Russian and East European Finance and Trade, vol. 37, no. 4,
July–August, pp. 50–60.

ISSN 1061–2009/2001 $9.50 + 0.00.

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Turkey's Full Membership to the European Union

An Analysis in View of Business Cycles

Turkey's desire for membership, initially in the European Economic Cooperation (EEC), and later in the European Union (EU) started with the Ankara Agreement in 1963. As the movement continues today, the dates and financial terms for Turkey's full membership to the European Union have not yet been clearly determined. Although Turkey's globally competitive potential has flourished with the liberalization policies since the 1980s, and its dynamism and competitive force have often been expressed since the enactment of the Customs Union Agreement in 1995, Turkey continues to face challenges as European unification progresses.

Turkey's attitude toward full membership can generally be characterized as *sine qua non.* Although at times there have been signs of a change in this attitude, no major change has so far occurred. In spite of this, Turkey's sectoral adjustment efforts and performance do not conform to a full membership in the European Union.

There are, nevertheless, valid arguments for Turkey's *sine qua non* attitude toward the full EU membership. First, achieving institutional restructuring and adopting global standards in Turkey are more likely to occur if it joins the European Union than if it does not. Second, it has been envisioned that full membership to the European Union will not only increase the level of wealth in Turkey, but also reduce the risk premium and encourage foreign capital inflows compatible with Turkey's comparative advantages.

Even though such long-run benefits of EU membership have often been pointed out, the short- and medium-term benefits and costs of the membership process

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The authors are affiliated with Bilkent University, State Planning Organization, and Bilkent University, respectively. They thank Derya Sevinc for her valuable comments and assistance. The authors are responsible for all errors.

have not been discussed much. Such costs and benefits of the short- and medium-term adjustment process depend on the differences between the economies of Turkey and the European Union. Differences between the two regions with regard to growth dynamics, demand structures, transmission mechanisms, and production cycles are, for example, important in envisioning both the problems that could arise in the process of Turkey's integration to the European Union, and what should be demanded from the Union to overcome them. This study is a step in the direction of ascertaining such problems that Turkey is likely to face during the adjustment process.

This paper, therefore, investigates the production cycles in Turkey and the European Union and outlines their implications for the adjustment process. In the next section, we chronologically present the developments with regard to Turkey's relationship with the European Union. The third section outlines the membership criteria, and the fourth section reports the mutual financial terms for full membership. Then the fifth section presents the empirical findings regarding production cycles. Remarks on the findings are provided in the sixth section. Finally, the findings are summarized.

An Overview of the Relationship Between Turkey and the European Union

The relationship between Turkey and the EEC toward a cooperation started with the Ankara Agreement, which was signed on September 12, 1963 and put into effect on December 1, 1964. This agreement carries elements pertaining to the establishment of the Customs Agreement and the Financial Protocol. The second and third Financial Protocols have also been paraphrased in 1970 and 1977. The European Union did not yet pass, however, the fourth Financial Protocol that has been shelved since 1980.

Besides the Ankara Agreement, an additional protocol, which was signed on November 23, 1970, and put into effect on January 1, 1973, specified the time schedule for the steps Turkey will take during the next 22 years to join the Customs Union. Within this perspective, the European Commission has accepted the Matutes Plan—a package of proposals to complete the Customs Union on June 7, 1990. The plan involved proposals toward increasing fiscal and industrial-technological collaboration, and strengthening the political and cultural relationships between Turkey and the European Union. The Matutes Plan proposed by the European Commission, however, has not been approved by the European Congress.

On March 6, 1995, in transition to the final stage of the Customs Union, the Turkish–EU Membership Council decided on collaboration in various sectors, and on extending the political dialogue. In addition, on December 13, 1995, the European Parliament made the decision to finalize the Customs Agreement with Turkey. Hence, the final stage of the Customs Union was completed on January 1, 1996.

During this period, the financial aid Turkey was supposed to receive was not extended due to vetoes within the European Union. Nevertheless, after being included into the MEDA[1] Program of the European Union for nonmember countries, Turkey acquired the right, during the 1996–1999 period, to benefit from resources worth 375 ecu that the European Union provided to the MEDA countries. On September 19, 1996, the European Parliament called for no additional resources to be made available by the Commission to Turkey except for the funds that were made available within the capacity of MEDA. On July 15, 1997, the Agenda 2000, published by the European Commission, made proposals for Turkey's progression to the European Union with respect to various sectors and extending the Customs Union to cover the services and the agricultural sectors.

In December 1997, the European Council convened in Luxembourg and agreed that Turkey does meet the conditions to join the European Union. During the meetings, the need to determine a strategy for Turkey's progression to the European Union in every respect was also provisioned. Following this, however, Turkey declared to discontinue its political dialogue with the European Union, arguing that the decision was discriminating against Turkey vis-à-vis the other applicant countries.

Based on the principle agreement during the Luxembourg meetings, a document titled "European Strategy for Turkey" was published. According to this, and in line with the former agreements, conditions that would lead to Turkey's EU membership were further spelled out. The executive summary of the Cardiff Summit, held on June 15–16, 1998, indicates the approval of the strategy for Turkey.

According to the decisions taken at the Summit, Turkey was included in the system of reporting that other candidate countries have to follow also. Hence, the first report investigating Turkey's performance with respect to the Copenhagen Criteria was published by the European Union on November 4, 1999. The next report was published on October 13, 1999. The importance of the periodically published reports on Turkey, along with those on the other candidate countries, was due to their essential role in the Helsinki meetings, held in December 1998, with regard to the discussions about the countries' progression to candidacy.

The report on Turkey, which was published after the EU meetings held in Strasbourg on October 13, 1999, had favorable remarks and called for Turkey's progression to candidacy (see European Commission 1999). Nevertheless, Turkey maintained its cautious approach toward this report, which was of an informal nature, until the Helsinki Summit.

Criteria for Full Membership

The criteria for EU membership was publicized by a declaration at the end of the Copenhagen meetings, which were held by the European Commission on June 21–22, 1993. In a section titled "Central and East European Countries," these countries have been referred to as the "associate countries." In the same document it is stated that, according to the decision taken during the Copenhagen meetings, countries in this group could join the European Union if they wish to, provided they meet the economic and political conditions set forward by the European Union.

Under the same section of the document, reaching institutional stability that could secure the capacity for the dominance of democracy and law, human rights, minority rights, well-functioning market economy, and the competitive pressures emanating from the market forces within the Union are all expressed as the conditions for membership.[2] In addition, the Council has also stated the limitations for membership acceptance. The same section of the document expresses that the capacity of the Union to accept membership applications needs to serve the benefits of both the Union and the applying countries.

The section of the same document, "Relations with Turkey," presents views, based on the agreement dated 1964 and the protocol dated 1970, in line with establishing limits of the relationship with Turkey. Judging from the expressions in the Copenhagen Declaration, however, central and eastern European countries have an important role within the context of the EU's expansionist policies. These countries need to meet specific criteria and to apply for the membership to be a full EU member. Nevertheless, to protect itself against unexpected developments and demands, the Union declares that it has the final word on whether or not to accept countries that may not fully integrate with the Union. In addition, when closely inspected, the Copenhagen criteria show sufficiently flexible expressions and incompletely drawn lines with regard to economic and political requirements, leaving room for subjectivity.

Unlike the Copenhagen criteria for EU membership, criteria for European Monetary Union (EMU) membership are relatively well defined. The five main criteria put forward in the Maastricht Treaty for EMU membership are structured with regard to low inflation, interest rates, stable exchange rates, and sustainable levels of debt and deficits:

1. The ratio of budget deficits to gross domestic product (GDP) may not exceed 3 percent.
2. The ratio of Public debt to GDP may not exceed 60 percent.
3. Inflation rate in a member country may not exceed 1.5 percentage points, plus the average of the lowest three inflation rates in the Union.
4. Long-term interest rate in a member country may not exceed the average interest rate of the three member countries that have the lowest inflation rate plus two percentage points.
5. Membership to the EMU requires membership to the European Monetary System (EMS), and domestic currencies within this system should remain within the 15 percent band for at least two years.

In addition, however, an EMU member has to delegate monetary policy authority to the European Central Bank (ECB). Thus, individual members have to give up their independence in adjusting their monetary policy according to country circumstances and production structures. Due to the strict nature of the membership criteria, it is likely that the EMU will be realized at later stages of progression to EU membership (Malatyali 1998). This argument is strengthened by the observation that, as of September 2000, four of the fifteen EU members have not yet become members to the EMU, either on their own will or because they have not met the necessary conditions.

Mutual Financial Responsibilities of the European Union and Turkey in Cases of Membership and Full Membership

The European Union agrees to provide financial support for the candidate countries as long as it does not constitute a burden for the common budget. It is also expected, however, that financial support continues after a country becomes a full member. In fact, the total amount of financial support that the 10 countries—mostly central and eastern European—who have applied for candidacy for EU membership are expected to receive a total of €74.8 billion between 2000 and 2006 (see SPO 1999). Underlying this calculation is the assumption that five of these countries will become full members by 2002 and the other five in 2006.

The document "Agenda 2000," published by the European Commission in Brussels on March 18, 1998, states that the financial support to be provided to countries prior to their full membership covers agriculture, structural policies, and the PHARE program, which provides technical and financial support to both candidate and noncandidate countries as part of the EU enlargement process. According to this, the PHARE program will be provided to candidate countries with the purpose of restructuring the administrative and legislative systems and to be used in investment. In addition, the document provides both the financing of projects geared to achieve agricultural efficiency, and development and resource flow to environmental and transportation sectors. During the period 2000–2006, it is provisioned that candidates will receive at most €3 billion per year within the framework of these programs.

Based on the financial support provisioned in Agenda 2000, it appears that once Turkey is approved to become a candidate country in the Helsinki Summit, it will also be entitled to benefit from the aforementioned financial support. This could reinforce the restructuring attempts in various sectors and areas. In this juncture, it is useful to overview the financial relations between Turkey and the Union.

Upon the inspection of the Table 1, it appears that Turkey has not sufficiently benefited from the EU's commitments expressed within the framework of the Financial Declaration, dated March 6, 1995, though they are essential for Turkey to improve its economy and make it conformable with EU standards. As a Customs Union member that has not yet gained a status of a candidate for EU membership, Turkey has faced difficulties in using credits agreed to by the European Union.

In view of the difficulties faced with regard to the flow of relatively small amounts of funds during the nonmembership phase, it is also useful to conjecture the relationship between Turkey, once it becomes a full member, and the EU bud-

Table 1

Current Status of the Financial Relations Between the European Union and Turkey

Aid		Amount (ecu millions)	Realization
Commission Aid		375	Vetoed by Greece
Renovated Mediterranean Policy		400	339.5
European Investment Bank—Special Credit		750	Inactivated
Euro-Mediterranean Partnership Program	Advance	375	MEDA: 375, prohibited by the European Union
	Credit	700	EUROMED: 200; totally disbursed
Macroeconomic Adjustment Aid		200	An option in cases of emergency only
Total		**2,800**	

Source: Şener (1999).

get. In the case of full membership, Turkey will face obligations toward the Union budget as well as gaining access to use funds from the EU budget. One of the ways with which member countries support the EU budget is the customs tax. According to the Customs Union Agreement, member countries have to provide the common budget with part of the customs revenues obtained from the imports from other countries. In addition, within the framework of common agricultural policy, countries make contributions for the Union budget from the taxes earned from agricultural commerce with the third parties. Another way the European Union obtains funds is from sugar production and storage. A share of value-added taxes commonly implemented in individual member countries are also given to the EU budget. Moreover, it was agreed in 1988 that member countries provide the Union budget with a specified portion of their GDPs.

From the Union budget that is made out of the items indicated above, transfers to member countries are realized via various funds. European Agricultural Guidance and Guarantee Fund (EAGGF)–Guarantee Section functions as a fund that contributes to the restructuring of agricultural markets. This fund supports agricultural exports, storage, and acquisitions of goods.

In addition, structural funds are used to reduce the differences between the member countries with regard to the level of economic and social development. The use of these type of funds have been interconnected to increase the efficiency in fund releases. These funds are EAGGF–Guidance Section, European Regional

Development Fund (ERDF), European Social Fund (ESF), and Adjustment Fund. The first of these funds aims to develop agricultural production through both stability and producer and consumer protection. The second one aims to achieve development in the relatively backward regions of member countries. The objective of the next one is to improve living standards of workers and to generate employment. This fund can be used toward payments of occupational retraining, relocation compensations, and unemployment insurance. Besides, the European Union may direct resources from the Adjustment Fund with the purpose of improving the member countries' social adjustment and to finance environmental and transportation infrastructure projects.

Table 2 shows the inflows to and outflows from Turkey within the context of the EU budgetary transfers explained above, in case Turkey becomes a full member. The calculations are based on 1997 data.

According to the figures in Table 2, Turkey's net benefit from the common budget will be, at most, €8.3 billion. These calculations reflect the static conditions of 1997 with a restructured agricultural sector and, thus, may imply higher transfers than actual. It is nevertheless obvious that, if circumstances remain similar to the current ones, Turkey will receive higher transfers than other candidate countries in the event of its full membership.

EU transfers to Turkey as a full member would continue until a full restructuring of the Turkish economy. Likewise, Greece, who became a member in 1981, received 34.7 billion ecu until 1997, Spain received 27 billion ecu between 1986 and 1997, and, within the same period, Portugal received 15.1 ecu as net resource transfers.[3] It is possible to get an idea about the relative financial burden Turkey's full membership will create on the EU budget whereas the net transfers to 10 central and eastern European countries amount to about €10–12 billion.[4]

An Econometric Analysis of the Relationship Between Production Indexes of the European Union and Turkey

Whether the trends in real variables, specifically in production, of the European Union and Turkey are related or not is a particularly important issue for Turkey's integration to the European Union. The importance of this issue arises since the common macroeconomic policies of the European Union target variables that should show similar trends in all member countries. In case these trends vary, however, the Union policies could lead to unintended consequences, such as increased duration of business cycles, in countries where trends significantly diverge from the average trends of the Union. In this section, we therefore investigate the industrial production trends in the European Union and Turkey by means of econometric analysis.

To test the hypothesis that industrial production in Turkey moves together with that in the European Union, we apply cointegration analysis using monthly data for the period 1992–1998. We use a trade-weighted industrial production index for the European Union after de-seasonalizing the production figures for all coun-

Table 2

The Effects of Turkey's Full Membership on the EU Budget (in millions of euros)

Turkey's contribution to the EU budget	
Customs tax	550
Agricultural tax	30
Sugar and glucose tax	100
Value-added tax	1,050
GNP contribution	2,100
Total	3,830
Turkey's potential benefits from the EU budget	
EAGGF–Guarantee Section	6,400
Structural Funds	5,750
EAGGF–Guidance Section	1,200
ERDF	2,300
ESF	750
Adjustment Fund	1,500
Total	12,150

Source: Sahin (1998), p. 118.

tries. (Data are obtained from the International Financial Statistics of the International Monetary Fund [IMF].)

The results of the analysis indicate that we cannot reject the null hypothesis in which there is no cointegrating relationship between the Turkish industrial production and the trade-weighted industrial production index of the European Union. As shown in Figure 1, the industrial production index of Turkey, which is represented by the solid line, do not show a co-movement with the weighted industrial production index of the European Union, which is shown by the dotted line. We support this observation using cointegration tests:

	DF	ADF (4 lags)	Phillips
Engle Granger Cointegration Test*	–2.37	–2.39	–2.43

* Significant at 5 percent level.

None of the above test statistics (i.e., the Dickey-Fuller (DF), and the augmented DF tests (ADF) statistics, as well as, the Phillips test statistics) rejects the null

Figure 1. **Trends in Industrial Production**

Note: Dashed line—European Union; Solid line—Turkey.

hypothesis of no cointegration between the Turkish industrial production index and the trade-weighted EU industrial production index, both seasonally adjusted:

	λ_{max}	λ_{trace}
Johansen Test*	5.53	5.53

* Significant at 5 percent level.

As a second cointegration test, we performed Johansen's λ_{max} and λ_{trace} statistics, both of which yield a result of 5.53, reassuring our former empirical evidence on no cointegration between these two series.[5] Figure 1 also shows that trends in the production indexes of the European Union (dashed line) and Turkey (solid line) show major differences.

Using the trade weights of Turkey, however, we observe that the United Kingdom shows no cointegrated relationship with the Union either (for additional findings, see Berument et al. 1999). Furthermore, the UK data also shows no cointegration with France or Germany. This may be one of the reasons behind the UK's withdrawal from the exchange rate mechanism. This reasoning constitutes a point of caution for Turkey joining the EMU, which sets the common monetary policy for the Union countries. Although joining the European Union may enhance welfare through the expansion of trade and institutional development, being dominated by macroeconomic policies that take as the reference point the average trends in the Union may have undesirable effects on the business cycles in Turkey.

Policy Implications

As the previous findings suggest, business cycles of Turkey do not coincide with that of the European Union. This is an important finding considering that Turkey is in the Customs Union, and 50 percent of Turkish exports and 52.5 percent of Turkish imports are with the European Union. Nevertheless, within an independent policy framework, Turkish economic policies may subdue the undesirable effects that result from being on a different phase of a business cycle than the European Union. As Figure 1 shows, the Turkish economy has indeed followed an expansionary path whereas the European Union has become rather stagnant after 1995. When viewed from the angle of Turkish exports to the European Union, for example, it can be considered that Turkey may direct its production to its domestic market in cases of contraction in the EU market.

In view of the progression to EU membership, however, at which phase the European Union is, vis-à-vis Turkey, with respect to its business cycles, has implications for the Turkish economy. When the European Union is on an expansionary path, for example, it is natural to expect the ECB to increase the interest rates. In case Turkey is on a contractionary phase, however, this would cause major harm for the Turkish economy by further tightening it as the Central Bank of Turkey as it would also have to follow the same policy as the ECB.

All these point to the fact that it is important for the Turkish economy to complete its structural adjustment prior to synchronizing its economic policies with those of the European Union. This is also essential for minimizing the financial transfers from the European Union as Turkey progresses to the full-membership stage. Furthermore, given that production dynamics of the European Union and Turkey are quite different, it is important for full membership that Turkey reaches to a competitive position to be able to affect the decisions of the EU institutions in determining the policies of integration.

The foregoing arguments also indicate that membership to the EMU prior to full EU membership may be an undesirable alternative to the regular sequence. The United Kingdom, for instance, has not yet joined the EMU in spite of its full membership in the European Union. One possible reason for this may be the inconsistencies between the business cycles of the United Kingdom and the European Union that led the United Kingdom not to seek full membership in the European Union.

Conclusion

Turkey's progression to full EU membership involves social and economic costs that are yet to be seen as Turkey undergoes commitments and economic restructuring in line with predetermined criteria. This study shows that the business cycles of Turkish industrial production are not synchronized with those of the European Union. It is, therefore, pertinent that this situation needs to be clearly addressed in

EU decision mechanisms and considered along with the other financial problems that could arise in the transition stage.

Notes

1. MEDA stands for "Financial and Technical Measures to Accompany the Reform of Economic and Social Structures in the Framework of Euro-Mediterranean Partnership."
2. Conclusions of the Presidency, p. 6.
3. See Sahin 1998, p. 118.
4. See Sahin 1998, p. 199.
5. The results have been reported using the industrial production index based 1994 = 100.

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