CUSTOMS UNION AND TURKEY

A COMPARATIVE ANALYSIS OF THE ADJUSTMENT PROCESSES EXPERIENCED BY SPAIN AND PORTUGALAND THE CASE FOR TURKEY

MBA THESIS

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June 1994

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A THESIS
SUBMITTED TO THE DEPARTMENT OF MANAGEMENT
AND GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
OF BİLKENT UNIVERSITY
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF
MASTER OF BUSINESS ADMINISTRATION

By

GONCA IŞIK YILMAZ

June, 1994

I certify that I have read this thesis and that in my opinion it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Business Administration.

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ACKNOWLEDGMENTS

I am grateful to Assoc. Prof. Gökhan Çapoğlu for his invaluable supervision throughout the study. I would also like to express my thanks to Assist. Prof. Gülnur Muradoğlu and Assist. Prof. Murat Mercan for their contribution, as the members of the examination committee.

TO MY PARENTS,

ABSTRACT

CUSTOMS UNION AND TURKEY:
A COMPARATIVE ANALYSIS OF THE ADJUSTMENT PROCESSES
EXPERIENCED BY SPAIN AND PORTUGAL, AND THE CASE FOR TURKEY

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June 1994

Customs union is defined as the undisturbed freedom of movement within the EC for goods, services, money, and economic agents. In this study, being highlighted by a comparative analysis, the union to be realized with the European Community and its probable impacts on the Turkish economy have been evaluated. The macroeconomic and sectoral environments have been examined in order to set base to the required adjustment processes, and anticipate and direct the future moves.

Keywords: Customs Union, European Community.

ÖZET

GÜMRÜK BİRLİĞİ VE TÜRKİYE: İSPANYA VE PORTEKİZ UYUM PROSESLERİNİN VE TÜRKİYE İÇİN OLAN DURUMUN KARŞILAŞTIRMALI ANALİZİ

Danışman: Doç.Dr. Gökhan Çapoğlu

Gümrük Birliği, Avrupa Topluluğu içerisinde, malların, hizmetlerin, para ve economik araçların engelsiz dolaşım özgürlüğü olarak tanımlanmaktadır. Bu çalışmada, Topluluk ile Türkiye arasında gerçekleştirilmesi planlanan gümrük birliği ve bu birliğin Türkiye ekonomisi üzerinde olası etkileri, karşılaştırmalı analizler ışığında değerlendirilmiştir. Gerekli uyum proseslerinin ve ilerleyen aşamalarda yapılacakların belirlenebilmesi amacıyla, çalışma makroekonomik ve sektörel bazda gerçekleştirilmiştir.

Anahtar Sözcükler: Gümrük Birliği, Avrupa Topluluğu.

I.INTRODUCTION

Turkey has a foot in the door of a customs union to be realized with the European Community, although it has not acquired full membership, yet. Under the pre-determined schedules and procedures, stated in the Additional Protocol of 1973, the country has committed itself to complete the union requirements within 22 years, that's by 1995.

The unstability of the macroeconomic environment brought out the need to, further, question the issue and its probable impacts, either sectoral or holistic. The long-lasting discussions on the challenges to be encountered have not, however, led to clear and well-defined processes to overcome them.

In this study, a comparative analysis has been provided in order to evaluate the current situation and set basis for what-to-do's. Being the last ones to integrate into the Community, having similar economic environments to Turkey, and having almost completed their internal adjustment processes for the customs union, Spain and Portugal have been selected for the comparison.

Since these countries have been integrated into the European Community (EC) by the second enlargement decision, and the accession arrangements have relied on many counterfeiting arguments posed by other member states of the Community, in the first section of the thesis, this enlargement process has been studied and its impacts on the unity have been evaluated.

In order to provide a theoretical basis for the study, the customs union issue, being defined as the 'undisturbed freedom of movement within the EC for goods, services, money, and economic agents', has been further examined.

As for the adjustment processes, in the third and fourth sections of the report, both Spain and Portugal have been assessed based on their macro and microeconomic structural formations. The reforms and liberalization acts have been analyzed to evaluate the union effects on the economies of the two countries.

Eventually, the required analysis for Turkey has been realized. Depending on the historical links between the country and the EC and the former relations (both economic and political), the impacts of the customs union on the Turkish economy have been studied. In the light of the compared indicators, the macroeconomic and sectoral assessments have been provided in order to lead to a conclusion on Turkey's anticipated future under the union practices.

II. SECOND ENLARGEMENT OF EC

The initial economic integration act of France, West Germany, Italy, Belgium, Luxembourg and the Netherlands, was later on extended to both political and other social arenas due to the new world order and global trends by the first and second enlargements. The Community happened to be of Nine with United Kingdom, Ireland and Denmark in 1973, and of Ten with Greece by the start of 1981.

EC decided to overtake this expansion process, because the reasons to do so were already stated in the Treaty of Rome. The member states were committed to pool their resources 'to preserve and strengthen peace and liberty' and to summon 'other peoples of Europe who share their ideal to join in their efforts', by the preamble.[1]

Portugal acquired the most important qualification for membership by adopting democracy following decades of dictatorship in 1974, and Spain followed it in 1975. The economy of Spain had remained backward and underdeveloped after many years of high protection. As for that of Portugal, it had been subordinated to the requirements of a colonial empire. The membership, from those aspects, seemed to bring significant benefits to both of the countries. The links to be developed with the EC would allow for successful transition to democracy as well as economic development.

The economies of the two countries were already seen to be integrating themselves closely with the EC by 1977, when the key decisions to join the Community were taken in Lisbon and Madrid. This process has continued so that, by 1983, Spain sent 48% of all its exports to EC countries and took 32% of its imports from them, while comparable figures for Portugal were 59% and 39% respectively. As for an older member, the UK had sent 32% of its exports to the Community on its accession in 1973.[2]

[1] EC News, January 1986.
[2] Direction of Trade Statistics Yearbook, 1985.

The negotiations had been attained after long-lasting discussions within the EC. The Community did not only argue on the acceptance procedures, but also on the timetables to be followed, and a huge number of special deals. The deals were including the integration into the CAP, the dismantling of tariffs governing trade between the new members and the EC, together with the erection by the new member states of the common external tariffs and its contributions to and benefits from the Community budget. Eventually the basic treaties of accession were signed on 12 June 1985. Spelling out the process of incorporation, the documents had covered 36 annexes, 25 protocols on issues ranging from Spanish motor car tariffs to restructuring the Portuguese steel industry, and 47 declarations and joint declarations by the existing member states.[3]

There were at least three key problems to be dealt with before accession could become a reality. Problems were entitled as:

1. the need to cut the excesses of CAP whose share of total Community budget expenditure was above 70 per cent in 1980: Spanish membership would add to costly surpluses of wine and olive oil and its highly competitive fruit and vegetable production would spark demands for protective expenditure from growers in Italy, France and Greece.
2. the budgetary crisis for which the CAP was largely responsible: The Community's budget revenues are derived from customs duties and agricultural levies on third country imports collected by member states at their borders, and from VAT payments. In a fully harmonized community in which similar VAT rates are levied on identical goods, the Community budget would have been able to claim up to 1 per cent of each member state's Vat revenues. In the absence of such harmonization it drew up to 1 per cent of retail sales of a common basket of goods and services, and this margin did not seem to finance the planned enlargement.[4] It was possible to raise the 1 per cent ceiling, but this was linked with a third problem.
3. the demand of UK to reduce its net contributions to the EC budget: The British Government would not allow the EC to raise extra money without a budget deal for Britain.

The Ten came together in France, in June 1984 and settled the British budget problem and agreed to raise the 1 per cent VAT ceiling to 1.4 per cent. However the internal

[3] Donges, J, et al., The Second Enlargement of the European Community, Kieler Studien, 1982.
[4] Ibid.

conflicts on reforming the Community's wine production regime and Greece's demands for huge expenditures in future years to offset the impact of enlargement on Mediterranean regions didn't allow the negotiations with Portugal and Spain be concluded by the end of the year. On 29 March 1985, the last obstacles were overcome and the following day the European Council noted that the fundamental issues of the negotiations with Spain and Portugal had been resolved.

Although the initially targeted date was 1 January 1983, due to the problems stated above, on 1 January 1986, the EC become 12 with the accession of these two countries. As a result of this second enlargement, it has reached to a population of 321 million which was almost two times of the number when the Community was first established in 1958. On the path of being a union, the EC, then, embraced to Twelve member states and was brought into a much younger population than the EC average by the entry of Spain and Portugal.

The adoption of Single European Act by the Council in December 1985 and the accession of Spain and Portugal at the beginning of 1986 stimulated a new perception of the process of integration- from "europessimism to europhoria" (Dale Smith, 1993).

The changes faced by the Community were not seemingly threatening and great. Its population expanded from 270 to 320 million, its gross domestic product (GDP) from £1,666 billion to £1,806 billion and its land mass from 640,000 to 870,000 square miles. The concerning part of this integration was, however, due to the political reasons. The enlargement was considered to shift the center of gravity and power away from the old and developed northern member states to the poorer Mediterranean south. With Spain's per capita GDP just over half the Community average and Portugal's less than a third, arguments over the role, size and the allocations of the EC budget were sharpened and a re-settlement was needed. The Community's capacity for coherent and cohesive action was tested.

The Treaty of Accession for Spain and Portugal was signed in June 1985, but it had allowed a ten years transition period to the above two countries for adopting themselves to fully apply to the EC rules. On the other hand, the impact of the membership was felt long before. Industry and agriculture in both countries were exposed to much stronger competition, and their economies reflected the strain of EC membership before they tasted its benefits. As for the EC, problems of controlling and reforming the Common

Agricultural Policy (CAP) were magnified along with the size and costs of some of its product surpluses.

II.1. RESULTS OF ENLARGEMENT

It was estimated that EC spending would increase by 20 per cent, whereas revenues would increase by 12 per cent. It turns out that, this actually entailed only the fairly moderate outlay of ECU 1.4 billion per year. The ironic factor tempering the cost was that both countries imported a sizable proportion of foodstuffs and would thus be called on to contribute a significant amount of variable levies into the Community fund.

A positive aspect of EC enlargement was a stronger political unity with higher voice in economic and political issues. Entry, also, served to modernize the new members, Iberia, traditionally being a backwater area of Europe. On the other hand, an EC of twelve rather than ten could be considered a weaker cohesive unit than before. Decision making difficulties might arise on political issues, and they might be less able to establish policies that would eventually lead to a united Europe.

III. CUSTOMS UNION

Having a theory of its own, customs union procedures and process deal with gains from specialization of production, economies of scale, greater competition, externalities associated with agglomeration, improvement in terms of trade, an increased rate of growth, and political unification.[5]

Among the static and dynamic effects of the customs union, the most sound ones are entitled by Overturf as follows:

1. the economies of scale, or increasing returns from large size, with specialization and product variety,
2. the competition which can result from opening up the formerly protected national markets and from accommodating several firms of optimal size within a single market, and

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[5] Overturf, 1986.

3. the possibility of faster innovation and an investment boom to follow the introduction of these new opportunities.

Economies of Scale: Greater market size allows for greater firm size and for greater economies of scale in research and development or technological knowledge formation. Customs union leads to an increase in intra-industry specialization and trade, which results with lowering of costs. European firms, before the union, produced many products for the home market, all within a narrow definition of their industry. Union made it possible to produce some of the products to serve a much wider market and take advantage of longer runs, with lower inventory costs, less downtime for switching between product runs and greater labor specialization. Consumers will also experience a rise in their welfare when these lower costs are passed on to the prices.

Specialization of Production: If a country prices the good in question higher than the world price, this autarky (no trade) price indicates that it does not have a comparative advantage, and does not efficiently utilize the factors of production related to that good. Free trade, as a result of the customs union, will lead to competition and ensure the world price be domestic as well. This, in turn, helps for greater welfare through increased consumption, a shifting of resources to probably more efficient use through specialization of production and an improvement in the welfare through free international trade.

External Economies Associated with Agglomeration: This is another possible gain from customs union. The producers are better able to consider optimal firm location, input prices and proximity to the resources. Low costs for specific types of financial, legal, or consulting services are some examples to such externalities. On the other hand, production centers may tend to develop by leaving regional backwaters of low growth and high unemployment if all factors are not sufficiently mobile.

Increased Rate of Growth: Another potential gain from the establishment of a customs union is an increase in the rate of growth. This will probably be achieved as a result of competition forcing technological advance, and greater investment in union wide markets.

Improvement in Terms of Trade: The terms of trade can be defined as the price of exports divided by the price of imports, and this is considered to give out the trade welfare in the amount of imports available to a society per unit of exports. The union causes improvement in terms of trade. A reduction in import prices, therefore, raises societal welfare.

Development of Political Union: Customs union, initially in the form of an economic integration, is anticipated to proceed in the path of developing a political union.

Increased Competition: By lowering the tariff barriers the efficiency of competition is forced.[6] Freer trade tends to force efficiency by forcing competition with other union industries. Union can be thought to give way to intra-union cartelization to replace the old oligopoly structure, but, for Europe, this is extremely difficult to achieve due to the Community antitrust attitude.

The gains from trade are reduced if an import tax is imposed on the good. Tariff imposition on world price (of the formerly freely traded good) increases domestic production, but, on the other hand, imports drop, total consumption decreases due to the high price and the country experiences a net loss on welfare in two ways. First, there is a loss in consumer welfare since consumers have to pay a higher price for the good and therefore cut back their quantity demanded. Second, there is a loss due to the fact that not all of the increased payment is actually received by the government and the producers.

In fact, it may have been these very domestic producers who put pressure on the government to initially impose the tariff. Under such circumstances, an increase in domestic production is called a loss in efficiency and production for the economy as a whole. A union creates freer trade and leads to a reduction of the above losses (Overturf, 1986).

Customs union also shows its effects in the forms of trade creation and trade diversion.

1. Trade Creation: As already explained, it is possible to encounter a reduction in the net welfare due to the losses incurred through tariff imposition. The trade creation effect is of the obverse situation and relates to a gain in welfare.
2. Trade Diversion: This effect relates to the diversion of trade from most efficient producer to the most efficient union producer and a shift in production.

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[6]Some problems can be expected to appear as in the form of oligopoly practices in which domestic producers, usually through barriers to entry, are able to constrain output, divide the market, artificially raise prices, and reap monopoly profit. This causes the consumer to suffer by paying too high a price for a possibly lower quality item, that is inefficiently produced.

Therefore, the benefits of a union depends on the balance between the two effects. It is theoretically possible that freer trade may not be optimal in the sense of increasing either the country's welfare or the overall productive efficiency of the world. As an example, pure trade diversion results from perfectly inelastic supply and demand curves, and is a pure loss from union formation. The higher the original tariffs on potential partners, the greater the probability of significant gain upon the elimination of those duties.

EC members benefit from increased intra-union trade due to specialization, by eliminating tariffs among themselves. It is estimated by the Eurostat that actual intra-EC trade has expanded at a much faster rate than the EC trade with the rest of the world. Direct estimates of trade creation and diversion, in Community case, show that the former has significantly outweighed the latter.

Although it can be concluded that such a union establishment and expansion leads to increased welfare in one or another way, some non-economic objectives of nations, including sovereignty maintenance, precedes over economic rationality and concentrated vested interests (industries losing protection) speak louder than desegregated consumers (Overturf, 1986).

Being defined as 'the undisturbed freedom of movement within the EC for goods, services, money and economic agents', information about the economic effects of the customs union was not timely provided by the economists. Viner[7], focusing the concept on the issue of trade diversion versus trade creation in static terms, opened up a debate on the wrong foot. This allowed the English economists to permit their preference for general free trade over a customs union, and Cooper and Massell[8] expressed the inclinations of many of them in highlighting the conclusion that, on the special assumptions that underlay the customs union theory (including perfect competition and full employment of all sources), there was always a 'non-discriminatory' policy that would be better than a customs union. After another fifteen years, the Wonnacotts pointed

[7]Jacob Viner, *The Customs Union Issue*, New York, Carnegie Endowment for International Peace, 1950.
[8]C.A.Cooper and B.F.Massell, 'A New Look at Customs Union Theory', *Economic Journal*, December 1965.

out that this conclusion rested on the assumption that the rest of the world didn't use tariffs.[9]

Almost all of the econometricians, working on the trade effects of the EC's customs union, concluded that 'trade creation has exceeded trade diversion by a considerable margin, typically between five and ten fold'.[10] The early customs union theorists were not incorrect, since they had let the effects depend on such matters as the height of the common external tariff and the size of the union. A reduction on the EC tariff through GATT negotiations might lead to a reduction in the scope of trade diversion.

The value of trade created by the second half of the 1960s was estimated to be between $5-11 billion for manufacturers, compared with $0-3.7 billion for trade diversion. On the other hand, the estimated gain to production and consumption, and hence welfare, was much less, because the newly traded goods were considered to have replaced. The most cited estimates are for a gain of 0.15 per cent to Community GNP, and 0.22 per cent (0.16 per cent trade creation and 0.06 per cent trade diversion) for the UK after entry into the EC. Estimates of the effect of the European Free Trade Association on its members ranged from 0.0041 per cent for the UK up to 0.036 for Denmark.[11]

Since the above studies did not end up with serious quantitative results, the attention was given to other related areas. In 1972, Corden observed that with the increasing returns that may be expected when there are economies of scale, the reduced cost, that can apply to the whole of production, is considerably more important than the trade effects.[12]

However, the political motives of the founders of the European Community ensured them a positive view of the economic consequences of mutual tariff disarmament. They were impressed by the scope that the large American market gave for efficient output of items

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[9] R.J. and P.Wonnacott, 'Is Unilateral Tariff Reduction Preferable to a Customs Union? The Curious Case of the Missing Foreign Tariffs- or, Beware of the Large Country Assumption', *Working Papers*, University of Maryland, 1980: and *American Economic Review*, September 1981.

[10] R.C.Hine, *The Political Economy of European Trade*, Brighton, Wheatsheaf Books, 1985, p.52.

[11] Bela Balassa,'*Trade Creation and Trade Diversion in the European Common Market: An Appraisal of the Evidence*', in Balassa (ed.), European Economic Integration, Amsterdam,1975, M.Miller and J.Spencer, 'The Static Economic Effect of the UK Joining the EEC: A General Equilibrium Approach', *Review of Economic Studies*, Feb.1977, pp.71-93.

[12] W.Corden, 'Economics of Scale and Customs Union Theory', *Journal of Political Economy*, May/June 1972.

such as aircraft and machinery for mass production. The Germans, Belgians and Dutch, later on French and Italian, industrialists were interested in the wider market.

Although estimates of the terms of trade are rare, it is thought to be of 'considerable relative importance' when compared with the static welfare effects. On the contrary, many economists failed to break the mould of static equilibrium analysis and focus sharply on the dynamic effects inside the common market.

IV. SPAIN: ADJUSTMENT PROCESS

When Spain's accession period to the EC is analyzed, it is observed that the country has followed up a series of improvements in inflation, output, employment and the external accounts. Although it is not the only reason, the adjustment process can be considered to be one of the country's most significant achievements. Being previously an extremely conservative market, Spain implemented reforms in its product, labor, and financial markets, and this was chased by an opening up of the balance of payments. The financial and structural reform moves were for the purpose of preparation to the European Single Market. The economic program implemented by the Spanish authorities over the period 1982-1986 was a combination of stabilization policies and gradual structural reforms. This strategy allowed for the country adjust to domestic and external imbalances.

IV.1. MACROECONOMIC BACKGROUND

Spain has left the self-sufficiency goal since 1959, and at the same time the first economic plan was drafted.[13] This, in turn, helped the country achieve an outstanding economic growth when compared to the other European countries. Spain has had a more significant stock and a faster rate of expansion than Portugal (and Greece, as well). The Spanish economy has faced a gradual opening to the foreign capital, while doubling in size (in GDP terms) during the 1960s and aiming to do so again in the 1970s until the onset of the 1973 oil crisis. Since Spain was heavily dependent on the imported energy supplies, the crisis showed its effects on Spain's balance of payments as in the form of foreign debt. The debt increased from US $3.6 billion in 1973 to US $24 billion in 1981.

[13]Data in this section are provided from the OECD Coutry Studies and Economic Surveys for Spain (1983-1988).

By the year 1984, approximately half of the workforce was employed by the service industry. The unemployment rate, which was raising steadily since 1977 has reached to 21.5 per cent of the total workforce in 1985. In other terms, the number of registered unemployed equaled 2.9 million. This was namely due to several factors such as the return of Spanish workers abroad, who have faced redundancies, encouragement of women, in the post-Franco era, to take place in the Spanish labor force (which led to an increase in the overall demand for jobs), and the population growth rate of Spain which was well above the EC average, and continues to be so.

In 1984, the EC absorbed 49.1 per cent of Spain's exports and supplied 33.4 per cent of its imports. While the service industry took the greatest share from the active workforce pie, manufacturing ranked the second employer with a share of 25.4 per cent, and agriculture the third with 17.8. The remaining, totaling approximately 7 per cent, was employed by construction sector. In 1985, agriculture accounted for 9 per cent of Spain's GDP, and agricultural exports represented about 20 per cent of total exports. The largest customer of Spanish exports was the Community itself (60 per cent). Therefore, Spanish integration to the EC would increase the areas in use for agricultural purposes by 30 per cent and the agricultural workforce by 25 per cent. On the other hand, it would be impossible for the dairy industry to survive after the customs union because of the high product quality standards and insufficient capital for livestock investment. The Treaty of Accession established a seven-year transition period for non-sensitive Spanish exports to the EC during which customs duties would gradually be abolished. In addition, fruit and vegetables, being considered as Spain's sensitive products, would have a ten-year transition period during which the EC promised to reduce its external tariffs on an increasing scale.

As in case of Portugal, in the mid-1980s, the Spanish industry was dominated by many small enterprises. These firms were operating with a small (or almost no) use of technological innovation, and 93 per cent of the industrial companies were employing less than 25 workers. When the integration to the EC was accomplished, these enterprises would face a great competition, resulting from lack of both greater financial resources and economies of scale, achieved by European firms.

The common features of Spain's steel industry with other West European steel producers, in 1980s, were namely excess capacity, overmanning, and low productivity. However, Spain succeeded in developing export markets when faced with a reduction in home demand, and ranked seventh largest exporter (of steel products) in the world.

Producing 1.17 million vehicles in 1984, Spain ranked as the sixth largest car manufacturer, and 61 per cent of its production was exported. From the point of view of foreign direct investment, the main car manufacturers (i.e. General Motors, Citroen, Renault, Peugeot, Fiat, and Nissan) had already set production in the country. Spain's national car producer, SEAT, signed an agreement with Volkswagen to share technology and to market VW models in Spain, in year 1983.

IV.2. LEGISLATIVE BACKGROUND TO FOREIGN DIRECT INVESTMENT

Spain needed to adopt an economic reform program, namely Stabilization Plan, when it joined the Organization for Economic Co-operation in 1959. This program allowed the country to implement an open policy towards foreign investment, and to overcome the growing current deficit on the balance of payments. The reform was planned to uphold the shortage of domestic savings and the lag in technological development.

On 27 July 1959, general guidelines, for participation in Spanish enterprises by foreign investors and Spaniards residing abroad, were introduced by a Decree. From that time on, the restrictions, on capital repatriation and profit transfers stemming from investments signed, were all abolished. In addition to the above Decree, Government introduced another one in 1963 to fully "liberalize foreign investment in 18 major industrial sectors by lifting restrictions on the percentage of capital that foreign firms and other non-residents could invest." [14]

Within the 1963-1972 period, the main industries benefiting from this restructuring were the chemical industries, motor vehicles, hotel industry, and metal and mechanical sectors. The foreign investment had reached to a peak of 14 billion pesetas (US $230 million) in 1972. Following year, the Ministry of Industry issued a Decree which brought a new legislation to consolidate the major provisions of previous laws into a single document

[14] The EC Fact Book.

(Decree No. 3021). By this paper, Government announced its aim of applying a more selective procedure for foreign investment. [15]

> ....The approval of new foreign majority investments was to become conditional upon three criteria: exporting, local sourcing of raw materials and local research and development.... although foreign participation above 50 per cent required special government authorization, the latter was liberally granted provided that at least one major contribution to the Spanish economy could be anticipated from the result of the foreign investment. [16]

As a result, the submission (two-stage) process for the prospective foreign investor was not that easy.

> The authorization procedure ranged from four to six weeks for a comparatively small metal-working unit to eight months for a multi-million dollar chemical plant...Most effected by the delays were pharmaceutical companies which regarded as unrealistic the Spanish Government's efforts to induce them to set up costly research and development facilities in Spain.[17]

The control mechanisms were not all that. Another one consisted of industrial permits required by the Ministry of Industry. Whatever the degree of foreign ownership, industries were separated into three classes.

- industries where permits were granted on a case-by-case basis (including public utilities, mining, motor vehicles, electrical appliances, and the processing of oil)
- industries where permits were granted subject to the fulfillment of certain technical or minimum capacity requirements and local content rules (including textiles, metal products and machinery, some chemicals and foodstuffs)
- industries not mentioned above, permits were granted without restrictions.

For the sectors including national defense and private security services, public information agencies, newspapers and publishing, film production and broadcasting, the exploitation of mercury mines, and water for public consumption, foreign participation was forbidden.

> In the air transport and public utilities sectors, the foreign investor does not require any authorization for the first 25 per cent of capital invested; the same rule applies to the first 40 per cent of foreign capital invested in shipping and oil refining and 49 per cent in

[15] In this section, the paragraphs in small characters are provided from the study of Buckley and Artisien on the employment impact of multinational enterprises in Greece, Portugal and Spain.
[16] Buckley and Artisien, pg.15.
[17] Ibid.

> mining....in Spain's less developed areas include capital incentives (in the form of cash grants and long-term loans) and a variety of tax and tariff reductions for new or expanding industries in growth centers... Additional benefits are also available to investments in industries considered to be of preferential or national interest: a law introduced in January 1977 (No.6) conferred tax and financial benefits on mining companies.[18]

Under the consideration of the implementations achieved on foreign investment plans, the Government needed to introduce new Decrees by the year 1981. These were mainly for the decentralization of the authorization procedure, in order to reduce the time required to process applications, and for regulations of the conditions under which authorizations are made, to reduce the element of discretion. By the Decrees of 1981, it was stated that:

1. if foreign participation exceeds 50 per cent, the investment is considered foreign to the extent of such participation.
2. if foreign participation is 25 per cent or if there is Spanish Government participation then the investment is treated as domestic.
3. if a foreign firm holds less than 50 per cent of the capital of a Spanish company, but exercises effective managerial control, the company is treated as foreign investment.

The foreign investment can take the form of capital, patents and know-how, and plant and machinery (being subject to the general import duties).

IV.3. TERMS OF ACCESSION

The discussions have been followed upon a wide range of issues and policies, such as transportation, regional policy, capital movements, economic and financial policy, rights of establishment, coal and steel, external relations, Euratom, harmonization of laws, taxation, social affairs, agriculture, fisheries, budget contributions and institutions as well as customs union. But, above all, since Spain had a large supply of low-cost labor and this labor power would be free to enter in the Common Market and compete for available jobs (especially threatening France), the labor mobility issue was resolved by postponing the free flow of labor into other Community states for a number of years.

In addition, the farmed area in the EC had expanded upon the Spanish entry by 30 percent, whereas potential consumers had only increased by 14 percent, potentially yielding even more of the surpluses that had plagued the Community. Spain, leaning

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[18] Buckley and Artisien, pg.16.

heavily on agriculture, demanded a rationalization of the CAP that would substitute direct income support payments to poor farmers, because the current support system was actually working for the rich (and northern) farmers.

Some issues were mainly due to specific products. Although the EC was self-sufficient in olive oil production, Spain presented an additional amount which would cause an increase in surplus volume. The addition of Spanish oil was estimated to cost the CAP more than ECU 800 million each year. Spanish fruits (especially citrus) and vegetables were serious candidates to compete with many Italian, Greek and Southern French products. Wine, which did not always elicit a disinterested response from the French in the past, was another significant competitive import.

The size of the Spanish fleet equaled almost 70 percent of the EC total. This caused arguments on issues such as fishing access to EC waters. This, in turn, required a long transition period.

Since Spanish industry, in contrast to agriculture, was relatively non-competitive, it also received a period of seven years transition to restructure the enhanced competition.

IV.4. STRUCTURAL REFORMS

It would not be possible for Spain to directly enter an integration with the EC and have a customs union without having a prior formation change. The achievements were the results of the social consensus which had emerged after 1975, and the successive adjustment programs and structural reforms of 1960s and 1970s.

Main moves can be stated as the elimination of most price and wage controls, the fiscal reforms, the re-structuring of the industrial sector and banking system, the efforts to increase the efficiency of the nationalized productive sector, and the privatization of the most profitable public companies (Appendix I). Spanish economy became able to move towards a market-oriented economy from an administered one by implementing the reforms successfully.

Although Spain had eliminated most of the economic imbalances, threatening the country for the period between 1970-1980, as it integrated into the EC, there were still weaknesses (lack of technological know-how, avoidance of competition, banking and service sector regulations, etc.) in the functioning of the labor, goods, and the financial markets. The public monopolies, including energy, transportation, and communication, and the private cartels did not allow for a just competition due to the regulations.

The gross saving ratio decreased from 28 per cent in 1974, to 21 per cent in 1985, and this appeared as another threatening factor to the sustainable growth. The increase in the budget deficit was not possible to avoid. As expected, the costs were not only in terms of economics but social as well. Since the EC membership required some core standards, Spain was, for sure, in need of re-structuralization in the form of continuous social and economic reforms. Spain would be better able to gain credibility towards its financial policies by joining the ERM (Exchange Rate Mechanism).

As a summary, the commercial protection between EC and Spain would be phased out by following a progressive and reciprocal procedure. The above given transition periods were designed to facilitate the integration and not to make better off one side while worsening off the other. By the trade liberalization act, Spain aimed to increase its economic openness from 18.1 per cent of GDP in 1985 to 22.6 percent of GDP in 1990.[19] This act would also allow for a convergence between the prices of EC and Spanish traded goods sector. On the other hand, in the beginning of the integration process, the trade balance would be negatively effected. However, an important shift in the geographic composition of Spain's trade was recorded in favor of the EC countries.[20]

Spain had the least comparative advantage in industrial goods. Due to the progressive removal of import protection on these goods, the imbalance in Spain's exports to and imports from EC member states deteriorated form a surplus of 6.7 per cent in 1985 to a deficit of 16.4 per cent in 1989 (and later on to 13.6 per cent in 1991). This was also made easier by the elimination of export subsidies after the introduction of the value added tax (VAT) system.[21]

The key ingredients of the stabilization effort were namely "the failure to secure greater price stability and the rapid deterioration of the fiscal accounts" (Pastor, 1993). These

[19] Galy,M., Pastor,G., and Pujol,T., *Spain: Converging with the European Community*, IMF Publications, Washington DC, February 1993.
[20] OECD Economic Survey-Spain, 1988.
[21] OECD Economic Survey-Spain, 1993.

factors, thus, reduced the public's confidence in the Government's commitment to reduce inflation.

The trade liberalization act caused to alter the resource allocation structure in Spain and the countries in question. In the period 1986-1990 the net trade diversion equaled to 1 per cent of total trade. Since the agricultural products were not treated as favorable as the industrial goods, this brought the diversion movement with it.[22]

In addition to the above conditions, "the competitive pressure effect was doubled by the introduction of stabilization or appreciation of peseta on the sectors most exposed to competition". Spain was extremely successful in following up the EC directives when activating the adjustment process. Therefore, Spanish financial market became able to have a voice in the international markets. [23]

Capital liberalization helped financing of the current account deficit and led to a boost in domestic investment. To attract foreign direct investment and sustained flow of long term capital, some motivation factors were designed and introduced. While the motivators for portfolio investors were high interest rates and stabilization of peseta, these were low labor costs, stable political and social environment, and the dynamics of the EC integration process for the direct investors. IMF report on Spain's adjustment process shows that, net foreign direct investments grew at an average annual growth rate of 45 per cent over the period 1985-1990. [24]

The FDIs concentrated on the service sector, especially financial services, right after the accession. Those activities were highly profitable, in addition to their being concealed from competition.

The most visible improvement was achieved in the manufactured goods sector, because in this sector the Spanish producers were directly exposed to European competition. In the agricultural sector, the Spanish prices were adjusted to EC intervention prices imposed by the Common Agricultural Policy (CAP). Therefore, an increase in food prices

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[22] Ibid.

[23] Galy,M., Pastor,G., and Pujol,T., *Spain: Converging with the European Community*, IMF Publications, Washington DC, February 1993.

[24] Ibid.

was not possible to be prevented (Appendix III). Higher price increases were observed in the non-traded goods sector due to the market structures and lower productivity.

To reduce market rigidities, Spain accelerated the implementation of structural reforms. The Spanish Government introduced various development programs after the accession to the EC in order to improve the competitiveness of the Spanish industry which had to encounter customs union, to reduce Spain's dependence on the imported energy and to favor a more balanced regional development. On the other hand, all these programs were not merely supported by the Government, but also the EC financing.

Galy entitles the reasons for the structural reforms as the means:

- to improve the allocation of resources,
- to facilitate market mechanisms, and
- to eliminate or restrict the monopoly power of the private sector.

Even though the weight of the public companies in the Spanish economy was well beyond the European standards, the 1981-1984 rationalization program was combined with the privatization act aiming to reduce this ratio. The measures implemented to ease rigidities in labor market were part of an effort to support the financial stabilization program by much needed structural reforms. An Industrial Reconversion Program[25] was designated to restructure most affected sectors of Spanish Industry, including steel, shipbuilding and textiles. The program provided budgetary support to a process of retrenchment involving substantial employment reductions, compensation and retraining for those affected, and an investment program intended to accelerate the modernization of key industrial sectors.

Heavy investment in energy-intensive sectors (i.e. steel, chemicals, and shipbuilding), together with an unavoidable dependence on imported energy, had left the country vulnerable to external shocks, as in case of oil crisis. As well as the structural reforms,

[25]The IMF report explains the program as an "attempt to lessen the social costs associated with the process of retrenchment through a number of complementary measures aimed at facilitating the return to the labor force of those workers who lost their jobs. Fiscal and financial incentives were set up for firms willing to settle in those geographic areas most affected by the reconversion. Workers over 55 were given the option of taking early retirement while others received severance payments and unemployment compensation for up to 18 months. Workers were also given the option of surrendering their severance payment to the Employment Promotion Fund, whose revenues would be used to supplement unemployment benefits, and through retraining, to assist the workers in seeking new employment opportunities, offering subsidies to firms willing to hire them on a permanent basis."

and the trade and capital liberalization moves, Spain gave special importance to the energy planning. Since the Government decided to reduce the imported energy dependence of the country, the plan, briefly, aimed to reduce the energy consumption, and was renewed in 1991. Energy policy emphasized the need to increase the share of domestic sources in total energy consumption, and in conjunction with demand and supply oriented policies implemented as part of the National Energy Plan. The share of natural gas and renewable resources in the final demand of energy was forecasted to exceed 9 per cent in the energy balance. The domestically produced coal would remain the main source of energy. As for the oil, the prices would follow the same trend with the international market. Special consideration would be given to the environmental factors.

EC has developed structural funds to aid regional development programs in the member states, and Spain appears as one of the most benefiting countries from these grants. Although the funds are designed to reduce the imbalances in Spain, their effectiveness is questionable. The structural funds, Spain benefited from, are namely European Social Fund (ESF), European Fund for Regional Development (ERDF), and Fund for Agricultural Development (EAGGF). The net transfers to Spain, in 1990, represented 0.3 per cent of the GDP.

Financial Liberalization

Operating under tight and protectionist regulations, the Spanish financial system needed to move towards a liberalization. Pastor states in his studies that, 'The banking activities were highly protected against competition, and far from being innovative. The sector was dominated by the large banks, who also have big stakes in the industry.' In order to achieve the requirements stated in the EC directives, the authorities implemented a set of actions.

The most visible move was in the form of deregulation of the banking system. In order to facilitate competition, throughout the period 1969-1987 the interest rates were liberalized. Institutional segmentation was revised to overcome the operational problems it brought forth.

The Spanish banking system would be regulated under the principles set in the Second Banking Directive. For the foreign banks, it is stated that,

> ...any bank authorized by its home member state will be able to provide a wide array of banking services in any EC country. This is the so-called single banking license provision....permits host countries to enforce their own rules on liquidity, business conduct, and investor protection rules.

In Spain, it would not be possible to have more than four branches for the foreign banks till 1990. This number was extended in the following years by one or two. Being subject to the capital adequacy, limits to branching have been liberalized outside their geographical region of operation since 1989.

For the domestic investors, creation of new banks was due to the approval of the Ministry of Economy and Finance. During the severe banking crisis, the investors who are willing to enter banking sector were forced to buy and rename an existing bank which was small or almost in bankrupt.

Effects of Financial Liberalization

Although it is not very cost efficient, the Spanish banking system proved to be sound from the point of view of solvency and financial margin. The cost perspective, on the other hand, brought the most dense branch network in Europe. Pastor[26], in his study, states that *either Spain was over-banked in relation to other European countries or financial services are overpriced because of inefficiencies or non-competitive pricing or both.*

The increasing number of small and medium-sized banks led to a decrease in bank concentration through 1987. Being far away from innovative operations, the Spanish banks were introduced new financial services and new technology when implementing their activities by the foreign banks. Those competitors allowed for the interbank market and initiated merchant banking.[27]

The financing mechanisms of the economy were deepened by the financial liberalization. The market structures changed. Capital allocation procedures, concentration ratios, and bank mergers were all directly affected. Banking industry had to face competition which, in turn, brought the need of innovation of activities.

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[26]Galy,M., Pastor,G., and Pujol,T., *Spain: Converging with the European Community,* IMF Publications, Washington DC, February 1993.
[27]Ibid.

The Spanish financial markets were not that sophisticated to stand against the free capital inflows. The stock exchange was segmented, and suffered lack of depth. Therefore, until the country's accession to the EC in 1986, these inflows were under the tight control determined by the provision of the Act of Foreign Investment (1974). Since the policy conflicts even arose after the entry to the ERM, some capital controls were introduced.

Capital controls served to different set of purposes all aiming to reduce capital mobility. The non-residents were not allowed (or limited) to speculate against the peseta. Their access to the Spanish capital markets were restricted.

Another set of capital control measures aimed to dampen short-term capital outflows. Unless the balances were of the international trade or denominated in ECU, the residents were prohibited to hold deposits in foreign currencies.[28]

In addition, the Spanish stock exchange was monitored and foreign asset issuance was regulated. While manipulating resident foreign borrowing, transitory measures were designed to prevent the unjustified appreciation of peseta.

Personal Income Tax Reform

Although not right after the accession, Spain felt the need to simplify the tax system. This reform was activated starting from 1991, and served the purposes of 'reducing the number of taxes, rates, and special regimes, as well as minimizing distortions in resource allocations' (Pastor, 1993). What was targeted was 'a more unified tax treatment of investments in financial and real assets' and 'a more lenient treatment of capital income earned by non-residents'. Besides, it provided incentives for the small investor.

The income tax reform took different forms for residents and non-residents (from EC or third countries). For non-residents from EC countries, it eliminated the payment of withholding taxes on interest income and taxes on capital gains resulting from the purchase and sale of financial assets issued in Spain. Meanwhile, for non-residents from third countries, exemptions would be due to bilateral agreements.

[28]Country Studies, Spain, Commission of the European Communities Directorate, Number 7, March 92.

IV.5. SPAIN AND CUSTOMS UNION

With Spain, as formerly with Greece, the first area to be mostly dealt with, in the entry negotiations, was the customs union. This concept was a product of the Community, therefore they would have no, or relatively less difficulties, in establishing a union in a short time for all products. The Commission determined the transition period to be between 5 to 10 years. On the other hand, Spain, insisting on the longer option, wanted a single transition period both for the industry and the agriculture. This was mainly due to a compensation of the strengths and weaknesses of both sides.

Spain had exploited the Trade Agreement of 1970 which allowed it to maintain high protective barriers on imports and to export successfully to the Community. The reason why the customs union was intended to be activated as soon as possible was that, Community was in a superior industrial position than Spain, they had large investments in the Iberia (e.g. cars), and South European markets were seen relatively buoyant for the kind of goods which had been the staple of European industries during the long boom.

Spain was highly competitive in traditional industries, such as textiles, leather goods, steel and ships. The Confederation of British Industries suggested that safeguards (allowed in Article 226 of the Treaty of Rome for the transition period) be built into the accession treaties with the new entrants as regards to some sectors.

Under the above considerations, the new members, by asking to join the Community, had to face open market competition, and dismantle their non-tariff barriers. In addition, even though they had the right to prolong the transition periods, (e.g. in steel) such a decision should be approved by the Community.

Spain and Greece were at an important stage in their industrial growth when they need to move from reliance on the traditional industries, such as textiles, to more advanced ones influenced by product innovation and specialization. Spain, which was in many ways comparable to Italy with a time lag of a few years, was well advanced in this direction, but was still relatively weak in the capital goods and the high technology. For Portugal, the distance to be covered, was too long without substantial aid and time.

V. PORTUGAL: ADJUSTMENT PROCESS

Portugal has always been the land on the edge, caught between traditional ways of living -fishing and farming- and the technology and integration. It lays on 34,332 square miles (88,944 km^2) with a population of under 10 million.

When compared to Spain, the Portuguese accession to EC was not that debatable. Community did not have great expectations towards Portugal, except in textiles and wine, because Portugal was the poorest in Western Europe. However, it had a great interest (along with Spain, Greece, Ireland, Italy, and Britain) in expanding social and regional funding. In addition, labor was also possible to be attracted by the higher wages in other EC states.

V.1. MACROECONOMIC BACKGROUND

According to the OECD figures, the unemployment rate in Portugal has reached to 9.8 per cent of the total labor force, which equaled 448,700 people by the end of 1983.[29] This was also worsened by the return of migrant workers and the arrival of residents from former colonies. The country has ranked one of the poorest in Europe with respect to per capita income, and with a gross domestic product of US $2,398.

In the pre-accession period, the sectoral breakdown of the labor force shows that most of the work-force was distributed to manufacturing and agriculture. On the other hand, the agricultural sector, although employing approximately 23 per cent of working population, only accounted for 6 per cent of the GDP. The low productivity in the farming industry was an important concern when arranging the terms of accession to the EC, in order to fall in line with the Community agricultural policy and implementations.

The manufacturing sector accounted for 85 per cent of Portugal's exports. The activities were mainly labor-intensive, and relied on mainly low technology production under traditional specialization in low cost. Because of the above reasons. the products were unsophisticated, when compared to EC's, such as textiles. leather goods, and woodwork. The industry needed a serious improvement to secure a share from the foreign markets,

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[29] Data in this section are provided from OECD Economic Surveys on Portugal for the years 1986-1990.

since the input obtained from the migrant workers had declined, and also to overcome the foreign debt.

The sectors owned by or under the control of the state, namely steel, petrochemical, brewing, cement and engineering industries, have started to stagnate because of some external as well as internal factors. The interest rates on borrowing abroad have risen and Escuedo has depreciated. While keeping the wage increases below inflation, the Government decided to reorganize these 'nationalized' industries. It was made easier for the companies to lay off the surplus labor by new legislation. In addition to these, the firms which acquire and get use of modern technology were better, and under easy terms, able to reach capital.

Almost 25 per cent of the total exports were of the textiles products. However, the firms operating in this sector, being large in number, were all small employing less than 50 workers. This has allowed the country to work with lower labor costs than the EC member states. Therefore, Portugal had to accept some severe terms with regards to integration of her textiles into the EC.

By the years 1984-1986, the EC countries made up over 65 per cent of Portugal's exports and over 55 per cent of its imports. The depreciation of the Escuedo in 1983 resulted in an increasing share of export markets, particularly to the EC. The strength of the country's foreign trade lied in textiles, clothing, leather goods, footwear and the wood industry. On the other hand, it was very dependent on exports of primary products, which made her vulnerable to sudden changes in those products' terms of trade. Starting from the 1980s, new industries, such as electrical and electronic equipment, transport equipment, and petrochemicals, were introduced and developed. These had a positive effect on the export performance.

Especially in the energy sector, Portugal had a high import bill, which was dominated by the mineral products (e.g. crude oil), because the country had exploited few of its natural resources.

Portugal designed a trade policy to prepare the economy for EC accession. While gradually removing the import barriers, it was allowed to maintain tariffs on some EC imports until 1993. Some exports to the other member states were under reduced tariffs and increased quotas.

V.2. LEGISLATIVE BACKGROUND TO FOREIGN DIRECT INVESTMENT

In order to co-ordinate, supervise, and authorize foreign direct investment, the Portuguese Government established the Foreign Investment Institute, following the 1974 revolution. The rules governing foreign investment were set out in the Foreign Investment Code, enacted by Decree-Law 348/77 of 24 August 1977, and amended by Decree-Law 174/82 of 12 May 1982. The Code was revised in 1986.

Buckley and Artisien (1987) state that, the 1977 law had outlined the Government's concern for greater diversification of investment sources and more selective sectoral distribution.

> Under the 'general regime', foreign firms are entitled to all the incentives available within Portuguese legislation without any discrimination regarding the origin of the foreign capital. direct foreign investment, which is subject to the "contractual regime", benefits from additional incentives (of a fiscal or other nature), reflecting the host country's three-pronged economic policy: to promote its export oriented industries, to reduce its dependence on imports and to attract foreign capital to its cheap supplies of domestic labor. The list of 'priority' industries includes mining, fishing, processing of organic and inorganic chemicals, pharmaceuticals, food processing, textile and apparel manufacturing, cork and leather products, furniture, and refining of non-ferrous metals.
>
> Three major objectives underlie Portugal's order of priority industries earmarked for foreign investment. First, to encourage foreign investment in heavy industry which draws on domestic supplies of raw materials (in particular iron ore, copper, lead, zinc); secondly, to develop the international competitiveness of traditional industries such as textiles. Although Portugal's exports of textiles to the EC are subject to quotas, the unsuitability of some products for European markets means that the value of exports often fall short of the permitted quota. A third objective is to attract foreign investment in industries where Portugal already has a technological or other comparative advantage (i.e. light electrical equipment, electronics, and telecommunication equipment).[30]

The Portuguese Government introduced the system of integrated investment incentives, in May 1980, to promote the foreign investment. The scheme did not discriminate

[30] Buckley and Artisien, pg.13.

between Portuguese and foreign capital, and was based on a point system derived from economic performance, sectoral priority(such as basic chemicals, minerals, or food processing), and regional priority criteria (i.e. high points for an investment bringing in capital in priority sectors, and located in a less developed region). This system consisted of a variety of fiscal and financial incentives as in the form of tax holidays, interest rate subsidies and grants. The foreign investors would be able to exempt from (or a 50 per cent reduction on) conveyance tax on property purchase, manufacturing and complementary taxes for up to nine years, value added tax on gains from capital increases, capital gains tax on loan interest, in addition to the speedy write-offs (up to 12 years) of property assets.

Some sectors including insurance, public services, and armament were considered to be closer to private capital. Therefore, Portugal did not allow foreign direct investment in these areas.

> The State guarantees the transfer abroad of dividends and profits after deductions have been made for legal amortization and taxes. No restrictions exist on the transfer abroad of the proceeds arising from the sale or liquidation of a foreign investment, unless there is a significant deterioration in the host country's balance of payments..... a further guarantee that the sum transferred per year shall not be less than 20 per cent of the total value. (Financial Times, March 18, 1986)[31]

Foreign Direct Investment in Portugal followed an increasing trend prior to the accession to and customs union with the EC. This was mainly observed in the service industries (although manufacturing sector included chemicals, metal manufacture and machinery, basic metals, paper and printing, and other manufactures).

V.3. TERMS OF ACCESSION

Portugal's first application was realized in 1977. This was not a successful start since the policy implementation and the laws in regulation were not consistent with the integration trend. As the democratic renewal in 1980 took place, Portugal became a better candidate for the EC.

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[31] Ibid, pg.14.

Although the Accession Agreement between Portugal and the EC, that was signed on 12th June 1985, was expected to have major medium- and long-term implications for the Portuguese economy, starting from 1986 these effects became visible in some specific areas (Appendix II). The Agreement has provided for two types of transitional arrangement for the agricultural issue. Due to the conventional arrangement, a seven year transitional period at the end of which the prices of the products in question (e.g. tobacco and sugar) should be fully aligned on those applying in the EC. However, the majority of the agricultural products, that were significant for Portugal (e.g. grain, rice, milk, fruit and vegetables, wine, most meats) were subject to transitional arrangements comprising two five-year periods. Portugal began to introduce a package of measures designed to bring prices and subsidies into line with those of EC during the first five years. On the other hand the harmonization process to be applied in the second period was mandatory and should be completed by the end of 1996. In the following seven or ten years, customs duties and quotas would also be phased out.

The arrangement consists of a seven-year transition period for the Portuguese industry. Since customs duties were lower by then on most industrial goods, an important effect of membership appeared as in the form of the removal of the quantity restraints on trade. It was also agreed that, trade barriers between Portugal and Spain would be progressively lowered with a five-year transition period for certain sensitive goods such as textiles, starting from 1st January 1986.

In order to minimize the risk factor, in some areas, the Portuguese authorities have needed to monitor developments very closely and to ensure that the financial resources they receive were used efficiently. In the short term, Portugal seemed to have greater opportunities for exports of certain industrial goods, such as textiles, which were formerly subject to strict quotas. In addition its exports of light industrial products to Spain were expected to increase. Another promising aspect for Portugal was a probable significant rise in the foreign direct investment in Portugal because of the low labor costs.

The most obvious risks were on Portugal's ability to make full use of the resources received from the EC because of the poor state of its public finances. The bulk of Community aid necessitated substantial counterpart funds, and Portugal hesitated about reaching the resources, which represented additional expenditure, given the low level of public investment (OECD Country Surveys, 1986). From the beginning of the second five-year period, a price shock, affecting certain agricultural goods, the scale depending on comparative price trends in the EC and the rest of the world, was expected. Unemployment was also considered to be open to a rise if labour shedding in agriculture was not matched by increased numbers of jobs in industry and the services. One of the major unknown factors in Portugal's membership was the capacity of Portuguese agriculture to adjust stiffer competition and improve yields significantly. On the other hand, this avenue seemed to be an opportunity towards successful EC entry rather than a threat.

For the first six years following entry, Portugal was refunded a gradually diminishing share of her contribution, although transfer to the Community of customs receipts was based on national production, when analysis is from the balance of payments and budget perspectives. The respective values were 87, 70, 55, 40, 25, and 5 per cent from 1986 to 1991 (OECD Survey, 1992).

In 1991, at the end of the first transition period, with respect to the Accession Agreement articles, Portugal may be required to pay monetary compensatory amounts if the prices of her products are not fully harmonized with her European partners. Portugal received project-linked credits. The transfer sources were whether European Social Fund, ERDF, or EAGGF.

The free movement of Portuguese workers to EC countries, except for Luxembourg, was made possible after a seven-year transitional period. As for Luxembourg, this period was lengthened to ten years. After transitional periods of five to seven years, Portugal would start to apply the rules concerning capital movements that were already applicable in EC member states. Meanwhile, foreign direct investment in Portugal would gradually be liberalized over a period of four years.

Following the accession to the EC, and overcoming a long period of economic difficulty, the country achieved an improvement in economic terms. However, it will be misleading to connect all this achievement to integration. Some part of the economic performance was attributable to the improving world context, and, in addition, the recession faced in 1983-1984 was followed by a natural recovery period.

In general terms, 'output growth picked up markedly to 4½ per cent on average from 1986 to 1990, as against 3 per cent in the preceding decade, the unemployment rate was cut in half by 1990, and the rate of inflation, which had exceeded 20 per cent was brought down to an average of less than 12 per cent' (OECD Country Studies, 1992).

Portugal was aware of the need of solving its structural problems in order to improve the long-run macroeconomic performance. Therefore the adjustment progress has been accomplished in the structure of production and in improving the functioning of markets.

V.4: EC STRUCTURAL FUNDS

Being integrated to the EC, Portugal acquired rights to get use of the EC structural funds. Financial inflows from structural funds represented over 1 per cent of GDP in 1986-1987 period. The funds were aimed to help satisfy the real economic convergence. Some of them were in the form of infrastructural investments for overcoming Portugal's major problems in transportation, communications, technology, and health care. By improving education and increasing occupational training, human capital formation would be stimulated. In addition, a special ECU 700 million fund was set up to assist the adjustment of the agricultural sector. EC incentive programs were designed to accelerate private physical capital formation.[32] Meanwhile, as an indirect approach to improve product quality, business was made able to get assistance in form of management consulting.

However, as it was for Spain, it is open to question whether these funds were efficiently spent or not, since their incremental effects can not be traced that easily and independent of the other factors.

V.5. STRUCTURAL REFORMS

In order to facilitate and smooth the integration process into the EC, Portugal needed to follow a number of structural reforms. These were aimed to ease the adjustment steps by improving the functioning of the markets.

[32] EC incentive programs covered 20-40 per cent of the costs of eligible innovation and modernization expenditures and 50-70 per cent of R&D.

Privatization

Market mechanisms in Portugal were suffering from the lack of reliance. In order to conquer this problem, the Portuguese authorities decided to reduce the role of the Government in the productive sector. As a second step, the finances of the public corporations would be consolidated. These corporations, although not operated and managed efficiently, were accounting for a large share of output. When compared with their European counterparts, most of the public firms were unproductive and excessively capital intensive. These proved to be the quicksands of Government subsidies.

Starting from 1988, a series of acts and decrees have been established. They allowed to:

- reduce the burden of State intervention in the economy,
- stimulate the development of capital market by broadening household equity ownership,
- cut public indebtedness, and
- improve efficiency.

At the same time, by the introduction of 1988 land reform, collective farms were allowed to be privatized. The privatization act, as a whole, improved the financial situation of the public firms.

Taxation Reform

Tax reform was carried out through several stages. By the implementation of VAT system, an improvement in additional tax revenues was recorded as in the form of 2 percentage points of GDP.[33] However, Portugal has not completed the required harmonization process of indirect taxation under the EC directives, yet. The 1989 direct taxation reform allowed for broadening the base, lowering effective marginal rates and diminishing opportunities for avoidance and evasion. Tax incentives to investment were based on primarily regional incentives.

Labor Market Reform

Labor market reform was designed to improve unemployment coverage and generosity, to facilitate lay-offs, and to restrict the agreements with short-term contracts. By 1995, work week was decided to be reduced from 44 to 40 hours. Since there was an unusually high degree of wage flexibility by international standards, lack of employment flexibility

[33] OECD Economic Outlook, 1990.

was not too costly for the country. On the other hand, the wage flexibility helped keep real wage increases below gains in labor productivity.

Capital Market

As for the financial liberalization moves, many regulatory changes were introduced. As explained for Spanish case, the interest rates were liberalized. No matter their type or ownership structure, the competition between different financial intermediaries was phased out. Capital controls were designed to monitor the capital outflows, as well as inflows, and finally monetary control was modified in order to end the access to credit ceilings.

Product Market Adjustment

Prior to the accession period, in the early 1980s, compared to its European partners, Portugal's production and employment structure was characterized by a rather high share in agriculture and other primary products and low shares in energy and services. As a result of the inefficient resource utilization, 20 per cent of the employed population were generating less than 10 per cent of the net output. A widening gap among the productivities of agriculture and other sectors was observed. Hudson (1985), in his research stated that the suffering of productivity was due to the *poor education of farm population, inadequate infrastructure in many parts of the country, an inefficient distribution system, and the sub-optimal size of most farms.*

The agricultural activities were supported by the EC through the PEDAP program. Investment per cent of value added in this sector increased from 12.5 in 1980 to 17.4 in 1989. A drastic labor shake-out seemed to come closer because of the downward price adjustment toward EC levels. However, this was solved by the imminent retirement of many farmers, 40 per cent of whom were over 55.

The industrial sector was, and is, relatively large, and had a more modernized stock of capital. The industrial structure proved to be in a dualistic form, with large, capital-intensive businesses, side by side with small-scale, labor intensive production.

In addition to the imbalances described above, Portugal faced another weakness as in the form of technological dependence. Although the overall ratio of R&D expenditure to GDP has risen from 0.34 per cent in 1980 to 0.53 in 1989, the firms' demand for R&D

remained insufficient. They continued to rely on technological improvements included in imports of machinery and technology licensing from foreign sources.

The textiles sub-sector, which was almost the heart of industrial exports, had to encounter an increasing competition from developing countries with or without a continuation of Multi-Fiber Arrangement. The marketing channels were not properly utilized, and the industry lacked investment. Therefore, studies on product quality improvement and product differentiation were conducted.

The fishing sector also benefited from the EC subsidies in order to rationalize and to enlarge average boat size.

Factor Market Adjustment

International adjustment for the factor market occurred through the export of labor rather than the import of capital. 4.3 million Portuguese citizens are forecasted to live abroad of which some 1 million are legally resident in other EC countries. However, Straubhaar (1988) considered the aggregate (migratory) flows as unimportant, with Portugal's labor market at full employment and in view of the social, cultural, and linguistic barriers. On the other hand, the wage and salary gap between Portugal and other EC member states most probably would result with a costly emigration of its qualified residents.

As in Spain, there happened to be an increase in the autonomous capital inflows of both short and long-term nature. Since foreign direct investment inflows are a vital channel to achieve real economic convergence as well as to effect industrial restructuring, Portugal made good use of its labor cost advantage which attracted the foreign investors who were seeking to set up a local export platform or to share in the extremely high returns available on the domestic market. Within manufacturing, the most significant growth was achieved in the traditional exporting sectors (textiles, clothing) and in resource-based industries.

Following the accession, Portugal, like Spain succeeded in reducing its real income differential with the EC average. Unemployment declined and participation increased in response to the pick-up in productivity outcomes. Nevertheless, this was not the case for Spain. Although its real convergence was as fast as in Portugal, the joblessness problem proved to be rather considerable. Favorable demographics and rising participation played a secondary role in the Spanish case.

In addition, for Portugal, the human capital was enhanced by increasing the school-leaving age by three years in 1986 and by rapid increases in training expenditures under the Community Support Framework. Physical capital intensity was upgraded by capital inflows, especially in the form of direct investment. Furthermore, EC structural funds became important channels for augmenting the capital intensity of production.

Due to the massive inflows of private capital and EC transfers, the economy was put in an overheated state. Although the inflationary impact could have been offset by demand reducing stabilization policies, such contractionary efforts remained to be unsuccessful.

V.6. PORTUGAL AND CUSTOMS UNION

By the accession to the EC, Portugal had to face a significant change in its structural barriers to trade. Since high-cost domestic supply would be displaced by lower-cost production from the EC, trade-creation effects were to be expected. Meanwhile, this effect would be offset by welfare reducing trade-diversion when lowest-cost third country producers were eliminated by competing EC exporters, or even domestic producers facing higher domestic protection. The new settings forced the authorities to reduce organizational slack, which in turn provided increased competition and improved competitiveness. Available scale economies were exploited as a result of the market integration.

Following the accession, Portugal experienced a sharp increase in the share of trade with its EC partners.[34] This was more visible on the import side. Another trade impact of the customs union, was the concentration of trade among fewer partners.

Both for Spain and Portugal, the exports and imports became less diversified after the customs union. Overall product composition of merchandise trade changed, especially from the import side, due to the reduction in purchases of foreign raw materials and semi-manufactures. As of the exports, the agricultural products, energy, and textiles started to lose their importance. The growth was on the crude materials side and some certain

[34] By the year 1989, Portugal ranked fourth among the twelve on this measure. Noteworthy was the shrinkage in the US share of the Portugal's agricultural imports, which began prior to accession for supply reasons.

categories of manufactures, including clothing. However, the shift to resource intensive industries at the expense of those of labor intensive, was not so significant. Portuguese industry remained to be weak at utilizing economies of scale, R&D activities, and human capital inputs.

The tariff reductions allowed for an increase in the share of intra-industry trade, which signaled trade creation. Nevertheless, the increase was more rapid for Spain.

VI. TURKEY-EC RELATIONS

Turkey has, in fact, reacted early (1960) to take place in the union that was based to the Treaty of Rome (1957). For that time being, most of the current member states were not interested in such an integration, and also there were contra-arguments to it, as in case of UK's entry. After coming to terms, in 1963, the Ankara Agreement was signed. Although not in-written, the final goal for Turkey was defined to be full membership, and customs union would just be a milestone in achieving this mission. The Additional Protocol, signed in 1970, explained the schedules and procedures of the contracts stated in Ankara Agreement. This proves that Customs Union is not a new concept for Turkey. It is just the end application of Additional Protocol.

Turkey and the European Community were committed by the Additional Protocol of 1973, to complete the customs union within 22 years, that is, by 1995. Customs union, being conditioned to the membership or postponement is defended by the private sector, therefore will be started on 1 January 1995. The remarkable issues requiring workshop will be namely economic, industrial, monetary, environmental, cultural, scientific and statistical. It is stated by the Minister of Foreign Affairs that Turkey will not be demanding money from European Community. In addition to the economic questions in mind, EC, also, claims Turkey of not being sensitive on human rights and the rights of the minorities. Commission Chairman Jacques Delors stated, in November 1993, that "There are no priorities among the countries nominated to become members of the European Union. Turkey will certainly become a member one day. But actually it falls on your part to show efforts on this issue." These words seem to be a good indicator of the uncertainty in the EC accession of Turkey.

EC, for the first time, is making a customs union agreement with a country that it does not embrace. Therefore, Customs Union is believed to bring some problems to both parties. One of the primary problems is the loss of government incomes obtained from customs tax and funds. The loss on the Turkish part is considered to reach more than 3 billion dollars, since the three financial protocols (since 1980) have been blocked. On the other hand EC has some concerns about the Mass Housing Fund application in Turkey. Being an import tax whose proceeds are earmarked for a low cost housing program, this fund is claimed to be incompatible with the Additional Protocol and impossible to fit into the context of a customs union. In addition, free imports are estimated to bring a burden of at least 2 billion dollars to the Turkish Government. Private sector will experience a change in the competitive structure of the industries they are acting in, and inevitably automotive, durable goods, and electronics and electrical supplies industries will face a major disturbance. Although the agreement terms are to minimize the loss of both parties, due to the above considerations, EC is obliged to provide financial support to recover this loss.

After mid-70s, the relations between EC and Turkey started to get worse off. Of the many reasons, Cyprus Operation, following it, the unsatisfied customs duty reductions due to the Protocol, and the military act in 12 September 1980, were the most visible ones. On the other hand, Turkey achieved a considerable economic performance after the 1980s.

VII. COMPARATIVE ANALYSIS

VII.1. Demographics

Since the customs union is not only an economic phenomena, but also another means to the integration, the analysis has to deal with other measures, as well. Demographics are of the major decision criteria, because they play the key roles, especially when an integration is considered.

When the accession of Spain and Portugal has been realized, although Portugal has not accompanied significant growth terms with it, the contribution of Spain has increased both the area and the population by a considerable amount (Table 1). The area was enlarged by 30.4% while the respective value for population was 12%. In addition, the enlargement played a positive role in the rejuvenation of the Community average due to the larger young population segment in these Iberian countries.

Table 1

1986	Area ('000 km²)	Population ('000)	Pop.Growth Rate (%)	Population below 15	15-64	above 64
EC (Ten)	1656.4	322796	0.3	19.9	66.2	13.9
Spain	504.8	38688	0.7	24.4	63.9	11.7
Portugal	92.1	10230	0.6	25.6	63.0	11.4
1993						
Turkey	774.8	58960	2.2	37.5	58.1	4.4
EC (Twelve)	2252.1	345000	0.4			

Source: Turkey State Institute of Statistics, Provincial and Regional Statistics, and OECD Country Studies, 1985-1990.

In case, Turkey becomes a part of the union, its contribution to population and land will be much higher than that of Spain's or Portugal's (34.6% increase in area and 17% increase in area).[35] When considered the population growth rates, the impact seems to accumulate through years, which does not sound to be an advantage. Since the rate for Turkey is remarkably higher than the EC average, this is expected to bring unemployment problem with it. The free circulation of Turkish workers has, therefore, continuously been avoided by the member states, such as France and Germany.

VII.2. Unemployment

When the second enlargement act was initiated, due to the Community's need to additional and low-cost labor force, the unemployment rates in Portugal and Spain have not appeared as important criteria for the decision making. Portugal, as a result of its huge number of workers residing abroad, seemed not to have a visible touch on the EC average, but Spain, with its high unemployment rate, became a matter of debate. Spain's integration into the EC has pulled the unemployment rate from 7.6% up to 8.2% (Eurostat 1987). On the other hand, today, the issue is rather concerning. The unemployment rates

[35] Calculated using the data in Table 2.

for Spain and Ireland are 19.3% each (OECD Economic Outlook, 1993). The Community average, being announced by the EC News as 9.9% for 1993, has been estimated to reach to 12% by the end of 1994. The contribution of Turkey to this value will, unfortunately, be severer, pulling it up to 13%. Turkey's negative impact on the EC unemployment level has been forecasted to be much higher than Spain's, which became a real problem for the Community.

VII.3. Composition by Sectors

The segmentation of active population is another deterministic measure to facilitate the adjustment processes. When the employment structures for Spain and Portugal have been analyzed with respect to their compositions, both countries have proved to give less importance to the agriculture and rather concentrate on Industry and Services (Table 2).

Table 2
Composition by Sectors in Spain and Portugal (1985)

1985	Agriculture	Industry (in %)	Services
Spain	18.0	32.7	49.3
Portugal	23.8	34.0	42.2

As stated in the previous parts of the study, the Community was already suffering from the agricultural surpluses, which further accumulated by the enlargement decision. Turkey, which acted as an agricultural country in the mid 1980s, seems to transform into a service-oriented one by the 1990s (Table 3).

Table 3
Composition by Sectors in Turkey in per centages (1990-1993)

	1990	1991	1992	1993
Agriculture	18.9	16.2	15.4	4.2
Industry	22.7	23.1	22.8	26.1
Services	58.4	60.7	61.8	69.7

The diminishing share of the agriculture has been explained by the State Institute of Statistics as the agriculture's losing importance and the urbanization. However, the share of the active population employed in the agricultural sectors over 40%, while the industry has only accommodated 18% of this labor force. Whatever the case is, the emphasis should be given to the sectors, either industrial or services, where Turkey has competitive power and comparative superiorities.

VII.4. GDP per Capita

As for the GDP per capita, in 1986, the figures for EC (12), Spain, and Portugal were $10.732, $5.945, and $2.984 respectively. The concerning issue was the integration of Portugal, which has had a GDP well beyond the EC average (almost one third). In 1993, while the GNP per capita for Turkey has still flown around $2.600, the large differential in between proves to be a disadvantage from the point of view of indicating the low level of the welfare.

VII.5. Growth Rates

Despite the GNP gap, Turkey has had a higher growth rate than Spain and Portugal for the last 20 years, ignoring exceptions (Table 4). If the general trend continues, the cumulative effect of growth rates will help to overcome above gap, in case a stable economic environment has been satisfied. Having a rate of growth of 4.5% in 1993, Turkey, also, experiences an increase in its exports.

Table 4

International Comparison of Recent Economic Growth Rates

(% annual average real growth)

	1978-83	1983-87
Turkey	4.6	6.4
Spain	2.0	3.0
Portugal	3.2	2.2
EC Average	2.2	2.4

Calculated by using the data obtained from Direction of Trade Statistics, 1993, and OECD Economic Studies-Turkey, 1990.

VII.6. Inflation Rates

The most fragile point in the decision making criteria appears to be the consumer and producer price indices. Turkey is extremely unsuccessful when compared the country's inflation rate with that of the Community average. Since the EC is still conscious about the high (relative to EC average) inflation rates of its last three members, the drastic picture of Turkey does not attract and facilitate the integration. In 1985, the Consumer Price Indices (CPI) for Spain, Portugal, and Turkey were 8.8, 11.7, and 34.6 per centages respectively (OECD Economic Outlook, 1988). Even then, Turkey has not seemed to be a perfect candidate to the Community. The country, in 1993, has a CPI of 69.2% (SIS Monthly Review, Dec.93). Considering that the Community average for inflation rate is 3.5% (Eurostat, 1993), Turkey's high CPI emerges as a negative pressure on the relations with the EC.

VII.7. Balance of Payment Accounts

Within the 1985-1987 period, although the foreign trade balances of Spain and Portugal have fluctuated (Table 5), almost doubling from 1986 to 1987, the large foreign trade deficit have not pulled the current account down to deficits. The increase in current account in year 1986 was explained by the positive impact of Spain's membership to the Community (Özkale, 1990) . In addition, the decrease in the following year, in the balance of foreign trade and balance of current account was supported by the considerable increase in the balance of capital movements, which indicated the results of the attractiveness of Spain to the investments.

Table 5

	SPAIN			PORTUGAL			TURKEY			
	1985	1986	1987	1985	1986	1987	1990	1991	1992	1993
(million $)										
Foreign Trade Balance	-6438	-5814	-12783	-1627	-1715	-3662	-9554	-7326	-8191	-3792
Current Account Balance	1687	5225	1660	380	1170	704	-2611	272	-943	-1877
Capital Account (except reserves)	-1908	-1842	11325	688	-1428	1394	-2397	3648	2961	3966

As for Portugal, the fluctuations have almost followed the same pattern. The decrease in the balance of foreign trade was accompanied by the decrease in the current account balance. But, when considered the capital account, as it was for Spain, the item has signaled a surplus of $1394 million in 1987. The relative figures for Turkey verifies that the country has not overcome its problems yet. The increasing deficit in the current account doubled with the negative foreign trade balance has left the country more vulnerable to the negative impacts of the customs union, than Spain and Portugal of 1986.

Turkey has, almost every period, suffered from the foreign balance of payments problem. This appeared as a disadvantage to its final goal, being an EC member state.

VII.7. Comparative Foreign Trade

As for the comparative analysis of the foreign trade, total export and import volumes of the analyzed countries for the 1985-1987 period have been given in Table 6. Ranking the first with its exports for the stated duration, Spain has also experienced a considerable increase in its imports account. Nevertheless, the tourism and worker revenues led to a surplus in the current account balance in 1987.

Table 6

	Total Exports			Total Imports		
	1985	1986	1987	1985	1986	1987
(million $)						
Spain	24247	27206	34192	29963	35057	49113
Portugal	5685.1	7242	9320.4	7652.4	9650	13966.6
Turkey	7958	7999	10164	11035	11027	13269

Source: Direction of Trade Statistics Yearbook, 1991.

Since the extremely different land sizes of Portugal and Turkey make it unmeaningful to compare the trade volumes, a comparison of exports to imports ratios will be more sound (Table 7). Both Spain and Portugal faced a decrease in their export to import ratio in 1987. This can be explained by the elimination of import barriers and, in turn, increase in imports and domestic consumption.

Table 7

Total Exports / Total Imports

	1985	1986	1987
Spain	80.9	77.6	69.6
Portugal	74.3	75.0	68.3
Turkey	72.1	72.5	74.6

Source: Calculated using Table 6

On the other hand, a more significant indicator of the trade relations is the exports and imports to and from the Community (Table 8). Although the exports to imports ratios in Table 7 seemed to be reduced, the trade with the EC has better developed.

Table 8

	Exports to EC			Imports from EC		
	1985	1986	1987	1985	1986	1987
(million $)						
Spain	12645	16417	21823	11041	17665	26815
share to total(%)	52.2	60.3	63.8	36.8	50.4	54.6
Portugal	3563	4944	6693	3510.7	5692	9289.7
share to total(%)	62.7	68.3	71.8	45.8	58.9	66.5

Source: Calculated using the data from Direction of Trade Statistics Yearbook, 1991.

Both imports and exports have run up. However, this time the export to import ratios (Table 9) have proved to follow a descending path. Turkey has increased its exports to the EC higher than both Spain and Portugal, and this increase was even above the increase in imports.

	Table 9 Exports to EC / Imports from EC (%) 1985	 1986	 1987
Spain	112	92.9	81.4
Portugal	113	86.9	76.6
Turkey	89.4	72.3	83.5

Source: Calculated using Table 8

The foreign trade account of the country with the EC has developed within the recent years. Although the EC share in exports of Turkey has decreased following 1980s, this was explained by the Iran-Iraq war, which led to an increase in the country's exports to this region.

VII.8. Turkey-EC Trade Relations

Turkey's main trading partner is the EC. Turkey-EC relations are not only important for the membership discussions. Except for the cut back that has occurred after the 1980 military move, EC ranked first among the foreign trade of Turkey (Table 10).

Table 10

EC Share in Turkish Foreign Trade (%)

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
% of Total Imports	27.7	27.0	31.7	41.0	43.9	41.1	38.5	44.3	43.8	46.7
Total Exports	35.1	38.3	39.4	40.8	47.9	43.7	46.7	55.7	51.8	52.6

Calculations are on the IMF Direction of Trade Statistics Yearbooks, Export and Import Data.

Turkey's exports to the Community increased at %18.5 per annum from 1979 to 1985, and at %14.6 from 1985 to 1989. On the other hand, the imports showed an increasing trend with the percentages of 10.4 and 14.7 for each period. This proves that the trade balance has not changed on behalf of Turkey. This may be considered as a result of the increase in imports as well as the non-desired trade limits.

The accession of Spain and Portugal to the EC did not create a diversion effect on the Turkish trade (Özkale, 1990). Because the ncrease in these countries' exports to EC remained well below the numbers for Turkey. Thus, the decrease in exports in 1988 may be a result of decreasing demand, or decreasing international prices of same products in the exports of evaluated countries. As for the 1990s, the EC has proved to be a very significant market for Turkey, since it has constituted more than 50% of the country's exports and 40% of the imports. However, from the EC perspective, Turkey has not carried such importance. The shares of Turkey's exports and imports in the EC trade are 0.563% and 0.00731% respectively in year 1992.[36]

VII.9. Competitive Structure

Özkale (1990) observed that, for the 1983-1988 period, Turkey has not seemed to be a competitor to these countries in the exports of all goods. For the exports of agricultural products, the highest similarity was calculated between Spain and Turkey, which signed their competing with each other. However, the share of agriculture in the exports of both of them was decreasing, leaving the competition insignificant. On the other hand, Portugal started to become an important competitor of Turkey in industrial goods sector.

VIII. THE CASE FOR TURKEY

As a result of the protectionist policies which promoted import substitution and rent economies, and the globalization trend, the Turkish economy needed to achieve a development towards export increases, and ac: in free market environment.

Undergoing a decade of rapid growth, Turkey had an annual GDP growth rate of 4.3% for 1971-1980 and 5.5% for 1981-1990 time periods. It has faced remarkable changes by initializing the implementation of liberal economic policies in the early 1980s. These were to minimize intervention of Government in economic life, and to enforce necessary measures for the effective operation of a free market economy.

[36] Calculated using Direction of Trade Statistics Yearbook 1993, Export and Import Data.

Some of those measures were export promotion and liberal import regimes. Export Promotion included a rise in the extent of foreign currency retention, as well as abolition of duties on imported materials used to manufacture exported products. Liberal Import Regimes consisted of removal of all taxes and duties on a very large list of imports to prepare Turkish industry to meet the challenges of international competition. This would be achieved via liberalization of the exchange control system, and the elimination of quota system.

Turkey made large investments on its infrastructure in motor ways, telecommunications, energy, other transportation networks and tourism. Meanwhile, the country developed its financial system, and established the institutional framework to develop the capital market. It presented new financial instruments along with liberal trade policies to promote exports and to remove barriers on imports.

VIII.1. Value Added Tax (VAT)

The similarity in the tax structures, by the alignment to VAT system, has appeared to be an already completed adjustment cycle. Turkey has showed conformity with the EC norms and directives in this regard.

VIII.2. Privatization Program

Starting from the mid 1980s, the Government has implemented the privatization program. The underlying purposes of this act were to minimize the involvement of the State in the economy, to accelerate and facilitate the establishment of market mechanisms within the context of liberal economic policies. In addition, the role of the Government in the economy would be confined to areas such as health, education, national security, and large scale infrastructural investments. It would be possible to provide the suitable legal and structural environment for free enterprises to operate.

Major targets of privatization were:

- to enhance competition in the economy,
- to decrease the financing burden of the State Economic Enterprises (SEE) on the national budget,
- to broaden and deepen the existing capital market by promoting wider share of ownership, and
- to provide efficient allocation of resources.

Public Participation High Council (PPHC) appears as the decision making and the executive body of the program, while Public Participation Administration (PPA) is responsible for the planning and execution.

In order to attract and encourage the foreign investors to invest in Turkey, the Turkish Government provides incentives and grants, which are grouped in two categories, namely investment and export incentives. As an example to investment incentives; it is possible to benefit from exemption from custom duties and taxes on imported machinery and equipment, and from low interest loans.

Major privatization methods used in Turkey include block sale, public offering, and a combination of block sale and public offering.[37]

When the foreign direct investment structure for Turkey is analyzed, it is observed that over 2000 companies (as many as in Denmark) from more than 75 countries invested in Turkey. During 1985-1990 FDI permissions have increased by 71%.

On the other hand, while Spain had pulled the share of public companies down to 10 to 15 % points by the adjustment act, this value is still at 40-45% for Turkey.

VIII.3. Technical Preparation to the Customs Union

The EC had in EC News (No:22), on December 1993, stated that in order to prepare the Turkish customs officers to the customs union to be realized, an education program would be given starting from October 1993, and thus be supported by the Community (costing ECU 630.000). A donation of ECU 230.000 would be spent for the feasibility analysis of the installation of computer systems for the customs services. Besides, the administrative workshop between the EC and the Turkish Governmental Institutions would be accompanied by ECU 200.00. Since one of the major problems has been the patent rights, expertizing education would be supplied to form the staff for Turkish Patent Bureau. However, due to the Community budget problems and some political conflicts (stemming from the 'human rights in Turkey' issue), the technical preparation project has been postponed to a later date.

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[37]For the period 1986-1992, block sale privatization applications constituted 31.86% of the total sales, and public offering 39.37%. The stock flotations in the Istanbul Stock Exchange were 28.77% (PPA Publishment, 1992).

VIII.4. LABOR MARKET

The share of the labor force in the total population that is actively involved in the production constitutes a larger value for the industrialized countries. For Turkey, this ratio has been calculated to be 38.5% in 1991, although it was 43.3% in 1968 (ILO, 1991 Yearbook of Labor Statistics). On the other hand, the figures do not differ considerably from those of the EC member states. In addition, the ILO Statistics show that, in Turkey, the employer, employee and wageless family employee shares have as 26.22, 36.75, and 31.54 per centages respectively (1991). The great share of the latter indicates a structural problem, since it has been a sign of hidden unemployed segment (especially in agricultural sector). Therefore, the hidden economy results with a higher pressure (such as income tax) on the salaried workers.

Labor Costs

Spain and Portugal have been in an advantageous position with respect to the labor costs, when the accession was realized. The low labor costs allowed these countries be more attractive to the foreign direct investments. However, in 1993, the labor costs in Turkey became almost the same with the member states, Ireland, Spain and Portugal. The numerical efficiency is well beyond. Due to the '91 Agreement with the workers, the cost of a worker (e.g. metal worker) became $12,000, 4 times of the GNP per capita.[38] This is a conflict for the macroeconomic decision making mechanisms.

The regulation and organization of the employment terms have already been defined in the Treaty of Rome. The deals have been identified by the Social Act Program, Single European Act, and the Community Social Rights Requirement, and have included issues such as employment, education, law, social security, union rights, woman workers, young unemployed, retirement policy, free circulation, and the employment of the handicapped. Since Turkey has not solved some of the problems concerning the above items, the country should adopt a labor market adjustment process. Besides, the recent privatization moves and lay-offs led to an increase in the unemployed population. In order to avoid a social boost, a compensation program should be adopted, as it was the Industrial Reconversion Program in Spain.

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[38] Avrupa Birliği ve Gümrük Birliği, MESS Publication, No:197, April 1994.

VIII.5. SECTORAL EVALUATION

VIII.5.1.AGRICULTURAL SECTOR

Turkey has proved to achieve self-sufficiency in agricultural sector due to its geographics and climate. In addition, the Government actively intervenes in the sector by support funds and protectionist policies. In order to set a basis for the national accounting procedures, the agriculture sector in Turkey has been defined as the combination of three sub-sectors, which can be stated as follows:

I. Farming (including Plant Production, Animal Production, and Agricultural Craft)
II. Forestry
III. Fisheries and (Land) Hunting

In the pre-Second World War era, the activities, regulations, and procedures in this sector were based on several institutional forms. Following 1940s, the technological point of view became more significant, and the approaches developed were in the way to change the production function rather than modifying the related legal structure. Chased by the technical developments (i.e. chemical, biological), the modernization period has been activated.

Currently, on one hand, the sector involves a technologically developed (and developing) which produces for the market and is sensitive to price movements. However, on the other hand, there still continues the activities of a poorer segment, which follows traditional production methods on small areas, that do not allow for benefiting from economies of scale.

Aruoba (1992) states that the major bottlenecks were due to animal breeding, especially red meat and milk production, and marketing restrictions. Rather than imposing on plant production, the idea of giving emphasis to animal production and implementing relevant policies was supported and launched by the Turkish Milk, Meat, Food Producers Union (SETBIR).

As for the customs union, Turkey has already followed the transitory measures determined in the Additional Protocol and CAP. Thus, the next step should be to improve the product quality and standards in order to penetrate and compete in the EC market. The Community has faced a considerable agricultural surplus problem by the integration of Spain and Portugal (Appendix II). The common products, olive oil, fruit and vegetables, and wine appeared to be threatening as a result of the overproduction which costed 1.645 million ECU to the EC. In addition, within the 1980-90 period, Turkey's share of agricultural products in the country's total exports to EC has dropped from 51.1% to 15.2%.[39] This differential has been explained by the sector's losing importance.

The issue is the enlargement of EC towards south. The southern countries of Europe are believed to be similar to Turkey, because of similar products, technologies, culture, and sociological structure. The enlargement has not threatened the exports of Turkish conventional agricultural products. However, all the other export products may be effected by the Spanish products benefiting from customs tax exempts. Even though Turkey exports its agricultural products to EC without custom, Spain will be saved by non-tariff barriers.

By the initiation of the customs union, Turkey will be strictly subordinated to the CAP regulations. Since the gradual tariff reductions were already realized, it is of a low probability to encounter further economic problems. However, the CAP prevents the price competition. As an alternative, Turkey can increase its agricultural exports towards the third countries. Being a previous example, Greece has lost its competitiveness in this sector by the implementation of CAP.[40] Spain and Portugal differed from Greece, because they did not get use of common membership status.

VIII.5.2. INDUSTRIAL SECTOR

As it was for Portugal and Spain, the most concerning problems to be posed have been due to the sectors with structural overcapacity, such as textiles. Having followed import substitution and rent economies for a long time period, the sector experienced an adoption problem to the newly emerging industrial policies. In order to facilitate the adoption process, several strategical policies have been designated. These have targeted:

I. to force the firms in the industry to adopt

by lowering the domestic demand,

by increasing competition, or

by increasing the resource cost; and

II. to ease the adoption process for the firms

by making foreign markets attractive,

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[39]HDTM Statistics, 1992.

[40]Sarris, 1984.

- by increasing abroad competition power,
- by overcoming input bottlenecks, or
- by reducing partial resource costs.

As a result of the implementations, the capacity utilization has increased from 50% in 1980s to 74% in 1990 and the private sector has pioneered the industrial investment, but the share of the industrial investment in total investments has decreased (SIS Annual, 1992). The latter was related to the utilization of overcapacity in some sectors, capacity expansion of some of the already existing factories, and the use of better quality, import raw materials as inputs to production.

While the share of industrial goods in Turkish exports has jumped from 41.4% in 1980 to 82.7% in 1990, the respective share in the country's imports has only decreased by 2 points (from 98.7% in 1980 to 96.2% in 1990).[41] The ever-lasting trade deficits and the above shares represent the importance of the relations with the Community.

From the competitive power aspect, the low unit labor costs in Spain and Portugal gave these countries a superiority. For Turkey, however, the Common Tariffs making the customs tax fall has been forecasted to lead (and is leading) the automotive sector be worse off, and unemployment in turn.

As for the textile industry, the Community has faced a stagflation following the First Oil Crisis. The decrease in the intra-Community trade led to the applications of non-tariff barriers among member states, under the excuse of unsatisfied standards or norms. Thus, starting with the UK's self-determined quantity restraints on Turkish thread exports in 1975, the Community declared to put quotas on several ready wear products. What is to be done for the textile sector, which currently sounds to be the most promising, is to identify the filling ratios for the quotas. For the ratios over 90%, if the export capacity allows, new marketing policies should be adopted either to third world countries or to the Eastern Europe. For the ratios below 50%, better quality standards and sales procedures should be satisfied to get use of the quota content.

In 1990s, although the EC has represented a very significant market for the Turkish exports and imports (50% and 42% respectively), the share of Turkey in the Community

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[41] HDTM Statistics, 1990.

imports and exports does not prove to be sound. Besides, the 58% of the EC imports have been due to the intra-Community trade (Eurostat 1990).

From the point of view of industrial production, since the raw materials are of the highest importance in competitive production and Turkey has no advantage in them, the raw material suppliers will all be put out of operation. In addition, the country has disadvantages stemming from transportation difficulties. As some probable results of this union, in Turkey, the automotive companies, such as Fiat and Renault, may turn to their origins. However, the side sectors (especially raw material suppliers) will disappear.

Turkish industrial goods are imported by the Community with tax exemptions. The only exception is the ceiling on petroleum products. In addition, there applied quotas on textile exports. Therefore, in the industrial goods sector, except for textile and petroleum products, the real problem is the lack of competitiveness.

VIII.5.3. ENERGY PLANNING

Turkey ranks the first in energy costs within the Community. The import dependency on energy has been forecasted to increase for the following 20 years by the Ministry of Energy and Natural Resources. Besides, the energy consumption patterns seemed to follow an emerging trend towards industrial sector, rather than housing (Aruoba, 1992). The increasing use of geothermal energy and the natural gas, and the need for secondary energy resources has been anticipated to lead to the activation of recycling plants. As it was for the EC member states and other developed countries of the world, unless the energy consumption measures are defined within the Government policies, it won't be possible to overcome the increasing deficit and import dependency.

VIII.5.4. BANKING SERVICES

The Turkish banking system has faced significant legal and structural modifications following the free market economies that have been activated starting from 1980s. Banks have been allowed to implement positive real interest rates. The environment has been made suitable and attractive for the foreign bankers to operate and serve. As in case of Portugal and Spain, several innovative approaches have been initiated and modernization of banking activities have been hurried. It has been allowed to establish new trade banks. In addition, the Turkish bankers have started to function abroad.

Together with the above basic changes, some institutional reforms have accelerated the renewal of banking system. By the new banking directive, the permissions to open branch offices were loosened. Regulations have been designated not to permit the vote rights to accumulate in the hands of big shareholders (partners). Special auditing processes have been implemented for monitoring the banks, and the banking system has been enlarged to involve specific finance institutions as well. Since Turkish banking services have been active players in the European market, the atmosphere for the services sector seems to be more promising than energy, industry, or agriculture.

IX. CONCLUSION

Unless the macroeconomic stabilization and the related balances are achieved, Turkey will be carrying a heavy burden by getting into a customs union with the EC. It can be misleading to enter a customs union by making one sector better off, while another worse. A country-wide approach is needed in order to maximize the benefits and minimize losses. The last entrants of the Community are trying to save themselves from the possible damages to be posed by the Turkish exports. Greece continuously rejects the Financial Protocol, Portugal reacts to Turkish textile exports, and Spain is conscientious on industrial goods.

25 years ago, Spain was almost of the same tableau with Turkey from GNP and GNP per capita aspects. However, today it has a significant economic power. For Greece, although it is impossible for the country to have a value added more than Turkey, its GNP is much higher due to its benefiting from Community funds.

As already indicated, there emerges some deficiencies in the development process of customs union from the point of view of Turkey. First, Turkey is not a part of the Community decision making mechanism, but only consultation. Second, it does not get use of the free circulation right of production factors. And finally, Turkey will not be able to benefit from EC structural funds, which played an important role in the adjustment processes of Spain and Portugal.

Given the comparative analysis and evaluation, the probable negative impacts of customs union on Turkey can be stated as follows:

- The industrial sector, which is the only one to accommodate the increasing unemployed resulting from population growth and high population in agriculture, may be in a position that does not allow the sector save, even, the current workers.
- If some sensitive sectors are made open to competition before a short transition period, they can no longer be active.
- Turkey's need to finance (possible) increasing imports may end up with the re-activation of protectionist applications.
- Unless the elimination of customs revenues is compensated by the Community, the public deficit may reach to peak points.

It is estimated that Turkey would face a loss of $3-6 billion in the first instance (Mess Publish, 1994), due to the tax exempts, but it has still committed itself to the customs union. On the other hand, the Community has failed on two issues, namely free circulation of workers and financial cooperation, which are significant facilitators of the adjustment process. As an example, the 600 million ECU to be paid in 1986 has not been supplied to Turkey till now. Besides, this amount, in the form of an adjustment period aid, would be increased at every 5 years time.

In his recent announcement, Jacques Delors, the Community Head, states that EC would enlarge towards south even including Malta and South Cyprus, but not Turkey. As well as the economic factors, the Community seems to display a reactive behavior to religious and cultural factors.

In order to provide macroeconomic stability and to reduce inflation rate to reasonable levels, the policy makers (politicians in this case) need to identify their objectives clearly and make long-term plans. This will be possible through balancing the budget deficit. Turkey should improve and increase the number of the sectors where it has comparative superiorities. On the other hand the imbalances in the economic environment do not attract the investments required to get into customs union.

APPENDIX

APPENDIX I

Example Cases for the Privatization of Publicly Owned Companies in Spain
Source: IMF Occasional Paper
No:101

The Spanish privatization act was started with the sales of approximately thirty countries, and partial privatization by sales of minority holdings on the stock exchange. The latter included General Eléctrica Sociedad Anónima (GESA), Empresa Nacional de Celulosas y Papel (ENCE), Empresa Nacional de Electricidad Sociedad Anónima (ENDESA), and REPSOL, the state enterprise in charge of oil production and distribution.

In the industrial sector, the Instituto Nacional de Industria (INI) was split in two parts: the Teneo Group or INISA receiving all the profitable or potentially profitable firms, and the Sociedad Estatal del Instituto Nacional de Industria (INISE), the remaining firms. INISA was expected to invest in private sector companies, and in the long run, to open up its own capital to private investors. By contrast, INISE would remain a public enterprise including the firms operating in steel industry, mining, weaponry, and shipbuilding, and these firms would require subsidies from the Government.

APPENDIX II

EC MEMO , BRUSSELS, 20 DECEMBER 1985
THE MAIN PROVISIONS OF THE ACCESSION AGREEMENTS

1. INSTITUTIONS

From 1 January 1986, Council will have twelve members. Spain's eight votes and Portugal's five will bring the total number of votes to 76, with 54 being required for a qualified majority (Germany, France, Italy, and the United Kingdom: 10 votes; Belgium, Greece, and the Netherlands: 5 votes; Denmark and Ireland: 3 votes; Luxembourg: 2 votes).

The two Spanish members and one Portuguese member of the Commission will bring the total number of Commissioners to 17. The European Parliament will have 518 members with the addition of 60 Spanish and 24 Portuguese members, designated by their national parliaments in the first instance and then by direct universal suffrage before 31 December 1987.

The number of the judges at the Court of Justice will rise from 11 to 13, Portugal and Spain each sending one. There will be six Advocates-General, Portugal and Spain taking it in turns to designate the sixth.

Membership of the Economic and social Committee will increase by 21 members for Spain and 12 for Portugal, making 189 in total. The Court of Auditors will also be expanded, with each new Member State sending one member.

Adjustment will also be made to the ECSC Consultative Committee, the Scientific and Technical committee of Euratom, the Advisory Committee and the capital of the Euratom Supply Agency and the administration of the European Investment Bank.

2. CUSTOMS UNION

Spain:
progressive abolition of customs duties over a seven-year transitional period;
abolition of quantitative restrictions on the date of accession;

alignment of the Spanish customs tariff on the Common Customs Tariff over a period of seven years;
application of competition rules and introduction of VAT on the date of accession;
special provisions for motor vehicles, textiles, the steel industry, and national policies.

Portugal:
progressive abolition of intra-Community customs duties over seven-year transitional period and, simultaneously;
alignment of the Portuguese tariff on that of the Community;
a two-stage abolition of quantitative restrictions and other measures;
postponement of full introduction of VAT until the fourth year after accession;
special provisions for motor vehicles, textiles and national monopolies.

3. AGRICULTURE

Spain:
progressive application of the machinery of the common organizations of the markets and establishment of the free circulation of goods after transitional periods varying according to the products;

application of general or "classic" arrangements to most agricultural products over a seven-year period with a progressive alignment of prices and aids, accession compensatory amounts, the gradual implementation of customs union and Spain's progressive application of the Community's preferential arrangements;

special arrangements for wine, vegetable oils, and fresh fruit and vegetables, and a surveillance system for imports of sensitive products (fruit and vegetables, milk, butter, cheese, beef/veal, common wheat, milk powder, potatoes and wine).

Portugal:
same general principles as for Spain with "classic" transitional arrangements which will apply to processed fruit and vegetables, sugar and iso-glucose, and vegetable oils, in general over a seven-year transitional period (10 years for vegetable oils), with the Community bringing forward tariff dismantlement by one year, and indeed four in the case of tomatoes;

specific transitional arrangements for 85% of Portuguese production (cereals, rice, milk and milk products, beef/veal, pig-meat, eggs and poultry, fresh fruit and vegetables, and wine);

a surveillance system for imports, a specific development program and production rules for tomato concentrates, canned tomatoes, sunflowers, colza and rapeseed;

special arrangements for sugar and the same arrangements as for Spain in the case of vegetable oils.

4. FISHERIES

Spain:
reciprocal access to maritime zones and respective stocks with monitoring arrangements;

on accession, application of the common fisheries policy subject to certain conditions;

progressive dismantling of intra-Community customs tariffs and alignment on the common external tariff over a seven-year transitional period, except for special circumstances, with special provisions for access to the zone lying between 6 and 12 nautical miles for the exclusive economic zones and for certain sensitive species;

pre-accession aid of 28.5 million ECU.

Portugal:
no access for vessels of the present Member States to the 12 nautical mile coastal zone off Portugal and vice versa;
varying restrictions in the exclusive economic zone beyond the 12 mile line, to be reviewed by 31 December 1995;
application of the common fisheries policy subject to certain reservations;
customs dismantling over seven years for Portugal and six years for the Community, with some special arrangements;
some provisions as for Spain concerning relations with non-member countries;
special provisions for sardines and structural matters.

5. SOCIAL AFFAIRS

Spain:
application of social legislation, including that concerning the Social Fund, on accession; seven-year transitional period during which certain restrictive national measures may be retained;
five years after accession, review of the transitional arrangements for free circulation of workers; special provisions for equal treatment, access to employment and social insurance benefits.

Portugal: same provisions as Spain.

6. BUDGETARY PROVISIONS

Spain:
full participation in the financing of the budget and in expenditure, subject to certain transitional measures, Spain will qualify for the various structural funds on accession;
special provisions for the repayment of the VAT contribution, the amount repaid being set according to a sliding scale until 1992.

Portugal:
full participation in the financing of the budget and in expenditure, subject to certain transitional measures;
postponement of the full introduction of VAT until the fourth year after accession;
special provisions on the graduated refund of VAT contributions based on GNP applicable for six years;
aid to the balance of payments in the form of a 1 million ECU loan over six years.

EFFECTS OF ACCESSION

1. AGRICULTURE
Spain's accession will increase Community's agricultural land area by 30%, the farm labor force by 25% and the number of holdings by 32%, while the number of consumers will grow by 14%. Portugal's accession will increase the area by only 4%, the agricultural labor force by 12.8% and the number of consumers by 3.6%.

As for agricultural production, Spain's entry will increase vegetable production by 25%, that of fresh fruit by 48% and that of olive oil by 59%. Full cream milk output will rise by only 6% and that of cereals by 14.5%. Livestock numbers will rise by only 6%.

Overall, the Community will increase its degree of self-sufficiency in Mediterranean products (wine, fruit and vegetables, olive oil), with surpluses arising for some products, while the level will fall in the case of some livestock and cereal products.

The greatest problems will occur in olive oil, fruit and vegetables, and wine.

It is estimated that the Community of Twelve will have a surplus of 230.000 tones of olive oil, making it 122% self-sufficient, not only because of increased production following Spain's entry (increasing the self-sufficiency level by approximately 109%) but also because of the fact that the consumers are substituting cheaper vegetable oils for olive oil. The cost of the Community of Twelve's overproduction is estimated at 1.645 million ECU against 845 million ECU for the Community of Ten.

Portugal's entry will not have any great impact on the self-sufficiency levels for citrus fruit and other fresh fruit and vegetables. But Spain's entry is another matter: Spain produces a large surplus of citrus fruit (235%) and, to a lesser extent, other fruit and vegetables (percentages varying between 100% and 120%).

Spain has 2.8 million hectares of irrigated land, increasing the area of irrigated land in the Mediterranean regions of the Community by 80%.

With twelve members, the Community's degree of self-sufficiency in citrus fruit will increase considerably, reaching 89%. The Community will become fully self-sufficient or more in the case of other fresh fruit and vegetables.

In the wine sector, Portugal has a surplus (122%), but the country represents only 5% of Community production. In Spain, 1.7 million hectares are planted to vines and Spanish production is 24% of the Community figure. Broadly speaking, the Community of Twelve should be self-sufficient in wine, with the danger of increased surpluses of white wine.

2. FISHERIES

As regards to fisheries, the main problem posed by Spain's accession is that of access to the Community's resources and restructuring measures in the sector.

Spain is a major producer and consumer of fishery products. A quarter of all fishermen in the Community of Twelve will be Spanish, and Spanish catches will account for a third of catches by value and a quarter by quantity. The tonnage of the Spanish fleet is equivalent to 70% of the tonnage of nine Community Member States (excluding Greece). Despite this, Spain has an overall deficit in the fishery products.

In view of the fact that the Community is undergoing the same difficulties as Spain regarding fishing capacity in relation to the fishing grounds available, Spanish accession will aggravate the problem and entail major and costly restructuring measures.

Further difficulties are expected because the Community will represent Spain internationally. Spain has concluded many fisheries agreement with non-Community countries on the basis of financial compensation in order to compensate for the loss of natural resources and these agreements provide a great deal of work for part of the Spanish fleet.

3. INDUSTRY

The 1970 preferential agreement between Spain and the Community and the 1972 agreement with Portugal offered these two countries substantial tariff concessions on an already low common external tariff. In general, the main impact of accession has already been felt in the Community of Ten. The opposite is true for the acceding countries. Spain, in particular, has to dismantle extremely protectionist customs duties and its tax and aids system has to be adapted to Community rules. In this respect, the introduction of VAT by Spain on 1 January 1986 is a notable step forward. Portugal has to abolish customs duties on a long list of products and its non-tariff barriers. The productivity of Spanish industry stands at about 40% of that of the Community, and the gap is even wider in the case of Portugal. The drop in productive investment is also a major problem.

However, the most tricky problems are those of sectors with structural over capacity (steel, shipbuilding, textiles) and the promotion of growth sectors (electronics and information technology, chemicals, agrifood).

4. EMPLOYMENT

The effect of the accession of Portugal and Spain will be to reduce the percentage of active population in the Community. In 1984, 44% of the population in the Community of Ten was in work or unemployed against only 35% in Spain but 45% in Portugal.

Spain's situation is particularly critical since a fifth of its active population (20.2%) is unemployed, making Spain the country with the most unemployed according to the spring 1984 figures, followed by Ireland (16.5%), the Netherlands (12.8%), Belgium (11.9%), and Italy (9.6%).

The 2.6 million Spanish unemployed will thus be added to 12.7 million in the Community of Ten, which together with those of Portugal brings joblessness in the Community of Twelve up to 10.4%.

5. THE BUDGET

In view of the present situation regarding the 1986 budget, it is difficult to specify the effects of enlargement. It should, however, be noted that the resources of the various structural funds (EAGGF, ERDF, ESF) will rise considerably; enlargement will mean an increase of some 2.500 million ECU in 1986.

However, additional resources may prove necessary to ensure that Spain, and in particular, Portugal, do not become "net contributors" to the Community budget on accession.

EC↔Spain ($ million)	EC→Spain Aid resulting from Funds	Spain→EC (VAT, Customs Tax, etc.)	NET
1986	1025	1109	(-)84
1987	1757	1373	384
1988	3824	2223	1601
1989	4683	2874	1809
1990	4943	3743	1200

APPENDIX III

CHANGES IN SPAIN'S COMMERCIAL PROTECTION SINCE EC MEMBERSHIP

Industrial Products

- Gradual tariff rate reduction process from the base rate (approximately 14 per cent) to zero in the case of other EC countries, and from the base rate to the (lower) Common External Tariff rate (approximately 4-5 per cent).

- The timetable for the above reduction is as follows:

March 1	1986	10.0 per cent	reduction
January 1	1987	12.5 per cent	reduction
January 1	1988	15.0 per cent	reduction
January 1	1989	15.0 per cent	reduction
January 1	1990	12.5 per cent	reduction
January 1	1991	12.5 per cent	reduction
January 1	1992	12.5 per cent	reduction
January 1	1993	10.0 per cent	reduction
Total		100 per cent	reduction

Agricultural Products

- Products originating in an EC country have preference (relative to products originating in non-EC countries) in other EC countries.

- Common Agricultural Policy accepted as of 1986.

- Gradual tariff rate reduction for agricultural products to be completed by January 1, 1993. The timetable for fruits, vegetables, and vegetable fats extends to January 1, 1996.

Source: IMF Publications, Occasional Paper No:101

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