persons from the EU would not be able to enjoy the other three freedoms without financial liberalization.

The freedom of capital movement has been developing progressively since the Maastricht Treaty. Free movement of capital is regulated by both the provisions of the primary and the secondary legislation of the EC. The basic requirements are set out in Articles 56-60 of the Treaty Establishing the European Communities and they are directly applicable. The current wording of Article 56 of the Treaty prohibits "all restrictions on the movement of capital and on payments between Member States and between Member States and third countries." Council Directive 88/361 established the basic principle of free

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movement of capital as a matter of Community law. The Article 1(1) of the Directive states that "Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States." The EU Acquis provides for full liberalization of the movement of capital between the Member States and between the Member States and third countries as of 1 July 1990, and this liberalization is one of the prerequisites for the first stage of the development of the European Monetary Union (EMU). Since then, the Member States and Accession Countries should have lifted all restrictions relating to the freedom of capital movements and cross border payments between Member States and between Member States and third countries.

Free movement of capital deals with the following three issues:

- Free movement of capital

- Payment systems

- Money laundering

These three issues are closely related. Obviously, the freedom of capital movement could not be achieved without the existence of a well-developed payment system. The acquis in this area is aimed at the standardization of technical methods and the application of payment systems, which promote and facilitate the free movement of capital. Furthermore, the full liberalization of capital movement should not prevent the application of measures against money laundering. However, this paper primarily focuses on the free movement of capital and excludes payment systems and money laundering.

According to the Capital Movement Directive,[1] the free movement of capital includes: direct investments, investments in real estate, operation in securities normally dealt with in the capital market and on the money market, operations in current and deposit accounts with financial institutions, credits related to commercial transactions or to the provision of services in which a resident participates, financial loans and credits, sureties, other guarantees and rights of pledge, personal capital movements (loans, gifts and endowments, dowries, inheritances and legacies), etc.

The Turkish regime on the free movement of capital is to a certain degree aligned with the EU regulations. However, some restrictions still remain. The screening process started on 3 October 2005.

This paper is structured as follows: the next section contains an overview on EU-Turkish relations. Turkey's financial liberalization and capital movements are explained in Section Three. Section Four examines the EU regulations on the free movement of capital. While Section Five analyzes Turkey's capital movement regulations and compares them with the acquis, Section Six concludes. This paper primarily focus on free movement of capital, therefore it does not include neither money laundering nor other freedoms nor other related legislations in depth, in the EU and in Turkey.

[1] OJ 1998 L178/5

II. Introductory Remarks about EU-Turkish Relations

Turkey has been a member of the Council of Europe, NATO, OSCE, and some other European institutions for the last five decades. It is an Associate Member of the European Community (EC); it has had member status in the Customs Union since January 1996.

Turkey has had a long relationship with the European integration. She made her first application to join the European Economic Community (EEC) in July 1959. The application was accepted under Article 238 of the Treaty of Rome, which provided that the EEC could establish an association with any European country.

As an early member of NATO, Turkey concluded an association agreement with the EEC in 1963 that began the process of establishing a customs union and the association included the promise of eventual full membership.[2] This association came into being with the signing of the Ankara Agreement in September 1963. This Agreement envisaged the progressive establishment of a customs union which would bring the two sides closer together in economic and trade matters. The Ankara Agreement was supplemented by an additional protocol signed in November 1970, which set out a timetable for the elimination of tariffs and quotas on goods traded between Turkey and the EEC.

In 1987, Turkey applied for membership. In 1995, a customs union was formed. The Customs Union not only included manufactured goods and foods, but also provided for the harmonization of competition regulations and technical legislation, protection of copyrights and the elimination of monopolies. Most importantly, the customs union led to increased trade exchange between the EU and Turkey in absolute figures.

Turkey is the only country in Europe that has concluded the Customs Union with the EU but has not started accession negotiations. This means that it has opened its market to the EU markets to the same degree as the candidate countries have, but it is receiving much less financial assistance from the Community. Turkey treated the Customs Union as a step towards full membership, while Brussels saw it as a kind of substitute.[3]

In 1999, Turkey was formally adopted as a candidate member. Accession is dependent on her meeting certain conditions, including satisfactory settlement of the "Cyprus issue" and economic reforms. Most importantly, however, Turkey had to meet the so-called Copenhagen Criteria which are achieving stability of democratic institutions, the rule of law, human rights and protection of minorities. Since the Amsterdam Treaty (1997), these have been considered as the minimum criteria for EU eligibility. In 1995, after forming the Customs Union, in December 1999, Turkey was officially granted an accession candidate status by the European Council. From an economic point of view along with political reasons, Turkey has had a stable func-

[2] L.M. McLaren, 'Turkey's Eventual Membership of the EU: Turkish Elite Perspectives on the Issue,' 38 *Journal of Common Market Studies*, (2000) pp. 117-29.
[3] Harun Arıkan, Turkey and the EU, (Hants 2003) p. 57-59.

tioning market economy over the last fifty years and the Customs Union which show that Turkey has the capacity to compete within the EU.[4]

On the other hand, analysts tend to point out that there has been no case in EU history where accession negotiations, once started, have not led to an offer of full membership. During the accession process, European law is to be adopted rather than negotiated. The talks are expected to last at least a decade. Turkey's accession process will rest on three pillars: full implementation of the Copenhagen criteria, complying with the EU acquis and civil society dialogue.[5]

After forty years of association with the EU, the granting of Turkey's candidacy by the Helsinki European Council in 1999 started a new period for EU-Turkish relations. In the new era, membership has come even closer. The European Union, at the Copenhagen Council of 12-13 December 2002, committed itself to starting accession negotiations without delay if Turkey would fulfill the Copenhagen political criteria by December 2004. Turkey is currently going through a dynamic process of legal, political and economic reforms on the road to European Union membership. The purpose of this process is to guarantee the functioning of the democratic system with all its rules and institutions. There is no doubt that participatory democracy, the rule of law, human rights and fundamental freedoms are not only universal values, but are also the most reliable bases for political and economic stability and development.

It is obvious that Turkey has undertaken radical constitutional and economic reforms to satisfy the Copenhagen criteria for the opening of accession negotiations with the European Union since 2001. With the fulfillment of the Copenhagen Criteria, the European Council of Heads of State and Government agreed on 17 December 2004 to launch membership talks on 3 October 2005, a decision which was reaffirmed in the European Council meeting of 17 June 2005. Turkey also drew up a National Plan for the Adoption of the Acquis, which outlined the government's own strategy for the harmonisation of its legislation with that of the EU.[6]

The EU Council of Ministers decided unanimously to adopt the 'Negotiating Framework for Turkey. This European Commission-drafted document, published in June 2005 and set out the road map to conduct the EU membership talks.[7] Although the "shared objective" of these negotiations is accession, which cannot happen before 2014, they are an "open-ended process whose outcome cannot be guaranteed beforehand" which means no irrevocable commitment or timeline has been given for membership.[8]

Hakura (2005) states that "EU entry is dependent on three factors: (i) Turkish fulfillment of membership requirements; (ii) its economic performance during accession; and (iii) the EU's and Turkey's geopolitical-economic environments around 2015. Within that timeframe, the situation of the EU and Turkey could change profoundly – hence

[4] L. Dobson, " We Have the Stars, Let's Add the Moon: Turkey, the EU, and the Constitutional Values of Free Citizens", Federal Trust Constitutional Online Paper No. 10/04, July, 2004.

[5] EU-Turkey negotiations and European Enlargement, *at* http://ec.europa.eu/enlargement/turkey/eu_turkey_relations_en.htm.

[6] *See also* the declaration by the European Community and its Mmeber States of 21 September 2005.

[7] Negotiating Framework for Turkey, European Commission, *available at* http://www.europa.eu.int/comm/enlargement/docs/pdf/negitiating_framework_turkey.pd (last visited on 20 June 2006).

[8] L. M. McLaren, "Turkish Parliamentarians' Perspectives on Turkey's Relations with the European Union'," *in* Meltem Muftuler-Bac, ed(s). *Turkish Studies, special issue on Turkish-EU relations, and Turkey and the EU,*. Unknown: Unknown, 2003, pp. 195-218.

today's mindless speculation does not necessarily have a bearing on, or reflect the future."[9]

Many commentators believe that negotiations will be very difficult for both sides. The adoption and implementation of 100,000 pages of EU legislation (known as the *acquis communautaire* or acquis; acquis is used in this paper) will be covered by the negotiations. Negotiations has been separated into 35 chapters or policy areas. For each chapter, the EU member states will unanimously lay down benchmarks or preconditions for the provisional closure and, where appropriate, the opening of a chapter.[10]

Undoubtedly, the accession process could encourage sizeable inward foreign direct investment, which would lower Turkish unemployment levels and increase prosperity. For instance, more than $10B foreign direct investment (FDI) has been invested in Turkey since accession negotiations started in December 2005.

In addition to the accession negotiations, two other pillars are designed to provide assistance to Turkey in the pre-accession phase: reinforce and support the reform process in Turkey and strengthen the political and cultural dialogue.

A. EC Accession Partnership with Turkey

The Accession Partnership, which is based on the pre-accession strategy, is the main instrument providing Turkey with guidance in its preparations for accession.

- The objectives of the Accession Partnership are to establish:
- priorities for reform with a view to preparing for accession;
- financial resources provided for implementing these priorities.

The Accession Partnership with Turkey was established in 2001 and has been revised twice, in 2003 and in 2006. The purpose of the Accession Partnership is to support the Turkish government in its efforts to meet the political accession criteria. It covers the priorities for accession preparations, particularly implementation of the acquis, and pre-accession assistance from EU funds. It is a flexible instrument designed to encourage Turkey to continue its efforts to prepare for accession and integration. In order to achieve the objectives identified in the Accession Partnership, In 2001 and 2003, Turkey adopted national programs for transposing the Community acquis.

It is widely accepted that accession negotiations with Turkey will be a multi-stage process, largely following the pattern of previous enlargements. The "screening process" targets identification of existing discrepancies between the acquis and regulations and practices in Turkey. There are thirty five chapters of the acquis to be negotiated between the Commission and Turkey. Each chapter individually comprises the entire EU legislation in that area. The consent of all member countries are required to permit the closure of any chapter. The Commission is expected to highlight and emphasize crucial implementa-

[9] Fadi Hakura, European Programme ep bp 05/02,September 2005, "Partnership Is No Privilege The Alternative to EU Membership Is No Turkish Delight", Chatham House, p. 2.
[10] Hakura, 2005, p. 3.

tions during the negotiation process. Thus, negotiations are likely to indicate concrete implementation benchmarks for closure. After closure of all chapters, the Commission will recommend that the negotiations be concluded. If the Commission gives a positive assessment on negotiations, the Accession Treaty will be approved by the Council, the European Parliament, EU countries, and Turkey. However, some EU member countries are expected to hold a referendum on Turkey's accession.[11]

B. Three-pillar negotiations

The first pillar concerns cooperation to strengthen and support the reform process in Turkey, in relation to the continuous fulfilment of the Copenhagen political criteria. Therefore, the progress of the reforms will be monitored closely by the EU institutions.[12]

However, the Commission also recommended that if Turkey seriously and persistently breaches the principles of liberty, democracy, respect for human rights and fundamental freedoms or the rule of law on which the Union is founded, the negotiations will be suspended by a qualified majority in the Council.

The second pillar entails the specific way in which accession negotiations with Turkey are to be approached. They will be held in the framework of an Intergovernmental Conference consisting of all Member States of the EU. For each chapter of the negotiations, the Council must lay down benchmarks for the provisional closure of negotiations, including a satisfactory track record on implementation of the acquis. Existing legal obligations relating to alignment with the acquis must be fulfilled before negotiations on the chapters concerned are closed. Long transition periods may be necessary.[13]

However, there are some chapters in which negotiations will be harder, such as structural policies and agriculture. Therefore, the Commission may apply specific arrangements concerning agriculture and permanent safeguards concerning the free movement of workers. Moreover, Turkey's accession is also likely to have an important financial and institutional impact on the EU. The EU will therefore need to describe its financial standpoint for the period from 2014 before the conclusion of negotiations.

The third pillar concerns enhanced political and cultural dialogue between the people of the EU Member States and Turkey. This includes a dialogue on cultural differences, education, religion, migration issues and concerns about minority rights and terrorism. Civil society should play the most important role in this dialogue, which the EU will facilitate.[14]

C. Economic Criteria for Membership Related to Capital Movements

There are several criteria mentioned in the Turkey 2005 Progress

[11] Mehmet Ugur, "Turkey and European Integration", 2004, Bertrams Print, p.14-35.
[12] "Turkey: the Comission Recommends Opening Accession Negotiations", *available at* http://europa.eu/scadplus/leg/en/s40015.htm, (last visited on 11 June 2006).
[13] *Id.*
[14] *Id.*

Report that should be met by Turkey. These are divided into three categories: political criteria, economic criteria and ability to assume the obligations of membership. Political and economic criteria will be examined in this paper respectively.

The Copenhagen criteria was adopted by the EU Member States to transform the new candidates, and thus to test their eligibility. The political criteria read as follows:

Membership requires that the candidate country has achieved stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union. The membership presupposes the candidate's ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union.[15]

However, Article 6/1 of the Treaty on European Union (TEU) re-defines the characteristics of the union as follows:

The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States.

On the other hand, the criteria for the admission of new members have been also re-defined by the Article 49 of the TEU:

"Any European States which respects the principles set out in Article 6(1) may apply to become a member of the Union..."

The political criteria, mentioned briefly above, for accession must be met by the candidate countries. These criteria were laid down by the Copenhagen European Council in June 1993 and require that candidate countries must have achieved "stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities."[16] Furthermore, the Commission will also monitor regional issues, including the requirements of Turkey's commitment to good neighborly relations and its commitment to resolve outstanding border disputes; its support for efforts to achieve a comprehensive settlement of the Cyprus problem and progress in the normalization of bilateral relations with Cyprus. Political criteria primarily include democracy and the rule of law and, human rights and the protection of minorities.[17]

As mentioned above, after the Commission recommendation, the Council decided in December 2004 that Turkey fulfilled the Copenhagen political criterion.[18] Since then, the priority has been given to the economic criterion and the harmonization of Turkey's regulations. In 2005, European Council Accession Partnership Report stated that membership in the Union requires the existence of a functioning market economy and the capacity to cope with the competitive pressure and market forces within the Union.

[15] European Council, Copenhagen, "Presidency Conclusions, 21 and 22 June, 1993," in Bulletin of the European Communities, vol. 6, 1993, paragraph I.13.
[16] "Turkey 2005 Progress Report" p. 9-12, European Commission, Brussels, available at http://www.europa.eu.int/comm/enlargement/docs/pdf/turkey_2005 progress_report.pdf, last visited on 20June2006.
[17] P. Taylor, "Turkey-EU Relations in 2001: Structural Change and Agency Oportunity" in Mamara Journal of European Studies, Volume 9, No.1, 2001, pp. 92-95.
[18] Presidency Conclusions – Brussels, 16/17 December 2004, Council Of The European Union, 16238/1/04

According to the Report, there are some economic criteria related to free movement of capital that Turkey needs to meet. These are as follows:

- Continuing to implement the current structural reform program agreed with the IMF and the World Bank, in particular, to ensure the control of public expenditure;

-Completing the implementation of the reforms in the financial sector, in particular the alignment of prudential and transparency regulations and their surveillance in international standards;

- Safeguarding the independence of market regulatory authorities;

- Accelerating the privatization of state-owned entities, in particular of state-owned banks, taking into account the social component;

- Continuing with market liberalization, and price reforms, in particular in the areas of energy and agriculture, with particular emphasis on tobacco and sugar;

- Continuing the economic dialogue with the EU, in particular in the framework of the pre-accession fiscal surveillance procedures, with emphasis on appropriate measures to achieve macroeconomic stability and predictability and on the implementation of structural reforms;

- Implementing means to address the problem of the informal economy;

- Improving professional training efforts, in particular for the younger population;

- Addressing labor market imbalances;

- Improving business climate, and in particular the functioning of commercial courts.

-To improve the functioning of the commercial judiciary, paying particular attention to the independence of the judiciary and appropriate use of the expert witness system

- Continuing reform of the agricultural sector;

- Ensuring the improvement of the general level of education and health, paying particular attention to the younger generation and disadvantaged regions;

- Facilitating and promoting the inflow of foreign direct investments;

Finally, more specifically concerning with the free movement of capital, Turkey should remove all restrictions affecting foreign direct investments originating from the EU in all economic sectors." [19]

[19] "Turkey 2005 Progress Report" p. 9-12, European Commsision, Brussels, *available at* http://www.europa.eu.int/comm/enlargement/docs/pdf/turkey_2005 progress_report.pdf, last visited on 20 June 2006.

III. Financial Openness and Capital Movements in Turkey

Since the second half of the 1970s, most developing countries have liberalized their capital accounts in the manner of financial openness. Despite differences among the countries, a number of developing countries have more liberal rules for foreign exchange transactions than some developed countries.[20]

The process of liberalization began in the 1980s simultaneously with stabilization programs which targeted economic transformation. The economic implementations addressed three major issues: foreign trade, domestic financial market and capital movements. Some analysts argue that the opening of the capital account induced adverse effects on financial intermediation, savings, investment, growth and foreign debt.[21] Moreover, financial openness or external financial liberalization, provided more liberalized economic and financial environment where residents could acquire assets and liabilities denominated in foreign currencies and non-residents could operate without restrictions in national financial markets.[22]

3.1. Financial Liberalisation in Turkey

According to Reisen[23] and Borotav,[24] there are mainly three reasons for renewed interest in financial openness. First, there has been an increasing *de facto* opening of the capital account, because of a growing integration of trade, financial innovation and financial opening by other countries. Second, some developing countries have become subject to pressure to open their financial system.[25] Third, external financial liberalization is usually considered the final stage of a comprehensive liberalization and adjustment package implemented by developing countries under the auspices of the World Bank and the IMF.[26]

The globalization of production and the resulting deeper integration of national markets have reinforced the link between domestic policies and trade liberalization. As border barriers to trade have fallen around the world, the impact of domestic regulations on international trade and investment has become more apparent than ever before. These reforms have renewed efforts undertaken over the last two decades to liberalize the economy and open it to international competition. Reduction of tariff barriers to trade, convertibility of the currency, the Customs Union with the EU and the launch of a privatization program have represented major steps towards increased openness. A number of measures have been recently taken or are under preparation to create a regulatory framework that supports the restructuring the economy.[27]

Integration of the developing national economies into the evolving world financial system has been achieved by a series of policies aimed at liberalizing their financial sectors. The motive behind liberalization was to restore growth and stability by raising savings and improving economic efficiency. A major consequence, however, has

[20] K. Boratav, 1993. Review Article: State and class in Turkey. *Review of Radical Political Economics* 25(1): 129–141.
[21] D. Rodrik, "Who Needs Capital-Account Convertibility?" in *Should the IMF Pursue Capital-Account Convertibility?* Princeton Essays in International Finance 207 (1998).; J. Stiglitz, and A. Bhattacharya (2000) "The Underpinnings of a Stable and Equitable Global Financial System: From Old Debates to a New Paradigm" *Annual World Bank Conference on Development Economics*, December, pp. 91-130.
[22] Akyuz, Yilmaz (1993), "Financial Liberalization: The Key Issues" , in Yilmaz Akyuz and Gunter Held (Eds), Finance and the Real Economy, Issues and Case Studies in Developing Countries, Santiago de Chile, United Nations.
[23] Reisen, 1993.
[24] Boratav, 1993.
[25] Reisen, 1993
[26] Boratav, 1993
[27] OECD, (2002) "Regulatory Reform in Turkey- Enhancing Market Openness Though Regulatory Reform" 14 June, *available at* http://www.oecd.org/dataoecd/40/9/1840760.pdf#search=%22Regulatory%20Reform%20in%20Turkey-%20Enhancing%20Market%20Openness%20Though%20Regulatory%20Reform%E2%80%9D%22 , last visited on 20June2006

been the exposure of these economies to short term capital movements –so called hot money- which have increased financial instability and have resulted in a series of financial crises in the developing countries.[28]

A. Regulatory Reforms

The Customs Union and the longer term goal of accession require Turkey to adopt the acquis communautaire. This entails far-reaching structural and legislative reforms in many areas, such as customs, duty concessions, competition policy, state aid, intellectual property rights, standards and sanitary and phyto-sanitary measures. With full liberalization of the capital account and the recognition of the full convertibility of the Turkish Lira in 1989, however, there has been a massive inflow of short term capital into the domestic economy.[29] Even though there was no officially stated exchange rate management policy during this period, the government seemed to use the exchange rate as the nominal anchor in trying to control inflationary expectations.[30]

As mentioned above, Turkey liberalized its capital account transactions in 1989, and flows of international capital immediately intensified, especially after 1990 when Turkey introduced full convertibility to the Turkish Lira. It was argued then that Turkish financial markets were not sufficiently developed – that the economy was not stable enough to deal with the high volatility of international capital flows. Moreover, there were concerns about the proper regulation and supervision of financial markets that free capital mobility would necessitate.[31]

Ersel states that the decision to liberalize the international capital flows were more political than economic.[32] For instance, in the case of Turkey, capital flows were expected to finance the growth and fulfill the borrowing requirement of the public sector. Therefore, capital account liberalization in Turkey had crucial impact on government spending, monetary expansion and inflation in the 1980s and 1990s.

During the 1980s, Turkey followed an economic policy of openness and liberalization. Following the severe debt crisis during 1978-1980, the liberalization experience included lifting quantitative restrictions on trade and moving away from an inward-oriented import substitution to an export-oriented growth strategy. On the financial liberalization side, Turkey implemented several steps; first the interest rate ceilings on bank loans were removed in 1981, and second, residents were allowed to hold foreign exchange denominated assets, beginning in 1984.[33]

Later on, while fiscal balances deteriorated, reforms in the financial and external sectors continued. The Central Bank of the Republic of Turkey (CBRT) took important steps to alter the institutional setting of policymaking and focused increasingly toward using indirect monetary policy instruments. The interbank money and foreign exchange markets were opened in 1986 and 1988, respectively, and open mar-

[28] B. Milanovic, (1999) *True World Income Distribution, 1988 and 1993: First Calculations Based on Household Surveys Alone*, mimeo, The World Bank, Washington D.C.; Rodrik, D. (1997) *Has Globalization Gone Too Far?* Institute for International Economics, Wash. D.C and 1998; Adelman, Irma and Erinç Yeldan (2000), "The Minimal Conditions for a Financial Crisis: A Multiregional Intertemporal CGE Model of the Asian Crisis." *World Development*, 28(6): pp.1087-1100, (June); Stiglitz and Bhattacharya, 2000.

[29] OECD Report (2002) p.3-12

[30] R. Dornbush, (1982) "Stabilization Policies in developing Countries: What Have We Learned?", *World Development*, 10(9):701-708; Diaz-Alejandro, C.F. (1985) "Good-Bye Financial Repression, Hello Financial Crash," *Journal Of Development Economics*, 19:1-24; J. M. Fanelli, and R. Frenkel, (1993), "On Gradualism, Shock Treatment and Sequencing," in UNCTAD, *International Monetary and Financial Issues for the 1990s,* Vol. II., New York, United Nations.

[31] Onis, 1996.D. Rodrik, (1991) "Premature Liberalization, Incomplete Stabilization: The Ozal Decade in Turkey" in M. Bruno, et. al. (eds.) Lessons of Economic Stabilization and Its Aftermath, Massachusetts: MIT Press.; E. Yeldan, (2001): Turkish economy in the process of globalization, (in Turkish) (İstanbul: İletişim); Nurhan Yenturk, "Short-Term Capital Inflows and Their Impact on Macroeconomic Order: Turkey in the 1990s." Developing Economies, vol. XXXVI, no 1, 1999.

[32] Ersel, H., 1996, The timing of capital account liberalization: The Turkish experience, New Perspectives on Turkey, 15, 45–64..

[33] Akyuz (1993)

ket operations were introduced in 1987. Bank lending and borrowing rates were fully liberalized in 1988.[34]

Late in the 1980s, the following developments took place in Turkey. First, since the government could not achieve the desired external balance, it abandoned the real exchange rate policy in 1989; since then, the exchange rate appreciated in real terms. Second, a complete financial liberalization package was adopted in 1989, which removed restrictions on capital controls, thus allowing foreign investors to invest freely. Additionally, in 1990, Turkey accepted the International Monetary Fund's (IMF) Article VIII, which allowed both residents and non-residents to conduct foreign exchange operations in Turkey and abroad, permitting commercial banks to engage freely in foreign exchange transactions.[35]

Finally, the interest rate ceiling on deposits was also removed in 1991. As a result, capital flows became a significant source for financing of the current account deficit, which reduced the relative importance of the official financing and workers' remittances. Furthermore, in the late 1990s and early 2000s, privatizations, financial crises and the IMF stabilisation programs forced Turkey to make further changes in the field of the free movement of capital.[36]

IV. Free Movement of Capital and Payments in the EU

Member States must remove, with some exceptions, all restrictions on the movement of capital both within the EU and between Member States and third countries. The acquis also includes rules concerning cross-border payments and the execution of transfer orders concerning securities. The directive on the fight against money laundering and terrorist financing requires banks and other economic operators, particularly when dealing with high value items and large cash transactions, to identify customers and report certain transactions.

The principle of the free movement of capital was agreed in the EEC Treaty, specifically in Articles 56-60 (ex 67-73). These provisions of the EEC Treaty, according to Article 2 of the Treaty, are based on two basic principles of the EEC: the creation of a common market and the gradual approximation of the economic policies of states.

The free movement of capital, according to both primary and secondary EC law, is divided into two categories: free movement of capital and free movement of payments. The free movement of capital means the transfer of values in the form of money, securities or rights across the borders of the EU member states with the purpose of investment. Free movement of payment means the transfer of financial recourses across state borders with the purpose of fulfilling obligations. Article 56 of the EC Treaty prohibits restrictions on the free movement of capital, not only between member states, but also between member states and non-member states. However, the provisions of Articles 57, 59 and 60 of the Treaty regulate the specific conditions

[34] Boratev and Yelden, (2001)
[35] OECD Report (2002) pp.8-14
[36] *Id.*

of restrictions. Also, Directive 1988 established the basic principle of free movement of capital as a matter of Community law. In its Annex, it states that the capital movement mentioned are taken to cover all the operation necessary for the purposes of capital movements.

A. Overview of the Free Movement of Capital

1. The Treaty of Rome and Economic Integration

The original provisions on the free movement of capital can be found in Articles 56-60 of the Treaty of Rome.[37] Typically, these rules were not as unconditional as those on the other Treaty freedoms.[38]

European integration, coupled with the process of globalization and other economic and social phenomena, has stressed the need to rethink traditional economic models; it has highlighted the crisis of national economic models and has required that we conceive new forms of constitutional relationships between public power and the economy.[39]

It is necessary to examine the Treaty to understand the ultimate goal of the European Community. The aim of Article 2 is to establish a common market. According to Article 14 of the Treaty, the single market is "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty." Therefore, the free movement of capital has been one of the fundamental freedoms within the Community.

According to Petersmann, free movement rules are the sources of legitimizing market integration and non-discriminatory competition, in that they increase individual autonomy, equality and responsibility, control abuses of government and maximize economic welfare. The result of this contribution is that the economic choices are no longer considered to be a matter of policy, but a question of constitutional rights.[40] As Maduro states, the market was conceived as the best source of legitimizing the European Economic Constitution. This goal should protect market freedom and individual rights against public power.[41]

2. Principles and Objectives of Free Movement of Capital

There is no doubt that the freedom of capital movement is one of the four fundamental freedoms along with the freedom of movement of goods, persons and services in the EU. Without the free movement of capital, the other freedoms would be less significant. Free movement of capital requires that first all restrictions should be lifted between Member States and between Member States and third countries and second, that legal and natural persons should be treated equally within the EU. Moreover, the free movement of capital is a vital necessity for a harmonious, balanced and sustainable economic development as well as a high degree of competitiveness and a stable investment climate, and profitable business environment.[42]

[37] Usher, (1999) Law of Money and Financial Services in the EC, p.15-16
[38] Craig and De Burca, Free Movement Of Goods, Workers, Services, And Establishment, p. 680.
[39] Miguel Poiares Maduro, "Reforming the Market or the State? Article 30 and the European Constitution: Economic Freedom and Political Rights", European Law Journal, Vol.3, No.1, March 1997, p.80.
[40] Maduro (1997) p.64.
[41] Maduro (1997) p.79.
[42] http://ec.europa.eu/comm/economy_finance/index_en.htm.

B. Outline of Provisions relating to the Free Movement of Capital

According to Article 56, the free movement of capital, which is the fourth freedom, can be separated into two elements:[43] capital (Article 51(1) of the Treaty) and payments (Article 51(2) of the Treaty).

All restrictions on the free movement of capital and payments between Member States or between Member States and third countries are prohibited by Article 56 of the Treaty. It is clear that there are two categories of capital movement. First is the movement of capital between a Member State to Member State or States[44] and the second is the movement of capital from a Member State to a third country or countries.[45] Accordingly, exceptions can be divided into two as well. The express exceptions to the free movement of capital are provided by the provision of Article 58 of the Treaty.

1. Treaty of Maastricht

The Maastricht Treaty, signed in 1992, came into force in 1993, and reduced the significance of this distinction, which adopted new rules on the movement of capital in 1994. In a single chapter, Chapter 4 of the Treaty of the European Union brought together both of the provisions on capital and those on payments, and they were reproduced in the contents of Directive 88/361.

Article 73(1) (the Maastricht number), renumbered at Amsterdam as Article 56(1), now provides that all restrictions on the movement of capital between Member states, and between Member States and third countries shall be prohibited. Art. 56(2) replaced Article 106 of the EEC treaty and extends this prohibition to all restrictions on payments. The fundamental distinction between these provisions and the original provisions is that capital movements to and from third countries appear to be treated the same way as movements between Member States.[46]

The EC Treaty neither defines the term “movements of capital” found in Article 56(1) nor does it define the term “payments” found in Article 56(2). However the Court has followed the definitions given in the case law such as in *Lambert*[47] and the case of *Luisi and Carbone*[48] in its rulings, and referred to the non-exhaustive list in the Annex to Directive 88/361 in order to establish whether the case in question fell within the classifications of capital movements.[49]

The Treaty of the European Union concerning Economic and Monetary Union (EMU) was signed at Maastricht (TEU) and radically changed the Articles that applied to the free movement of capital.[50] It introduced new provisions on capital movements and payments, making it the only Treaty freedom that has been substantively amended.[51] Initially, before the start of the third stage of the Economic and Monetary Union in January 1999, the question arose whether or not an integrated market with regards to the movement of capital could actually be achieved, since there was no way of controlling currency fluctua-

[43] This would suggest that the two concepts are different, and indeed early case law, *Luisi and Carbone* (Case 286/82), distinguished between the two, since the prohibition operates on both in the same terms, effectively the need to distinguish between the two has been removed.
[44] Article 58, see also Articles 119 and 120 (ex- 109h and 109i).
[45] Articles 57, 59 and 60.
[46] Usher (1999), p.16
[47] *Ministere Public v. Lambert, Case* 308/86 [1988] ECR 4369.
[48] *Luisi and Carbone v. Ministero del Tesoro*, Case 26/83 [1984] ECR 377
[49] C. Barnard, “The Substantive Law of the EU,” p. 464-465
[50] Craig and De Burca, p. 680.
[51] J. Usher, Law of Money and Financial Services in the EC, p.1.

tions and the related exchange rates of the currencies of Member States.

After all, if we take a look at the wording of the Articles of the Treaty, it has to be concluded that no distinction was made between Member States and the States outside the Eurozone. Although the current provisions of the EC Treaty were drafted with the EMU in mind, in principle the same rules apply to all Member States, irrespective of the fact that they do or do not participate in the Monetary Union.[52] Article 56 states that movements to and from third countries are to be treated the same way as movements between Member States, although in reality there are differences which remain.[53]

Article 56 of the Treaty, which is directly applicable, sets out the principle of full freedom of capital movements and payments, both between Member States and between Member States and third countries; Article 57 deals with the possibility of maintaining certain existing restrictions as of 31 December 1993 under national or Community law vis-à-vis third countries whereas Article 58 introduces the fields in which Member States can maintain information, prudential supervision and taxation requirements without capital movements being hindered; Article 59 provides for the possibility of taking safeguard measures if movements of capital to or from third countries cause serious difficulties for the operation of the Economic and Monetary Union; and Article 60 allows the Community or a Member State to take measures controlling movements of capital to or from third countries for security or foreign policy reasons.[54] As can be seen from the brief description of the Articles, other than Article 56, the other Articles limit the free movement of capital.

2. The 1988 Directive

The Single European Act, which considered the free movement of capital to be as important as the freedoms of goods and services, led to the adoption on 24 June 1988 of Directive 88/361/EEC. The Directive was designed to provide fully liberalized financial market and freedom for capital movements with effect from 1 July 1990, both between Member States and with third countries - *erga omnes* liberalization-.

Council Directive 88/361[55] established the basic principle of free movement of capital as a matter of Community law, for most Member States since 1 July 1990. The free movement of capital has become the only Treaty freedom to be achieved in the manner envisaged in the Treaty. Article 1(1) of the 1988 Directive states that "Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States." However, in the absence of a Treaty definition, the headings of the nomenclature indicate the concept of capital underlying the Directive: direct investments, investments in real estate, operations in securities handled in the capital market, operations in units of collective investment undertakings, operations in securities and other instruments undertaken on the

[52] Usher, p.15.
[53] J. Usher, 'Tax discrimination under the new capital movement provisions and the basic Treaty freedoms', in 'European Financial Area', Rudanko/Timonen, University of Helsinki 1998, p.271.
[54] Further information see http://europa.eu/pol/emu/index_en.htm.
[55] OJ 1988 L178/5.

money market, operations in current and deposit accounts with financial institutions, credits related to commercial transactions or to the provision of services in which a resident is participating, financial loans and credits, sureties, other guarantees and rights of pledge, transfer in performance of insurance contracts, personal capital movements, physical import and export of financial assets, and other capital movements. The introduction to the Annex further states that the capital movements mentioned are taken to cover all the operation necessary for the purposes of capital movements.

The 1988 Directive laid down the basic principle of unrestricted free movement of capital between persons resident in Member States. It was felt necessary to draft new Treaty provisions to the same effect. One substantive difference is that by treating payments between Member States in the same way as capital movements, the new Treaty provisions remove any lingering doubts as to the precise scope of the freedom to make current payments. As Professor Usher (1992) argues, a more fundamental reason is that as secondary legislation, the Directive could relatively easily be amended, and progress to the Economic and Monetary Union could not be envisaged unless monetary movements between Member States rested on the same legal basis as the other fundamental features of the Union. It may be submitted that both Article 1 of the 1988 Directive and Article 56 of the EEC Treaty were drafted in a manner sufficiently clear, precise, and unconditional to be directly effective.[56] The wording of the provision, as amended by Article 16(4) of the Single European Act,[57] was widely seen as a positive step towards the complete liberalization of capital movements.

C. Scope of the Free Movement of Capital

The freedom of the free movement of capital is applied to both community nationals and legal persons. The original Article 67 of the EEC merely required a person to be resident in the EC in order to rely on the freedom of capital whereas Article 56 makes no reference to such a requirement. "Like the provisions relating to the free movement of goods, and in contrast to those relating to services and people, the capital provisions may be relied on by third country nationals (TCNs). The situation is the same whether the capital movement is intra-Community, or between a third country and the Community."[58]

1. The Consequences of the Treaty Provisions and the Directive

As Professor Usher states that "whatever may be the meaning of capital in the context of the EC Treaty, the provisions relating to capital movements are distinguished by the fact that in the original version they were drafted in a style very different from that of the other Treaty freedoms, and by the fact that, its effect starts from the beginning of the second stage of the EMU on 1 January 1994. They were replaced by a completely new set of provisions similar in many respects to those governing the free movement of goods."[59]

Indeed, with regards to the competition rules of the Treaty, it has

[56] J. A. Usher., "Capital and Treaty on European Union" in 12 YEL, 1992, p.43-44.
[57] OJ 1987 L 169/1.
[58] Steiner, Woods and Twigg-Flesner, "EU Law", 9th edition, (Oxford: OUP, 2005) (Advance sample chapter 16 from the forthcoming edition).
[59] Usher (1999), p.15.

been accepted that the charges levied for transferring money from one Member State to another may affect trade between Member States.[60]

2. Evaluation of the Free Movement of Capital under the Directive

Two particular comments may be made about the nomenclature. First, in the continued silence of the Treaty, it remains a useful illustration of the principle of the free movement of capital even after the entry of Articles 56 to 60 under the Maastricht Treaty. This was confirmed by the ECJ in *Trummer and Mayer.*[61] Second, many of the movements listed were clearly current payments under Article 106(1).

Nevertheless, the 1988 Directive purported to be made under Articles 69 and 70(1), which related only to capital movements. However, it is clear that borrowing money from a bank in another Member State to buy a house fell within the scope of the Directive, as was held in *Svensson and Gustavsson v. Ministre du Logement.*[62] It was subsequently suggested by A.G Tesauro in his opinion in Case C-118/96 *Safir v. Skattemyndigheten I Dalarnas Lan*[63] that a narrower concept of capital movement should be adopted. The Court confirmed that a mortgage fell within the scope of a capital movement as defined in the Directive in *Trummer* and *Meyer,*[64] and held that this interpretation should be continued to apply to the free movement of capital under Article 56.[65]

Further emphasis on the difficulty in drawing a clear distinction between monetary movements and the other Treaty freedoms, Article 58(2) provides that the provisions of the Chapter on capital and payments shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with the Treaty.[66]

As Professor Usher argues, for all the differences in style, the new capital movement and current payment provisions represent a continuation of an evolution rather than a revolution, and in some respects they allow quite a surprising scope for national restrictions, particularly with regard to measures taken in the tax field. Nevertheless, the Maastricht Treaty on European Union sets out a framework which may enable the law of monetary movements to develop in parallel with the established rules relating to free movement of goods and the freedom to provide services.[67]

3. The ECJ Effects on Capital Movements

In the British *Golden Shares* case, the ECJ noted that even rules which apply without distinction to non-nationals and nationals alike can "deter investors from other Member States from making such investments and, consequently, [and] affect access to the market.[68]

According to this decision, it can be argued that the ECJ is moving away from a discrimination-based approach and looking at the impact on the market. In the *Golden Shares* case,[69] the UK government proposed that Article 56 be interpreted according to the principle in *Keck*.

[60] Usher (1999), p.27.
[61] C-222/97 [1999] ECR I-1661.
[62] C-484/93, *Peter Svensson a Lena Gustavsson v. Ministre du Logement et de l'Urbanisme* (1995) ECR I-3955.
[63] (1988) ECR I-1899.
[64] Case C-222/97.
[65] Usher (1999), p.20.
[66] Usher (1999) p.37-38
[67] J.A. Usher, "Capital and Treaty on European Union" in 12 YEL, 1992, p.57.
[68] Case C-98/01, *Commission* v. *UK* (*Golden Shares*), ECR 2003, p. I-4641.
[69] Case C-98/01, [2003] ECR I-4641.

It was argued that the rules in the issue had an impact on the market and these rules were not included by the scope of the prohibition. However, the ECJ did not deal with this issue directly.[70]

Article 56 may not be in internal situations. The ECJ gave a generous interpretation to when there is no internal situation such as the acquisition of property. In the paragraph 25 of *Reisch et al* case,[71] the ECJ held:

A reference for a preliminary ruling from a national court may be rejected by the Court only if it is quite obvious that the interpretation of Community law sought by that court bears no relation to the actual nature of the case or the subject-matter of the main action.

D. Exceptions to the Free Movement of Capital

It is clear to say that the equal treatment of Member States and non-Member States countries, with respect to the free movement of capital, is not unconditional but subject to some exceptions which are set out in the Treaty.

1. Other Directives

It is important to mention that some Directives limit the free movement of capital in the EU. First, the Investment Services Directive[72] applies to investment firms as defined in Article 1 in connection with the Annex to the Directive. The Second Banking Directive[73] applies to credit institutions as defined by its Article 1 in connection with Directive 77/780.[74] With regards to third countries, the Directives' approach seems to be liberal. Each Directive states in its preamble that "...the Community intends to keep its financial markets open to the rest of the world, to improve the liberalisation of the global financial markets in other third countries..." The Money Laundering Directive is widely seen as an essential measure for the protection of the integrity of the Single Market[75].

In *Van Eycke v. ASPA*,[76] the ECJ held that, since the opening of a savings account in another Member State was not at that time liberated under capital movement Directives, it was not a breach of the Treaty provisions on the freedom to provide services for Belgium to limit tax exemptions on such accounts to deposits in local currency at credit institutions having their head office in Belgium. Even after the liberalization of capital movements, the recitals to the Second Banking Directive recognized that capital safeguard measures under the 1988 Capital Movement Directive might lead to restrictions on the provision of banking services.[77]

2. Permitted Restrictions

Article 58 of the EC treaty contains two expressed derogations from Article 56. These derogations apply to both the movement of capital and current payments rules.[78] Member States may restrict free movement of capital and payments on the following grounds:

[70] Steiner, Woods and Twigg-Flesner, "The purpose behind the national rule is not relevant, although the ECJ will sometimes highlight when there is a protectionist motive (see e.g. *Verkooijen* (case C-35/98), para 34, *Reisch* (joined cases C-515, 519-540/99), para 32). It is the effect that is crucial and, as with the other freedoms, there is no *de minimis* exception.", 2005, advanced sample, p.4.
[71] Joined Cases C-515, 519-540/99, Hans Reisch and Others v. Bürgermeister der Landeshauptstadt Salzburg and Grundverkehrsbeauftragter des Landes Salzburg and Anton, [2002] ECR I-02157.
[72] OJ 1993 L 141/27.
[73] OJ 1989 L 386/1.
[74] OJ 1977 L 322/30.
[75] R. Parlour. and J. Howie., "Money Laundering in the Insurance and Pensions Sector" (1994) 2 Int.ILR 61, p.64.
[76] C-267/86 [1988] ECR 4769.
[77] Usher (1999), p.17
[78] Usher (1999), p.27

National Taxation Systems

This is a specific exception to the free movement of capital provisions. Although taxation remains within the competence of Member States, this power must be exercised within the scope of Community law.[79] The 1988 Directive proposals aimed at eliminating or reducing risks of tax evasion and tax avoidance were required to be put forward by the Commission and considered by the Council. The aim of Article 58(1)(a) was to permit discrimination in favor of non-residents. However, the provision must be taken in its context; in effect it was drafted as permission to take measures which might interfere with the free movement of capital and payments, rather than carte blanche to discriminate.[80]

Balance of Payments and Market Disturbances

There are two further provisions which may be relied on where there is balance of payment difficulties (Articles 119 and 120 EC) for non-European Member States. Although this empowers such Member States to take unilateral action,[81] the protective measures must cause the least possible disturbance to the common market and must not be wider in scope than is strictly necessary.[82] The Commission shall declare what measures it recommends the State concerned to take.[83]

Other Restrictions

Following the wording in Article 4 of the 1988 Directive, Article 58(1)(b) allows Member States to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on the grounds of public policy or public security.[84]

Impact on Establishment

Under Article 58(2), restrictions on capital movement may result in restrictions on the right of establishment.[85] Consequently, these restrictions must be compatible with the provisions of the freedom of establishment.[86]

Interpreting the derogations

It is obvious that the ECJ interpretations on free movement of capital are crucially important to interpret the derogations. As the Court held in the *Association Eglise de scientologie de Paris* case,[87] derogations from the fundamental principle of the free movement of capital must be interpreted strictly. A Member State cannot determine the scope of restrictions to free movement capital without any supervision by Community institutions[88].

Limited Safeguard

Article 3 provided a limited safeguard clause, allowing the Commission to authorize a Member State,[89] involved to take protective measures for a period not exceeding six months with respect to certain defined capital movements; under Article 3(2), the Member State

[79] Steiner, Woods and Twigg-Flesner, 2005.
[80] Usher (1999) p.32-33; J. Usher, 'Tax discrimination under the new capital movement provisions and the basic Treaty freedoms', in 'European Financial Area', Rudanko/Timonen, University of Helsinki 1998, p.261
[81] Subject only to veto or amendment by the Council acting by qualified majority.
[82] Steiner, Woods and Twigg-Flesner,, 2005.
[83] Usher (1999) p. 29.
[84] Usher (1999) p.33-34.
[85] Steiner, Woods and Twigg-Flesner,, 2005.
[86] Case C-141/99, *Algemene Maatschappij voor Investering en Dienstverlening NV (AMID) v Belgische Staat* [2000] ECR I-11619.
[87] Case C-54/99, *Association Eglise de. scientologie de Paris v. Prime Minister* [2000] ECR I-1335.
[88] Steiner, Woods and Twigg-Flesner,, 2005.
[89] Where short-term capital movements of exceptional magnitude impose severe strains on foreign exchange markets and lead to serious disturbances in a Member State's monetary and exchange rate policies, reflected especially in substantial variations in domestic liquidity.

itself might take such protective measures on the grounds of urgency, subject to review by the Commission.[90]

3. Restrictions on Free Movement of Capital between Member States and Third Countries

As Usher indicates, at first sight, a fundamental distinction between these provisions and the original provisions is that movements to and from third countries are to be treated the same way as movements between Member States. However, in reality substantial differences still remain.[91]

In principle, Article 56 of the EC Treaty secures the free movement of capital between Member States and third countries. However, the restrictions on free movement of capital set out in Article 58 apply equally to free movement with regards to third countries. There are also additional restrictions as regards to third countries.

Article 57

According to Article 57, Article 56 does not apply to national measures existing before 31 December 1993. Such restrictions may limit the freedom of capital between Member States and third countries. Member States are not required to abolish their existing lawful restrictions. Furthermore, the second paragraph of Article 57, empowering the Council to legislate on those capital movements, makes reference to endeavoring to achieve the objective of free movement of capital between Member States and third countries to the greatest extend possible.[92] However, the Council may act to remove such measures.[93]

Article 59

Under Article 59, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of the Economic and Monetary Union. In exceptional circumstances, the Council may take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary,.

Article 60

According to Article 60, the Council may take urgent measures where Community action to interrupt or reduce economic relations with one or more third countries is required by a common position or in a joint action adopted under the EU provisions regarding a common foreign and security policy, in relation to the movement of capital and payments with regards to the third countries concerned. Indeed, Member States by themselves may take unilateral measures against a third country with regards to capital movements and payments for serious political reasons.

The reasons mentioned above conclude that capital movements to and from third countries seems to be less liberalized than intra-Com-

[90] Usher (1999) p. 21-22.
[91] J.A. Usher.,"Capital and Treaty on European Union" in 12 YEL, 1992, p.42.
[92] Usher (1992) p.43.
[93] Steiner, Woods and Twigg-Flesner,, 2005.

munity movements.[94] Therefore, the freedom of capital movements is far from absolute.[95]

V. Measures for Harmonisation with the EU Legislation and Implementation

As mentioned above, Turkey's movement of capital legislation, too, has been liberalized since the 1980s. Compared to the EU legislation, many restrictions on free movement of capital have been removed. For instance, restrictions on foreign ownership in the telecommunications and mining sectors were removed in 2004.[96]

However, there are still some other restrictions on foreign ownership in other sectoral legislation in the areas of civil aviation, maritime transport, radio and television broadcasting, and energy.

The acquisition of real estate in some areas of Turkey has been unclear since the Constitutional Court decision in March 2005. The Court annulled provisions establishing the reciprocity principle for foreigners' real estate purchases "on the basis of possible threats to national integrity and the indivisible unity of the state."[97]

In sections below, other restrictions related to capital movements to Turkey and from Turkey will be analyzed. As mentioned above, the aquis provides that all restrictions on the movement of capital within the European Union and between the Member States and third countries are to be removed. Free movement of capital is one of the "four freedoms" and makes European financial services and markets integrated and open.

A. Foreign Investments in Turkey

Although Turkey has been removing restrictions on capital movements, some other restrictions affecting foreign investments, especially originating from EU countries, have still remained in some other economic sectors.

Furthermore, foreign investors are generally interested in the services sector in Turkey. Wholesale, retail, telecommunications, transport, real estate, constructions and manufacturing were the main attractive sectors for foreign investors in 2005 and 2006. The waste majority of foreign investors in Turkey were from the EU countries: Germany, (2338 companies), England (1147 companies) and Holland (1052 companies).[98]

Tourism Incentive Law No. 2634[99] and Cabotage Law No.815[100]

In principle, Articles 1 to 5 of the Law on Maritime Transportation, Cabotage and Harbouring and Performing Crafts and Trade in Turkish Territorial Waters prohibit foreigners to do business and work in certain positions in the maritime business. However, Articles 27 and 29 of the Tourism Incentive Law regulate the yacht tourism. Foreigners are allowed to sail in Turkish territorial waters for private and com-

[94] Steiner, Woods and Twigg-Flesner 2005.
[95] Usher (1992) p.43.
[96] Amendments in Mining Law No. 5177, 26/5/2004, OJ 25483, 05/06/2004; amendments in Telecommunications Law No. 5189, 16/06/2004, OJ No. 25510,2/7/2004.
[97] The Constitutional Court Decision No: 2003/70, Official Jornal No. 25797,26/04/2005 with effect on 26/07/2005.
[98] Sabah News Paper, 12/08/2006 Economy Addition.
[99] Law No. 2634, 12/03/0982, OJ17635,16.03.1982.
[100] Maritime Transportation, Cabotage and Harbouring and Performing Crafts and Trade in Turkish Territorial Waters Law No. 815,19/4/1926, OJ 359, 29/4/1926.

mercial yachts with a foreign flag, where they are used for excursion, sports and amusement. In the same way, Articles 3 and 27 of the Law No. 2634 allow enterprises, established abroad, to work in the tourism service sector in Turkey. Foreigners are restricted from carrying people between Turkish harbours. Thus regulations clearly are not completely aligned with the acquis and it should be amended.

The Law on the Establishment of Radio and Television Enterprises and Their Broadcasts No. 3984[101]

Law No. 3984 regulates that the radio and television broadcast sector contains restrictions concerning foreign capital. In order to be in harmony with the EU acquis, paragraph (h) of Article 29 of the Law No. 3984 on "Establishment and Ownership Ratio," which determines the allowable foreign capital ownership in radio and television enterprises, was amended to "the share of foreign capital in one private radio or television enterprise may not exceed 25 percent of the capital paid up."[102] Previously, this ratio was limited to 20%. Also, paragraph (i) of the Article 29 prohibits foreign investors to obtain any share of other broadcasting companies. These are clearly obstacles for foreign investors in Turkey and limit capital movements to Turkey.

Insurance Law No.7397[103]

According to Article 15, insurance companies are not permitted to invest their reserves in foreign assets. This provision below is not aligned with the EU acquis.

Turkish Civil Aviation Law No. 2920[104]

This Law contains some restrictions for foreign investors in Turkey. Article 15 and 31 do not allow foreign companies to operate between domestic airports. Therefore, necessary amendments should be done during the negotiation process with the EU.

Petrol Law No. 6326[105]

Article 39 of this Law limits foreigners to operate in the field of petrol digging. It needs to be amended as well.

Restrictions on Financial Market

According to the Article 15 of Decree No. 32 Regarding the Protection of the Value of the Turkish Currency, non-residents are not permitted to buy and sell securities which are not listed by the Capital Market Legislation; also banks and intermediary companies must be used. In addition to this, residents are not permitted purchase and sell securities that are not traded in foreign financial markets outside of authorised financial institutions.

These provisions also limit capital movements to and from Turkey. They should be aligned with the EU Acquis also.

B. Foreign Investments from Turkey

According to the Article 13 of Decree No.32, residents may freely

[101] Law No. 3984, 13/4/1994, OJ 21911, 20/4/1994.
[102] The Law No.3984 was amended by Law No.4756 published in the Official Gazette No. 24761 dated 21 May 2002 and Law No.4771 published in the Official Gazette No. 24841 dated 9 August 2002.
[103] Insurance Law No. 7397 dated 21/12/1959, Official Gazette 10394 dated 30/12/1959.
[104] Civil Aviation Law No. 2920 dated 14/10/1983, Official Gazette 18196 dated 19/10/1983.
[105] Petrol Law No. 6326 dated 7/3/1954, Official Gazette 8659 dated 16/3/1954.

transfer capital in order to establish companies for the purpose of investment or commercial activities abroad, up to USD 5 million or its equivalent. However, it is necessary to have permission from the Ministry for the investments amounting to more than USD 5 million. This obstacle is also not aligned with the EU acquis.

C. Foreign Trade and Obtaining Credit

In terms of international trade and international financing, Decree No.32 has some other restrictions for residents regarding the free movement of capital.

First, it is necessary for exporters in Turkey to bring and sell foreign exchange receipts of the goods, to the banks or special finance institutions according to the Article 8 of Decree No. 32 Regarding the Protection of the Value of the Turkish Currency.

Second, although, residents may freely obtain credit from abroad, the terms of pre-financing credits cannot exceed one year under Article 17(a) of the Decree No.32.

It is also clear to say that these regulations are not harmonized with the EU acquis.

D. Acquisition of Real Estate

Removing all restrictions affecting the acquisition of real estate in Turkey by the EU citizens and legal persons has the crucial importance in the process of the harmonization the acquis.

The Land Registry Law No. 2644[106]

Article 35 of the Law regulates real estate acquisition by foreign natural persons in Turkey. It is regulated in accordance with the principle of reciprocity and legal restrictions. A foreign natural person can freely acquire real estate of up to 2.5 hectares in size; with the authorization of the Council of Ministers, the limit may be extended up to 30 hectares. Legal inheritance is outside of this provision. Acquiring more than 30 hectares of real estate is subject to the authorization of the Council of Ministers.[107]

According to the foreign capital legislation,[108] there is no restriction on the acquisition of real estate by foreign companies which are established in Turkey. However, there are some restrictions for non-resident legal persons as well. According to the Amendment Law,[109] the same reciprocity principle for natural persons applies to the acquisition of land by non-resident firms.

Additionally, real property acquired by foreign legal and natural persons cannot exceed 0.5 percent of the region's total land, however the Minister of the Cabinet is authorized to change the limit accordingly. The Council of Ministers is also authorized to specify the areas in which foreign natural persons and foreign trading companies are not allowed to buy on the grounds of public interest and security.[110]

[106] Law No. 2644 dated 22/12/1934, Official Gazette 2892 dated 29/12/1934.
[107] Law No. 2644 was amended by Law 5444 dated 29/12/2005, Official Gazette 26046 dated 07/01/2006.
[108] Law No. 1567 and Decree No. 32.
[109] It amended the Law No. 2644, Law No. 4916 dated 3/7/2003, and Official Gazette 25173 dated 19/07/2003.
[110] Article 35 of the Law No. 2644.

Military Forbidden Zones and Security Areas Law No. 2565

According to Articles 9/b, 27 and 28 of the Military Forbidden Zones and Security Areas Law No. 2565, foreign natural and legal persons cannot acquire any real estate in military forbidden zones, security areas, and strategic areas. However, foreigners can rent real estate in these areas with the permission of the Council of Minister.

During accession negotiations with the EU, Turkey will have to remove the restrictions, mentioned in this section, affecting the ownership of real estate by EU citizens and legal persons.

E. Turkey's Progress towards Accession

The Turkish regime on the free movement of capital is, to a certain degree, aligned with the acquis, but some further efforts are required for the legislation to be fully in line. Liberalization must be extended to all transactions. Restrictions concerning foreign investment in various sectors, such as civil aviation, maritime transport, port enterprises, radio and television broadcasting, and mining and energy are still in place. There are also limitations on foreign investment in the transport sector (e.g. maritime and aviation companies) and in ports, where foreign participation may not exceed certain ceilings. The current system is not in conformity with the relevant Community acquis.

According to the 2005 report, Turkey's alignment with this chapter is generally still poor. In spite of the removal of restrictions to foreigners' access to property in part of the sectoral legislation, the situation in the area of the movement of capital and payments is still unclear after the recent decision of the Constitutional Court. The Turkish authorities will have to remove all barriers to the acquisition of property by citizens and legal persons of the European Union and also sectoral and structural obstacles. Turkey should bring this legislation into line with the acquis.[111]

Furthermore, in the field of capital movements, the situation concerning restrictions on investment by foreigners remains unclear after the recent decision of the Constitutional Court. Therefore, further progress is needed in removing all restrictions affecting the acquisition of real estate by EU citizens and legal persons as well as sectoral and structural barriers.

VI. Conclusion

The freedom of capital movement is one of the four fundamental freedoms alongside of the freedom of movement of goods, persons and services to assist the operation of the EU internal market. There is no doubt that the legal and natural persons from the EU would not be able to enjoy the other three freedoms without financial liberalization.

The Turkish regime on the free movement of capital is to a certain

[111] Turkey, 2005 Progress Report, p. 60-63, European Commission Brussels, 9 November 2005, *available at* http://www.abgs.gov.tr/dokumanlar/progress/Turkey_Progress_Report_2005.pdf

degree aligned with the EU regulations. However, some restrictions still remain. The screening process started on 3 October 2005. Turkey is going through a dynamic process of legal, political and economic reforms on the road to European Union membership. The purpose of this process is to guarantee the functioning of the democratic system with all its rules and institutions. Participatory democracy, the rule of law, human rights and fundamental freedoms are not only universal values, but are also the most reliable bases for political and economic stability and development.

Turkey liberalized its capital account transactions in 1989, and flows of international capital immediately intensified, especially after 1990 when Turkey the introduced full convertibility of the Turkish lira. Previous EU enlargements have demonstrated clearly that the accession process coincided with a leap in foreign direct investment (FDI) and creation of employment. By contrast, ten years ago, the establishment of the EU–Turkish Customs Union did not generate a similar growth in FDI. However, accession negotiations have already boosted FDI into Turkey.

The principle of the free movement of capital was agreed in Articles 56-60 (ex 67-73) of the EEC Treaty. These provisions of the EEC Treaty, according to Article 2 of the Treaty, are based on two basic principles of the EEC: the creation of a common market and the gradual approximation of the economic policies of States. Member States must remove, with some exceptions, all restrictions on the movement of capital both within the EU and between Member States and third countries. The acquis also includes rules concerning cross-border payments and the execution of transfer orders concerning securities. Without free movement of capital, the other freedoms would be less significant. Free movement of capital requires that first all restrictions should be lifted between Member States and between Member States and third countries, and, second, legal and natural persons should be treated equally within the EU.

Turkey's capital movement legislation has been liberalized since the 1980s. For instance, restrictions on foreign ownership in the telecommunications and mining sectors were removed in 2004. However, there are some other restrictions on foreign ownership in other sectoral legislation in the areas of civil aviation, maritime transport, radio and television broadcasting, and energy and these restrictions should be removed as soon as possible.

Not only the requirements of the EU legislation but also financial globalization have forced Turkey to change legislation to come close to the EU acquis. It is obvious that Turkey still needs to change many regulations to align with the Community acquis regarding free movement of capital. However, capital movement, Chapter 4, seems to be one of the easiest topics to be adopted during the process of harmonization.