

THE CUSTOMS UNION AS THE CATALYST OF GLOBALISATION

Sinan Ülgen¹

Besides the political motive, the completion of the Customs Union stems from a contractual obligation and from a number of economic expectations that can be listed in terms of ex ante order of priority as an increase in foreign direct investments, an improvement in global competitiveness, the consolidation of the European market and the modernisation of the country's economic legislation. 6 years down the road, Turkey's most important expectations remain seemingly unfulfilled whereas some degree of success can be attached to "less important" expectations. Yet the impact of this trade integration with Europe on Turkey's economic legislation proved to be by far the most important element of the Customs Union deal. Furthermore this importance will not wane in the future but on the contrary increase on account of the incorporation of the services sector in the Customs Union. The Customs Union's role and influence on the Turkish economy runs much deeper than what trade statistics may suggest. The Customs Union seems indeed to play a significant role in shaping globalisation's impact on Turkey. On the one hand, by opening up the sectors of the economy to international competition, it increased the exposure of the country to the currents of globalisation but at the same by contributing to the establishment of a proper institutional setting, it improved the capacity of the country to deal with the ills of globalisation and to optimize the benefits of globalisation.

The Turkey-EU Customs Union is a much-debated issue in Turkey. It is generally used as an example of globalisation's impact on Turkey. This article will assess the economic and political impact of this important form of trade integration and elaborate on whether the Customs Union did indeed open up Turkey to the winds of globalisation.

A political aspiration ranks first among the motives for the Turkish side for economic integration. It was believed that the completion of a customs union would put Turkey one step ahead of other aspiring members in terms of the level of integration achieved with the EU and hence provide a critical competitive advantage in the race to become a full member. In other words, Jean Monnet's principle of economic integration paving the way for political integration, which proved to be the fuel behind European integration, would also be applicable for the Turkish case.

Secondly, contractual obligations were also militating for the completion of the Customs Union. The Ankara Association Agreement and the Additional Protocol of 1973 had foreseen a transition period of 22 years before the liberalisation of trade between the parties, which meant that the Customs Union had to be completed by the end of 1995.

¹ Mr. Ülgen is the editor of this journal.

Thirdly, there were some very important economic expectations from this form of trade integration. It is therefore of import to address the question of the nature of these expectations, the degree of fulfilment of these expectations five years down the road and deduce from this brief analysis some guiding elements for the future.

In terms of economic expectations, four main items by order of *ex ante* perceived importance can be mentioned:

- (1) Increased direct investments
- (2) Improvement in global competitiveness
- (3) Consolidation of the European market
- (4) Modernisation of the country's economic legislation

Six years down the road, when asked to rate the degree of fulfilment of these expectations, I would say that the modernisation of the economic legislation comes first, followed by the consolidation of the European market, improvement in global competitiveness and lastly, increase in foreign investments. In other words, the list is upside down. Seemingly, Turkey's most important expectations remain unfulfilled whereas some degree of success can be attached to "less important" expectations.

In terms of an increase in foreign direct investments, economic integration with the EU did not produce the expected outcome. But what needs to be underlined is that there are many other factors, which came into play as regards foreign investment decisions. The establishment of a customs union, by itself would not and should not be expected to lead to a drastically different picture. Turkey's chronic political and macroeconomic instability combined with the impact of the Asian crisis were probably more influential in determining the real flow of investments. The reforms in Central and Eastern Europe coupled with the political will displayed by the EU to bring these countries as full members also undermined Turkey's relative position in the eyes of international investors.

In terms of the improvement of global competitiveness, we can attest to some success stories. The elimination of tariff protection led to restructuring in some industrial sectors. The most prominent example is the automotive industry where Turkish companies became more integrated in the global webs of production. However when we look at Turkey's trade accounts, one can clearly see a variable trade deficit *vis-a-vis* the EU over the years. For instance the trade deficit was 9 billion euros at the end of 2000. It decreased to 2.2 billion by the end of 2001. This shows that the Customs Union is not the only culprit. Exogenous factors such as differences in growth rates; the devaluation or the overvaluation of the currency due to the IMF supported stability program in force. Yet at the end of the day, running a sustainable trade deficit *vis-a-vis* the EU is not necessarily a bad thing for an economy like Turkey if one considers the fact that only 10% of our imports are consumption goods, the remaining being intermediate products or investments goods.

Furthermore it is worth noting that from a theoretical perspective, the Turkey-EU Customs Union fulfils many of the criteria for leading to trade creation and

therefore for enhancing welfare. Trade ties were already strong before the establishment of the Customs Union. The EU's share in Turkey's exports was 47% and in Turkey's imports 49%. Our trade barriers were quite substantial before the Customs Union. In addition to which the EU is the world's largest trading entity and Turkey's economy is quite diverse. These are all elements that prove the welfare-enhancing characteristic of the Customs Union.

It should also be recalled that the Customs Union provided a shelter against emerging protectionism in Europe in the wake of the Asian crisis. Turkey's exports to Western Europe remained unhindered, save a few exceptions in times of economic duress. This was a testimony to the fulfilment of the market consolidation objective of the Customs Union.

Last but not least, one needs to look at the impact of the trade integration with Europe on Turkey's economic legislation. Although this objective was number four out of a list of four on the *ex ante* expectations list, in hindsight, it can be said that this proved to be by far the most important element of the Customs Union deal. Furthermore, this importance will not wane in the future, but on the contrary, it will increase.

The Customs Union agreement required Turkey to adopt new legislation in such areas as commercial policy, competition policy and intellectual property rights. This development provided, on the hand, for the elimination of the possibility of populist interventions in the conduct of commercial policy and allowed for a much more transparent regime. On the other hand, it contributed to the modernisation of the legislation by introducing new policy areas and independent authorities in such areas as competition law. As a result, the business environment became less volatile and more in tune with international norms. These are all factors that increased the international attractiveness of the country as well as enhancing market discipline and efficiency leading to higher growth prospects.

These are areas whose impact will be better perceived in the medium and long term. But one thing is sure, the impact is real and lasting. Moreover, the influence of economic integration and hence the EU in modernising the domestic legislation paving the way for better growth prospects, will increase in the future. Indeed, next steps in the economic sphere are the incorporation of the services sector within the Customs Union.

This means a much more radical transformation of the Turkish economy. The Customs Union concerns actually only industrial goods. In other words, assuming that only half of all industrial production is subject to international trade, it concerns 15% of the national economy given that the industrial sector constitutes 30% of GDP. Whereas the services sector constitutes 60% of the GDP. That is why the incorporation of the services sector in the Customs Union is of utmost significance.

It will mean the opening to international competition of such fields of economic activity as telecommunications, energy, transport, banking, insurance, *etc.* It

will also herald the end of state monopoly in many of these areas. It will mean deregulation and liberalisation with all its associated benefits.

Another benefit that is worth mentioning of incorporating services in the Customs Union is the bearing that it will have on the state and enforcement of the relevant legislation in all these sectors of activity. In other words, Turkish banks for instance will henceforth have to comply with the EU's capital adequacy standards and adopt the EU banks' risk management policies. Suffice it to say that had Turkey been successful in including services in the original Customs Union agreement back in 1995, we would probably not be witnessing a banking crisis in this country nor talking about all the problems related to privatising Turkish Telecom.

In short, the Customs Union's role and influence on the Turkish economy runs much deeper than what trade statistics may suggest. There are many various channels through which this relationship affects the domestic economy. But the most important impact is the one that is most often overlooked: the Customs Union prepared Turkey to withstand the rigors of globalisation. The discipline brought about by the Customs Union happened to be exactly the type of reform that is needed to optimise the impact of globalisation on our national economy. The reason is the following.

It has been customary to talk about globalisation alongside its underlying principles of democracy and market economy. If these principles can be referred as the ideology of globalisation, then there a number of other principles such as good governance, the rule of law, social responsibility and transparency which came to the fore also with the phenomenon of globalisation and that can collectively be referred as the ethics of globalisation.

There is an interesting relationship between the ideology and the ethics of globalisation. The growing popularity of the ideology of globalisation as witnessed around the world after the breakdown of communism amplified the impact of ethics. In other words, the more the ideology of globalisation started to take root and therefore the more interdependent the nations of the world became, the higher the benefits or the costs of abiding or non abiding by the ethics of globalisation has become. Those who followed these rules of behaviour stood to win whereas those who flouted these rules stood to lose. For the winners, the riches of globalisation are increasing exponentially, whereas for the losers the detrimental effects of globalisation are also increasing exponentially.

So adopting the ideology of globalisation is not enough. Having a democratic government and a free market economy is not sufficient. These structures need to be complemented by the proper implementation of the ethical rules of globalisation. That is why the quality of a democracy or of a free market economy is starting to become more consequential than the mere existence of such structures.

It should also be pointed out that in a significant number of countries, the simultaneous application of these principles can by no means be taken for granted. Various economic crises in the latter part of the 1990s and the early 2000s in such diverse countries as Argentina, Brazil, Korea, Japan and Turkey are a case in point. In order to understand the true dimensions of this challenge, one has to look more closely into the obstacles, which prevent the concomitant application of these principles.

In democracies, the most visible threat in this respect is the tendency to indulge in policies, which are incompatible with the ethics of globalisation. A few but notable examples would include corruption, undermining the independence of the judiciary and populist economic policies.

Democracies have developed a number of solutions to deal with this challenge. The two most visible structural solutions seem however to be the establishment of independent regulatory authorities and participation in a process of supranational integration.

The spread of independent regulatory authorities (IRAs) is a relatively new phenomenon triggered by globalisation. Independent institutions ranging from a Central Bank to a Competition Authority to sectoral boards such as for telecommunications or energy are becoming a reality in many European countries. That is also the case for Turkey. The establishment of the Customs Union ushered in a Competition Authority, to be followed by an independent authority for state aids control. Similarly ongoing efforts for the harmonisation of the legislation led to the creation of new regulatory authorities.

Yet these institutions pose some fundamental democratic accountability problems. Unlike in the US where a presidential system prevails and therefore the executive is composed of non-elected elected technocrats, in European countries used to parliamentary democracy the executive is generally composed of elected politicians. In these systems, members of the executive share the political responsibility of their actions with the head of the executive. IRAs run counter to this trend. Even though competent, IRAs do not have the political responsibility of their actions. Then how to explain the irrefutable tendency pointing to the growth of these institutions?

The answer relates to the quest for the simultaneous application of globalisation's ideology and ethics. IRAs are a fundamental instrument in democracies allowing a rule based implementation of policies bereft of outside influences which may have led, in other circumstances, to inferior or populist policies. In other words, by limiting the freedom of action of the executive IRAs also limit the risk of political mismanagement and therefore the ever-increasing cost due to globalisation of violating the ethical rules of conduct. IRAs therefore provide a seal of approval for a country's adaptation to globalisation's requirements.

The other seal of approval relates to supranational integration. The EU experiment sets the example in this case. This *sui generis* model of economic and political integration rests on the novelty of sovereignty sharing. A new

supranational entity is to become sometimes exclusively competent in policy areas defined in the founding treaty and its amendments. As a result, member states are losing their executive powers in those policy areas whereas supranational institutions are acquiring competence. This trend was strengthened over time. At the beginning, a limited number of policy areas such as trade, customs and agricultural policies were “*communautaire*”ized whereas in subsequent years, new policy areas culminating with monetary policy entered the picture. The growth of supranationalism, if not to say federalism, should also be seen as the consolidation of globalisation’s ideology and ethics, a guarantee against the resurgence of bad governance or populist policies at the national level.

The Customs Union initiated a similar process in Turkey as well, starting with trade policy and competition policy. As the legislative harmonises with EU continues, additional policy areas will be incorporated in this policy framework. This framework, although criticised by some circles in Turkey due to the restrictions it imposes on the government in terms of independent policy making, enabled Turkey to adapt sooner, rather than later. to the challenges posed by globalisation.

In summary, the Customs Union seems indeed to play a significant role in shaping globalisation’s impact on Turkey. On the one hand, by opening up the sectors of the economy to international competition, it increased the exposure of the country to the currents of globalisation, but at the same time it improved the capacity of the country to deal with the ills of globalisation and to optimise the benefits of globalisation by contributing to the establishment of a proper institutional setting.