UNICE TASK FORCE ON ENLARGEMENT

2002 REPORT ON CANDIDATE COUNTRIES' PROGRESS TOWARDS EU ACCESSION

TURKEY

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Executive Summary

Turkey has the status of an EU candidate country since the Helsinki European Council in 1999. Negotiations have not formally started, as Turkey does not comply with the political criteria as yet. The Laeken European Council of December 2001 however stated that Turkey had made progress towards complying with the political criteria established for accession, in particular through the recent amendment of its constitution. This has brought forward the prospect of the opening of accession negotiations with Turkey.
Nevertheless, by virtue of the customs union, Turkey has already adopted some of the *Acquis communautaire*. Further work is under way on the free movement of services.

The two financial crises that struck Turkey in November 2000 and February 2001 were major contributors to the deterioration in the macro-economic situation. The gravity of the crisis prompted Turkey's National Assembly to adopt and ambitious programme of structural reforms, which IMF deemed to be a success in early 2002. Turkish exports to the EU in 2001 represented 52% of Turkey's total sales and Turkish imports from the EU were 45% of its total purchases.

The level of foreign direct investment is still very low in Turkey. This can be explained by the great volatility of the Turkish currency and the stock market. The administrative unwieldiness (numerous procedures, conflicts between authorities, slowness, significant corruption) of the judicial system together with the complexity of the tax system place a serious brake on foreign investment. The Turkish government recently passed new legislation addressing these problems and promoting foreign direct investment in Turkey. It also established an agency for promoting FDI.

Actions recommended

- Encourage macro-economic stability and improve the business environment.
- Rationalise the financial system.
- Pursue structural reforms and privatisation, in particular in the energy sector.
- Develop the regulatory framework linked to public procurement.
- Simplify procedures as well as the tax and customs regimes.
- Step up harmonisation of Turkish standards with EU standards, and allow their effective implementation.
- Combat corruption more actively (customs, banking sector, etc.).

1) Introduction

Turkey has the status of an EU candidate country since the Helsinki European Council in 1999. Negotiations have not formally started, as Turkey does not comply with the political criteria as yet. The Laeken European Council of December 2001 however stated that Turkey had made progress towards complying with the political criteria established for accession, in particular through the recent amendment of its constitution. This has brought forward the prospect of the opening of accession negotiations with Turkey.
Nevertheless, by virtue of the customs union, Turkey has already adopted some of the *Acquis communautaire*. Further work is under way on the free movement of services.

- **Macro-economic situation**

The two financial crises that struck Turkey in November 2000 and February 2001 were major contributors to the deterioration in the macro-economic situation. The year 2001 was marked by a fall in savings, an increase in unemployment and a lack of confidence among foreign investors. Yet, contrary to expectations, company failures were limited. Turkey's geographical situation and the size of the tourism sector make the country vulnerable to external shocks. However, the gravity of the crisis prompted Turkey's National Assembly to adopt and ambitious programme of structural reforms which IMF deemed to be a success in early 2002.

The process of putting a viable market economy in place has been placed on hold. In the short term, the government must endeavour to restore macro-economic stability with all the means at its disposal. In the medium term, a restructuring of various sectors (agriculture, banks, public undertakings) must be pursued so that the whole of the Turkish economy becomes competitive. If one section of the economy is already capable of coping with competitive pressure and market forces in a customs union with the EU, a fair number of Turkish businesses, notably smaller ones, have been badly affected by the crises.
Adopted by the Turkish government in March 2001, the National Programme for Adoption of the Acquis has the objective of radically transforming the country and moving it forward along the route towards EU accession.

- **EU/Turkey relations**

Turkish exports to the EU in 2001 represented 52% of Turkey's total sales (USD 16,078 million) and Turkish imports from the EU were 45% of its total purchases (USD 18,059 million). Last year Turkey saw its trade contract because its total exports increased by only 12.3% on 2000 (10.8% to the EU) and its imports were down 25.7% (down 32% from the EU).
Turkey's main sales comprise textiles and clothing, electrical equipment, steel products and cars (this sector has grown considerably in 2002) and its main purchases are fuels and oil products, electrical equipment and machinery, vehicles, steel products and chemicals.

2) Accession criteria

- **Borderless internal market**

Transposition of the *Acquis* for the **customs union** is the area where Turkey has made most progress. Turkey's alignment on the Common Customs Code was completed on 31 December 2000. Manufactured products circulate freely on the territory of the customs

union. However, there are still some non-tariff barriers on the Turkish side (see: Free movement of goods).
The rate of privatisation has slowed down since the financial crises. The government's privatisation programme announces a resumption of the process from the second half of 2002, hoping that the proceeds for 2002 will total USD 1.5 billion. In order to qualify for the next tranche of its IMF loan in April 2002, Turkey has promised to eliminate two thirds of excess personnel from state undertakings by October 2002 and the rest by June 2003, which seems very ambitious.

The level of **foreign direct investment** (FDI) is still very low in Turkey since it was estimated at USD 3,044 billion in 2001. The restructuring exercises announced in the banking sector and further liberalisation in a range of sectors (tobacco, alcohol, energy, telecommunications) should prompt FDI to pick up. The current weakness can be explained in part by the great volatility of the Turkish currency and the stock market. The administrative unwieldiness (numerous procedures, conflicts between authorities, slowness, significant corruption) of the judicial system together with the complexity of the tax system place a serious brake on foreign investment. One of the pre-conditions for the IMF loan of USD 16.3 billion is that Turkey improves the investment environment. The government has started to put in place a new system for promoting foreign investment designed to facilitate procedures in this area. With the assistance of foreign advisers, it recently expressed its wish to set up an Investment Promotion Agency: European business very much welcomes this move.
In the area of **public procurement**, the law tabled in parliament in November 2001 is in the course of adoption: it should make the award system more transparent and more reliable. The law on liberalisation of the tobacco sector has been voted.
In the area of **company law**, Turkey's alignment on EU legislation has not moved forward.
For **intellectual property rights**, Turkey has adopted several measures relating to copyright: alignment on the *acquis* (hire and lending, satellite and cable broadcasting), adoption of the Bern and Rome conventions, TRIPS agreement, and the two WIPO treaties. Piracy, in particular audiovisual, continues to be significant and the intellectual property rights system is not harmonised in practice.
Data protection remains unsatisfactory.

- **Free movement of goods**

The European Commission took provisional anti-dumping measures against imports of some steel products originating from Turkey in early April 2002. Within the next six months the traders involved will face surtaxes ranging from 4.2 to 53.1% on deliveries of some tubes and pipes made of welded steel, iron or unalloyed steel which are used essentially to transport liquids or gases for sanitary installations, heating networks, ventilation or air-conditioning systems, and automatic extinguisher systems, as well as in construction. The dumping margins have been estimated at 12.7% for the Turkish products.
Regarding transposition of new approach and global approach directives, a new framework law on preparation and implementation of technical legislation on products was adopted in June 2001. It serves as the legal basis for further alignment. Provisions still need to be adopted for placing products on the market, conformity assessment, surveillance and market inspection.
For the legislation covered by the old approach, various directives have been adopted on motor vehicles for forestry and agriculture, pressure vessels, footwear labelling, quantitative analysis for fibre mixes (textile sector), metrology, pre-packaging. No progress has been made in the non-harmonised area, and the principle of mutual recognition is often not applied.
TSE (Turkish certification body) imposes numerous administrative constraints and requires tests for some industrial products from the EU (cosmetics, ceramics, spare parts, textile products), creating *de facto* non-tariff barriers.

- **Free movement of capital**

To conform with the *acquis communautaire*, liberalisation of the financial sector needs to be extended to all transactions and authorisation procedures need to be scrapped.
Restrictions on foreign investments remain in some sectors: mining, energy, banks, broadcasting and telecommunications companies (25% threshold), air and maritime transport, real property.
The financial crises experienced by Turkey in November 2000 and February 2001 greatly undermined the viability of the Turkish banking sector. Following these crises, a law on the voted in April 2001 now gives the central bank the power to regulate issues and the circulation of the Turkish lira. It can also put in place systems for transfer and settlement of payments and securities.
Restructuring of the banking system is under way. The agency for bank supervision and regulation has been put in place: its role is to lend treasury funds to private-sector banks that need to be re-capitalised. The law on re-capitalisation of banks was voted in January 2002. This should make it possible to revive growth by creating a more solid and more transparent banking system. However, reservations have been expressed that this law may prop up some banks not deemed to be viable. Approval of this law was determinant for approval of a new IMF standby credit for USD 16 billion over three years.
Re-capitalisation of the banks is being accompanied by a restructuring of the public banks which are in the process of being privatised (privatisation should be completed by end-2003): Garanti, the fourth-largest Turkish bank after a merger last year, is still looking for a strategic international investor.
The government wants to encourage foreign investments in the Turkish banking sector.

- **Free movement of services**

Negotiations between the European Commission and the Turkish government on extension of the customs union to include free movement of services will be concluded before the end of 2002.

Freedom to provide services in Turkey is fairly limited. For non-financial services, restrictions imposed on foreign investors favour national preferences. Two regulations on securities have been adopted: one on the functioning of the investor indemnity fund and the other on creation and operation of a central register in charge of managing this fund. In the insurance sector, several laws have been adopted on insurance and reinsurance brokers, complementary pension schemes and assessors.
In the area of financial services, the reform carried through should accelerate privatisation of the banking sector. Inter alia, laws and regulations have been voted to clarify instruments for internal control, measurement (definitions and thresholds) and risk management in this sector.

- **Competition**

Progress has been made on concerted practices. Not only has legislative alignment been pursued with adoption of provisions on block exemptions, but the competition authority examined numerous cases of concerted practices in 2001. However, it lacks the resources to do its job properly.
For state aid, the picture is fairly negative. Progress in this area is subject to creation of an independent supervisory body, envisaged for early 2003. There is no register of state aid, nor a map of regional aid, only a list of commercial state monopolies and companies with exclusive rights. Elsewhere, Turkey is not meeting its obligations under the customs union since the monopoly held by Tekel for commercialisation of alcohol and tobacco has been maintained.

Future privatisations will reduce state price support. However, 25% of consumer prices still receive support. In the agricultural sector, price support systems should be replaced progressively by a system of direct income support.
There is considerable discrimination in the health sector for import licences. Some tender calls are "artificially" competitive and the Turkish economy is still dominated by a cartel of large multidisciplinary consortia.

- **Sectors**

Energy
Two framework laws in the electricity and gas sectors were adopted in the first half of 2001. Each provides for creation of a common authority: the energy market regulation council. As a result, Turkey has secured the benefit of IMF support. In addition, these laws define the structure and status of the respective players in these two sectors.
Turkey has the least liberalised electricity market in Europe (90% of electricity is distributed by the state). Pushed by IMF and the World Bank, it plans to liberalise its market. At the present time, four government agencies have a say on what happens in this sector and their views often diverge. The law adopted in March 2001 makes provision for restructuring and a break-up of producer groups, as well as the opening of production and distribution activities to competition. Nevertheless, this opening remains limited to 20% and the state maintains its monopoly in transport activities. Furthermore, no measures have been taken concerning market access or construction of new capacity. TEAS has been split into three entities in charge of different aspects: generation, transmission, new investments. However, implementation will take some time.
In the gas sector, BOTAS has been divided into two state undertakings in charge of distribution and transport. However, the framework law makes no provision for third-party access, break-up of producer groups, storage, etc.
Turkey is currently dependent on imports for 98% of its gas and 90% of its oil. If it is not a producer, Turkey is a strategic transit country for these two energy sources. The various plans for oil and gas pipelines are of real interest for the future since they will help ensure supplies to the European market, through interconnection with its network.
Privatisation of the energy sector needs to be pursued. The government's adoption of an action plan to combat corruption and promote transparency is a positive measure.

Telecommunications
The parliament has decided to bring an end to the monopoly of Turk Telecom on fixed lines at the end of 2003, i.e. a year earlier than provided for in Turkeys commitments to WTO. A fourth GSM licence was sold in August 2001, strengthening competition and prompting a marked reduction in charges.
Legislation moves forward: for instance, a regulation on the price ceiling mechanism was approved in September 2001. However, the areas of interconnection, data protection and universal service have not yet been addressed.
A new telecommunications authority has been created: its objectives are to bolster implementation of agreements designed to ensure that the existing mobile telecom operators share their network with new entrants to the market in exchange for payment. This authority must also prevent Turk Telecom, which has a monopoly on fixed lines, from extending its dominant position.
The administrative capacities of the telecom regulator and its independence vis-à-vis the corresponding ministry need to be strengthened.

Audiovisual
The president has vetoed a law regulating the audiovisual sector which was set to be adopted in June 2001. It raised questions about freedom of expression and the independence of the regulatory body, thereby violating the international standards applicable to the media to which Turkey has signed up.

Alignment of the sector on the acquis is still not in place for definitions, competence, freedom of reception, discrimination based on nationality, promotion of independent European works, advertising, distance selling. The limitation on the share of foreign capital in radio and television undertakings has been increased from 20 to 25% %.

- **Taxation**

Tax evasion is still very high in Turkey.
Progress has been made on excise duties. A single tax is applied to a large number of consumer products, the level of duty applied to fuels is above the EU minimum. However, Turkey still needs to revise the structure of duties and the obligatory exemptions, and the rates charged on tobacco and alcoholic drinks. The rates applied and exemptions in place for VAT must be reviewed.
Capital gains realised on mergers, de-mergers or share exchanges are now exempt from corporation tax.
Turkey's tax system is in the process of simplification: texts should be adopted in October 2002 when the country's next budget is adopted. Taxation is currently very heavy because accounting conventions fail to take account of the context of high inflation.

- **Customs**

The common customs code on "sensitive products" has been in force since January 2001, but a great effort still needs to be made for implementation, which is also the case for the Turkish customs code.
Training of the customs administration was strengthened last year, and 90% of transactions are now conducted electronically. Improvement of border management, the fight against irregularities and corruption, and a cut in border waiting times have to be pursued.

- **Justice and home affairs**

In September 2001 Turkey signed the Council of Europe's 1999 civil and penal conventions on corruption, together with the 1990 convention on laundering, search, seizure and confiscation of the proceeds from crime. Banks are expected to receive training in the area of combating corruption and money laundering following adoption of a law on this subject in May 2001.
A central service to fight contraband has been put in place.
Transparency International classifies Turkey among the risk of corruption is large: it is in 54th position (50th position in 2000) between El Salvador and Argentina.
Turkey has not concluded a convention facilitating the enforcement of European court decisions, hence the problems with executing foreign decisions.

- **External relations**

Turkey is currently negotiating bilateral free-trade agreements with Tunisia, Morocco, Egypt, the Palestinian Authority and Croatia. Discussions are envisaged for agreements with Malta, Jordan, South Africa and Bosnia-Herzegovina.
It is expected that Turkey will soon adopt the EU's generalised system of preferences.

3) Recommendations

In order to improve the business environment, FDI and Turkish investments, the short-term priorities in Turkey should concentrate on the following points:

- Encourage macro-economic stability and improve the business environment
- Rationalise the financial system
- Pursue structural reforms and privatisation, in particular in the energy sector
- Develop the regulatory framework linked to public procurement
- Simplify procedures as well as the tax and customs regimes
- Step up harmonisation of Turkish standards with EU standards, and allow their effective implementation
- Combat corruption more actively (customs, banking sector, etc.)

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