

THE EFFECTS OF ECONOMIC RELATIONS BETWEEN TURKEY AND EUROPEAN UNION ON TURKEY'S CANDIDATE PROCESS AND MACRO ECONOMIC PERFORMANCE

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Turkey is one of the candidate countries to European Union (EU) and it was also affected by this process. Turkey's membership process to EU is becoming more important for both sides, especially by the effects of recent economic development in Turkey. When it is considered the two of third of direct foreign investments come from EU countries to Turkey, it will be easy to understand that why this process is important. The big share of EU countries in Turkey's foreign trade makes necessary for investors to invest directly in Turkey. The aim of this study is to search what are the effects of economic relations between Turkey and EU on Turkey's candidate process. In this study, the effects of Turkey's foreign trade and investments relations on Turkey's membership process are analyzed and also asserted the effects EU-Turkey relations on Turkey's macro economic indicators.

Keywords: Foreign direct investments, EU-Turkey economic relations, portfolio investment, economic growth

INTRODUCTION

Increase in foreign direct investment boosted international trade volume. Some countries especially attractive for foreign investors because they are close other market countries. International capital investment increases portfolio investments. Capital portfolio investment in developed countries flows to developing countries and these movements called as hot money which has an important effect on countries economic growth. Due to these effects, European Union membership process becomes more important for Turkey.

Due to globalization and increasing importance of economic unions economic developments of developing countries depend on their own international relations (Kula, 2003: 14). The existent relations of Turkey with foreign world are becoming more important according to economic dimension of Turkey's European Union membership process. Considering the impacts of membership process the desire and efforts of Turkey to become member of EU makes necessary to examine current and future aspects of relation between Turkey and EU. Thereby, deviating results will show the impacts of economic relations membership process and the possibility of becoming full membership. The economic relation between Turkey and EU is not to consist of export or import and this situation can easily seen on data given below. So the effects of direct foreign investments and foreign portfolio investments on Turkey's macro economic variables should be measured and the direction and size of relation between these variables should be analysed. To understand the effects of Custom Union Agreement on Turkey's membership process is possible to analyze the economic data affected by the Agreement. Agreement is one of the turning points of Turkey's membership process for European Union. The increase in national income and employment rates in Turkey are expected by European Union in the process of membership.

DEVELOPMENT OF TURKEY'S FOREIGN ECONOMIC RELATIONS

It is obvious that investment rates should be increased for a continuous growth in the long term in Turkey. Since this need can not be meet by insider investments because of the weakness of capital accumulation, foreign investment becomes a key factor for economical development. Benefits Turkey expected from foreign investments can be summarized as followed:

- Solving the problem of unemployment,
- To provide economic development, increase in production and national income,
- To decrease public debts with tax income,
- To take a necessity step for competitive market situation,
- To supply investment accumulation,
- To complete technological development,
- To create supplier industry according to main industry.

International investments would support the country's economy if they are applied in good conditions, but if they are not, they could become threats for the economy. Because of these, we must compare international investment development and expecting benefits.

DEVELOPMENT OF FOREIGN TRADE

As known, our age is affected from globalization and diminishing of borders. World turns to be more globalize day by day and countries open their borders to outside world. They start to communicate with the world instead of inside. As a result, countries trace each other technologically and socially, and a change in one of them always affects the others.

Globalization, reaching information easily, and endless consumer needs forces countries to open themselves to the world.

World's structure begins to base on commercial relations and trade becomes the most important concept in the world. Your country's foreign trade development accelerates your economical development and your credit in world trade market increases as well.

During 1970-1980 period, while world faced stagnation, Turkey also was affected by this stagnation. Petrol crisis of 1973-74 and high inflation rates in the west countries causes destroyed foreign trade limits and equilibrium, on the other hand current transaction equilibrium debits increased. Turkish Lira was over evaluated in spite of exchange policies. In order to maintain economic equilibrium, Turkey takes import under pressure and increase exchange controls.

Turkey had a closed economic program since 1980, but it was affected by external conjuncture crisis and stagnation. In this period, customs discount and regulation implications were delayed between Turkey and EU countries. As a result, production rates decreased and unemployment rates increased. 1970s both Turkey and world were affected by these economic problems.

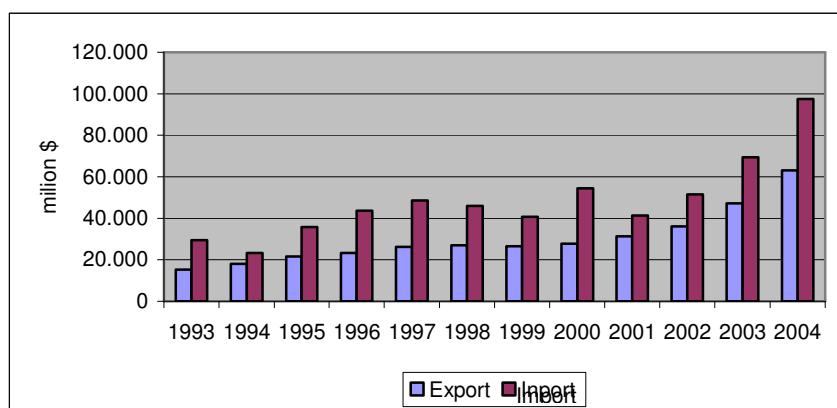
In 1980s new commercial improvements appeared both in the world and in Turkey. Especially Turkey entered a new economic period. A new program called "January 24th Decisions" including structural transformations was applied on January 24th 1980. In this period radical changes appeared in Turkey. The share of government investment decreased and external trade became free. Government stimulated foreign investments, profit transfers, and external contractor services. In this period import activities were liberalized degree by degree, and export activities was encouraged with tax decrease, low interest credits, custom dispensation to manufacturer exporters and encouragement systems. All of these changes showed us that Government's 24 January 1980 Decisions realized radical changes on the economy and make a transition from closed economy to open and liberal economy. So Turkey leaved from industry strategies depending on import to industry strategies depending on export.

The basic aims of these policies are to restructure Turkey's economy according to the changes in the world, to provide harmony between Turkey's economy and world economy. After the 1980s, share of external trade in national income increased from %4.2 in 1980 to % 13.5 in 1997.

Developments in foreign trade in 1980 were followed by the developments in 1983. Parallel to a new managerial forming in foreign trade, **Undersecretary of Treasury and Foreign Trade** was established dependent to the prime ministry by (13.12.1983 and decree law188). After 11 years, it was divided into two as **Undersecretary of Treasury and Undersecretary of Foreign Trade** by (9.12.1994 decree law 4059) **Undersecretary of Treasury** has functions of determining foreign trade policies, coordinating, applying

and developing export, stimulating export, import, construction business abroad, and bilateral and multilateral economic agreements.

With 24 January 1980 economy decisions, developments continued in Turkey's economy and free trade zone became more important. Government took new decisions about these subjects on 1985 and with 3218 law; "Free Trade Zone Law" came into force (KULA, 2003:45). This law's aim was to encourage export and establish free trade zones for external and internal investors.



Graphic 1: 1993–2004 The development of international trade

Source: GDFI (www.treasury.gov.tr)

The improvements in export and import since 1980 started to heal after 1990 and benefits from liberal policies was not enough. As a result of this Turkey's foreign trade is import weighted and the rate for foreign source dependence getting worse.

Considering the export and import amount between 1993 and 2004, import amount is always bigger than export amounts. Both export and import are rising but import growing speed always up the export growing speed.

THE DEVELOPMENT OF DIRECT FOREIGN INVESTMENTS

Turkish Republic starts out to do Economic Development Policy that prioritizing private and relatively liberalistic entrepreneurship in its first years. In beginning of the 1930's, it proceeds to an Economic Policy that aiming to accelerate industrial investment.

The certain conversion of this policy was finished at second part of 1940's. The principal features of this policy are;

- dominating free market conditions in foreign trade,
- supporting to private entrepreneurship all level
- limiting state control in Economy
- abating public investment at industry
- prioritizing agriculture, mechanization, public infrastructural investments (road transportation, energy etc.) and
- encouraging foreign direct investment.

In spite of certain commitment, privatization of public economic enterprise didn't realize. These applied policies bring about increasing GDB and demand significantly. Increased demand stimulated private sector investment. There was applied economic policy that concentrates on private sector in periods 1950-1960. But these policies didn't sufficient and foreign direct investments were needed for country's sustainable development.

Foreign Direct Investment law put in to force on 17 June 2003 numbered 4875. It contains foreign direct investment, foreign investor and foreign capital readjustment according to international standard.

According to this law foreign investor, real persons residing abroad possessing foreign nationality and Turkish citizens residing abroad, and foreign legal entities established under the laws of foreign countries and international institutions that effect foreign direct investments in Turkey.

Foreign direct investment that brought by foreign investor;

- Capital in cash in the form of convertible currency purchased and sold by the Central Bank of Turkey
- Stocks and bonds (other than Treasury bonds) and other forms of capital in kind participation in the companies,
- Machinery and equipment
- Industrial and intellectual properties, that are acquired from abroad, or; i) Establishment of a new company or a branch office, ii) Participation in an already existing company either by acquisition of shares except through stock exchanges or by acquisitions of minimum 10% of shares or an equal proportion of voting rights through stock exchanges, by means of;
- Reinvested earnings, financial claims, or any other investment related rights of financial value; and
- Commercial rights for to the exploration and extraction of natural resources, that are acquired in Turkey, by foreign investors

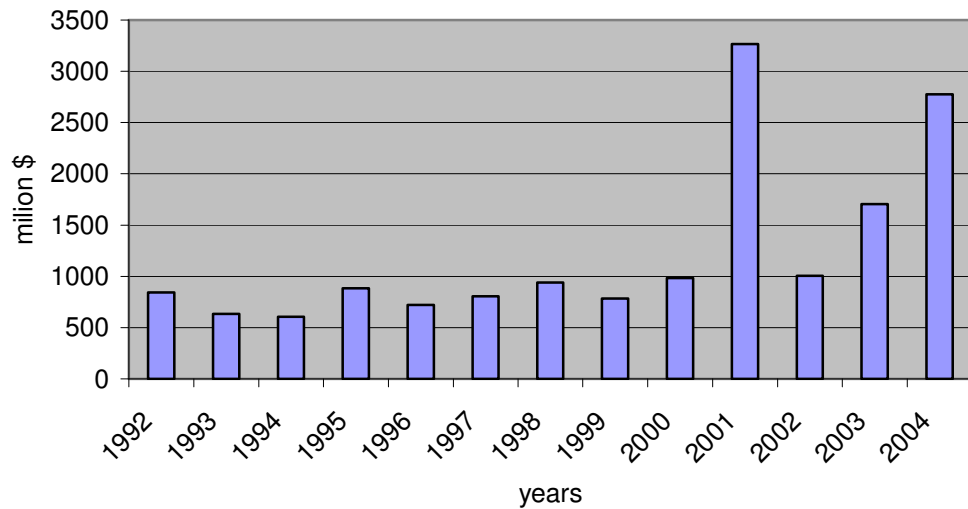
For long term sustainable development in Turkey, investment levels will be need to increase. When domestic investments are insufficient foreign capitals contribute to improvement of investments environment. The contributions of foreign direct investments to the country where invested;

- Foreign direct investments are significant factor for solving unemployment problem which is very important problem for a long time.
- Foreign direct investments are effected directly economic growth
- Foreign direct investments increase tax revenue
- Foreign direct investments act forming competitive market structure
- Foreign direct investments increase total investment capital, knowledge and technological transfer intercountry
- Forming of sub-industry with main industry has been contributed.

In accordance with the liberal policies that applied after 1980, Turkey gave more importance for foreign investments. Especially” The Law of Direct Foreign Investments” put in to force in 2003 improved these developments.

Foreign direct investments have importance for capital flowing in countries by providing employment, development high technology, transferring know-how and new managerial skills. The most important benefits of foreign direct investment is contribution of Gross Domestic Product.

The foreign direct investment between 1992-2004in Turkey is shown in Graphic 2.



Graphic 2: Foreign Direct Investment in Turkey

Source: : GDFI (www.treasury.gov.tr)

Turkey, so as to multiply foreign direct investments renewed the law and legislation of foreign capital after 1980. Foreign capital framework decisions changed in 1968, 1992 and, 1995. Foreign direct investments which come to Turkey low floated in terms of quantity in periods of 1994-2000. Foreign direct investments were at the lowest level in 1994. Foreign direct investments increased in following periods but the incentive policies newly put in to force and Custom Union Agreement between Turkey and EU multiplied the increase in foreign investments. This trend continued until 2000.

There was a rapid increase in foreign investment in 2001. The main reasons of this increase were, decisions taken by government after 2001 economic crisis, new applied politics and the reliable atmosphere created by the stand-by agreement with International Monetary Fund (IMF) in the framework of the Turkey's Programme for Transition to a Strong Economy. There was a small decrease in 2002 but, the increasing trend has continued up to present time.

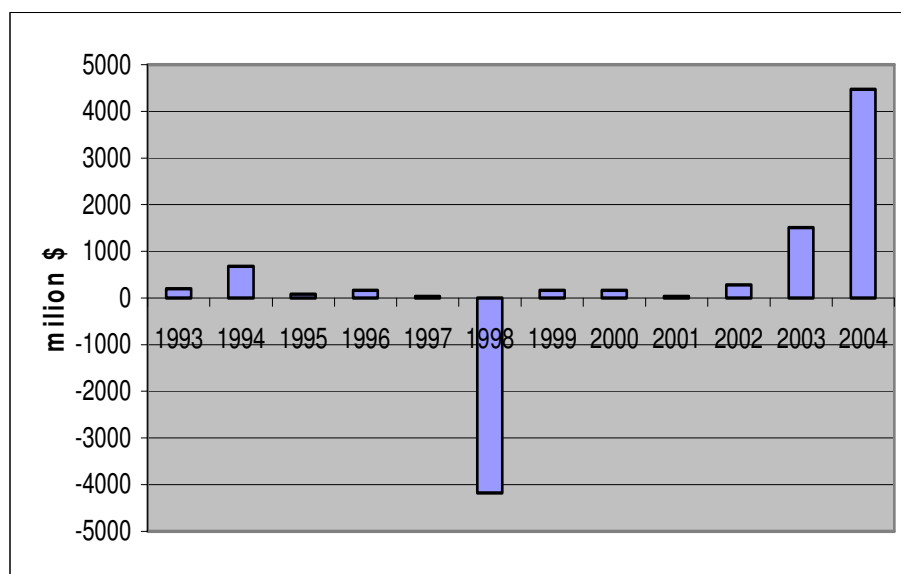
DEVELOPMENT OF PORTFOLIO INVESTMENTS

Another country or country's companies buy the listed shares in a country stock market and it is called as International portfolio investments. Portfolio investments are not only made by depending specific sector. Portfolio investments are financial investments so they are very sensitive for the changing in financial factors. Portfolio investments can be easily effected by the conditions of the country where they invested. A small change in applying economic policy can be change the position of the foreign portfolio investments in the country.

Economically and politically stable countries are more attractive than instable countries. Stable country is a precondition for portfolio investments otherwise; foreign portfolio investments leave the country. A portfolio investment makes hot money transfers to the countries where they come, makes deeper the existing markets and multiply the volume of market transactions. Foreign capital's respect on Turkey's financial markets is getting bigger by increasing the deepness of stock market and economic growth in Turkey.

Foreign portfolio investment started to come Turkey since 1986. Investment volume was increased by the regulation called article 32. Portfolio investment was 686 million dollars in 1994 but it was decreased to 85 million dollars in 1995. The decrease continued up to 34 million dollars in 1997. Portfolio investors left Turkey in 1998. The outgoing portfolio was about 4,179 billion dollars. The portfolio re-entrance occurred

in 1999. There was a little decrease in 2001 because of the economic crisis. Afterward foreign portfolio investors started to leave Turkey because of economic instability and worries.



Graphic 3: Foreign Portfolio Investment in Turkey

Source: TURKSTAT

Turkey arranged a Programme for Transition to a Strong Economy in 2002. Thereby, portfolio investment increased up to 286 million dollars. On 2004 Portfolio investment reached maximum level of its history.

DEVELOPMENT OF ECONOMIC RELATION BETWEEN TURKEY AND EU

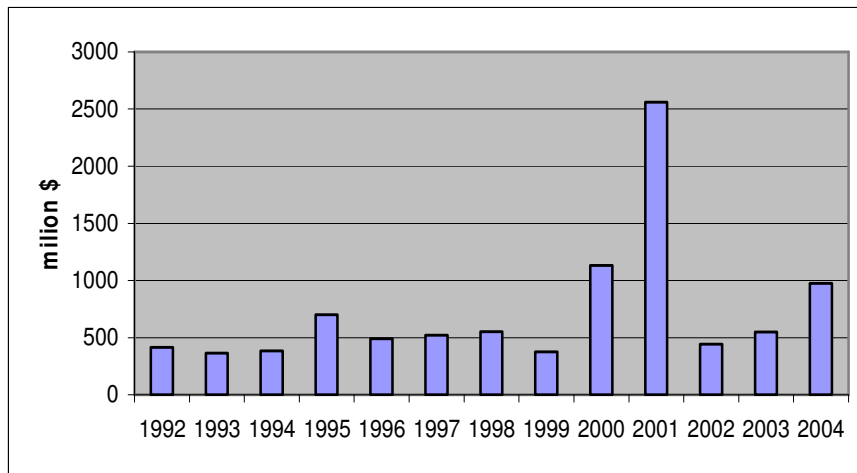
Turkey has intensive relations with EU especially economic. Two thirds of foreign investment com to Turkey comes from European Union countries. According to this condition EU has a big importance for Turkey's capital flows. Turkey develops some new incentives to improve these relations. **“The Law of Direct Foreign Investment”** which put in to force in 2004 provides some eases for foreign investors.

Turkey has close relations with EU for centuries. EU countries have % 54 shares in Turkey's foreign trade. Adding the candidate countries this shares will increase up to %77. By the way when foreign investments in Turkey are checked it is easily seen that the share of EU in foreign investments countries is quite high.

The sector specific distribution of foreign capitalized institutions in Turkey especially localize in manufacturing, industry and services sectors. %90 of the total foreign capital in Turkey comes from OECD countries. The EU has the big share among the OECD countries. It was also seen that foreign capital from Holland, France, Germany, United Kingdom Italy and Belgium permits increased rapidly due to effect of Custom Union Agreement with EU put in to force on 1st January in 1996.

THE DIRECT FOREIGN INVESTMENTS IN TURKEY COME FROM EU

The direct foreign investments make important additions on the countries where they invested. Turkey is a candidate country for EU. Some trade agreements were made member countries in the membership process. Through these agreement investments which come from EU countries is larger then come from other countries. (European Commission, 2005:62) The membership process of Turkey to EU increased this kind of investments.



Graphic 4: Foreign Direct Investment Come From EU to Turkey

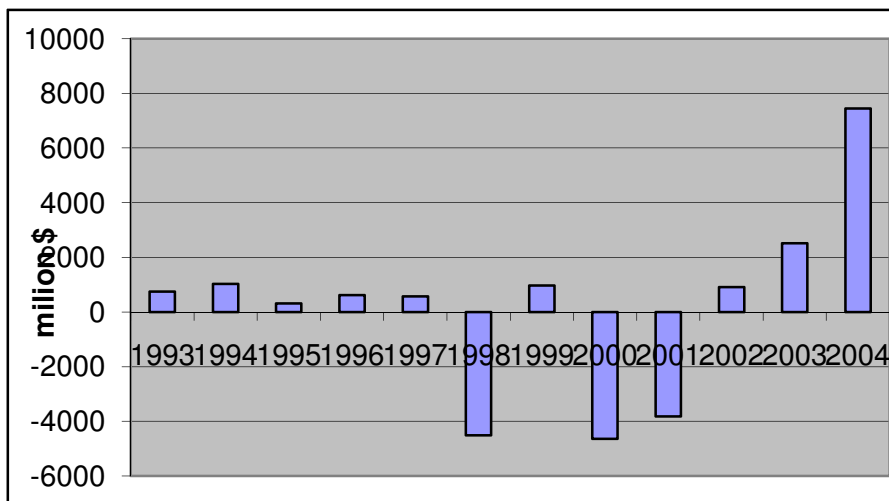
Source: YASED

When the foreign direct investments come from EU countries to Turkey are analyzed there were some fluctuation in the past. But most of them were in the periods 1998-2004. The direct foreign investments reached up to 1,132 billion dollars in 2000. Also in 2001 this trend continued and reached up to 2,561 billion dollars. But there was a huge decrease in the direct foreign investments in 2002. The direct foreign investments decreased from 2,561 billion dollars to 442 million dollars in this period. The foreign direct investments entered an increasing trend in 2003 and 2004.

THE PORTFOLIO INVESTMENTS FROM EU TO TURKEY

The most of portfolio investments which come to Turkey are coming from EU countries like direct foreign investments. This situation effects Turkey's economic life deeply. The fluctuation foreign portfolio investments effects Turkey's economy badly because of the direct relation with hot money and portfolio investments.

Graphic 5: Portfolio Investment from EU to Turkey



Source: TURKSTAT

As it is seen on Graphic 5 portfolio investments have very fluctuation trends in Turkey and it is also seen that there was portfolio outgoing in 1998 2000 and 2001. There was an increasing trend after the 2001

economic crisis in Turkey. Although Turkey and EU signed Custom Union Agreement in 1996 there were no enough portfolio investments from EU countries for first five years after the agreement. The increase of portfolio investments started after the year 2002.

THE EFFECTS OF CUSTOM UNION AGREEMENT ON TURKEY'S ECONOMIC PERFORMANCE

To understand the effects of Custom Union Agreement on Turkey's membership process is possible to analyze the economic data affected by the Agreement. Custom Union Agreement is one of the turning points of Turkey's membership process for European Union. The increase in national income and employment rates in Turkey are expected by European Union in the process of membership. The direct investments should be increased and foreign trade should be balanced to realize the long run sustainable increase in these two indicators. The graphics about these data are shown below. The relations of mentioned indicators are analyzed each other from the year 1996 when the Custom Union Agreement was signed to the year of 2008. The data set is used in this study between the period of 1998s when the first impacts of Custom Union Agreement were starting to seen and at the end of 2007. The summary about the data set are shown in the table below.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
FDI	40	-93,04	1900,00	85,1310	309,16084
PORTINV	40	-280000,00	1147,46	-7149,0828	44251,15277
UNEMR	40	5,53	12,45	8,9553	1,86125
GR	40	-10,34	14,35	3,9310	5,93441
TRBAL	40	-60,82	155,04	7,7540	35,11966
TRBALEU	40	-73,86	358,79	21,3213	89,01475
Valid (listwise)	N 40				

In this study, growth rate and unemployment rate of Turkey are used as dependent variables and, foreign direct investments, portfolio investments, the balance of foreign trade, balance of foreign trade with European Countries are used as independent variables. To avoid the differences caused by size percentage changes are used. There is four separate regression equation is composed by using the growth rate and unemployment rates as dependent in this study. To understand the relations between dependent an independent variables the equations are used below.

$$GR_i = \beta_0 + \beta_1 FDI_i + \varepsilon_i$$

$$UNEMR_i = \beta_0 + \beta_1 FDI_i + \varepsilon_i$$

$$GR_i = \beta_0 + \beta_1 PORTINV_i + \varepsilon_i$$

$$UNEMR_i = \beta_0 + \beta_1 PORTINV_i + \varepsilon_i$$

$$GR_i = \beta_0 + \beta_1 TRBAL_i + \varepsilon_i$$

$$UNEMR_i = \beta_0 + \beta_1 TRBAL_i + \varepsilon_i$$

$$GR_i = \beta_0 + \beta_1 TRBALEU_i + \varepsilon_i$$

$$UNEMR_i = \beta_0 + \beta_1 TRBALEU_i + \varepsilon_i$$

To measure the causality among the variables separate regression equations are used to examine each independent variable relation. The results are shown in Table 1. FDI symbolizes foreign direct investments, PORTINV symbolizes portfolio investments, TRBAL symbolizes balance of foreign trade, TRBALEU symbolizes balance of foreign trade with European Countries, GR symbolizes growth rate and UNEMR symbolizes unemployment rate. The *t* statistics value belongs to variables are shown in brackets.

Dep. var.	Constant	FDI	PORTIN V	TRBAL	TRBALE U	R ²
GR	3,746*** (3,821)	0,002 (0,701)				0,013
GR	3,728*** (3,96)		-2,8 E-005 (-1,334)			0,045
GR	3,722*** (3,87)			0,027 (0,998)		0,026
GR	3,787*** (3,891)				0,007 (0,629)	0,010
UNEMR	8,994*** (29,139)	0,000 (-0,462)				0,006
UNEMR	8,92*** (29,729)		-4,9 E-006 (-0,72)			0,013
UNEMR	8,921*** (29,304)			0,004 (0,522)		0,007
UNEMR	8,888*** (29,309)				0,003 (0,945)	0,023

Table 1: Regression Analysis Results of Growth and Unemployment Rate in 1998-2007

The derived regression results show that the relation among all variable is weak and is not meaningful statistically. The relation between direct foreign investments and unemployment rate is null statistically. This situation shows that the investments made by foreigners don't have a meaningful effect on promoting Turkey's production, depending employment rate and national income. In this period privatization activities were quite intensive. According to this scientific reality, the foreign direct investments were not new investments, but it was only the change of hands for existing companies and institutions. The foreign investors made investments in Turkey due to privatization but it did not create expecting effects

Another important finding is the relation between portfolio investments and growth rates. Although there was rapid increase in portfolio investments for the periods the negative relation for variables are considered as negative signal for economy.

The impact of foreign trade with European Countries on growth rate and unemployment rate is negative direction. When the continuous foreign trade deficit for the periods is considered the rise in foreign trade

deficit increases both growth and unemployment rates. So there are some implications can be made. These are; growth is not production oriented, gains derivate from portfolio investment can create increase in national income in addition, under valuated exchange rate policy makes national income to be seen higher artificially. Continuously growing imports without accretion in production makes visible lower growing rates in domestic production. This situation supports the increase in imports and the unemployment rates.

CONCLUSION

In according to complete the economic development for European Union membership is depending both domestic and external economic conditions for Turkey. Due to globalization the effects of foreign factors on economies are increasing by the rapid flow of capital. In this study, the effects of Turkey's foreign trade and investments relations on Turkey's membership process are inspected and also asserted the effects EU-Turkey relations on Turkey's macro economic indicators.

Considering the convergence criteria for EU, the result of regression analysis shows that there are no meaningful effects of Customs Union Agreement which put in to force 1996 on Turkey's macro economic indicators and membership process for EU. Foreign trade deficit for Turkey is becoming larger up to present time. But, the addition of EU to Turkey's deficit is not dramatic as other countries. Major finding of this article is that the increase in foreign direct investments has not positive effect on growth and employment rates. Foreign investments from EU countries continuously growing for the periods analyzed. The most of foreign capitals have bought existent institution in Turkey, in other words they are not new investments. It was only the change of hands for existing companies and institutions. This is not mean that there is no new investments but, not enough.

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