

Does Turkey have a special trade relation with the EU? A gravity model approach

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Abstract

We apply the gravity model to Turkey's trade flows over 1967–2001. First, we check whether this model fits Turkey's geographical pattern of trade in goods. Second, provided that the model works, we assess whether Turkey already has a “special” trade relation with the EU, namely whether merchandise exchanges between the two parties exceed what the gravity approach predicts. The main findings are: (i) the gravity model provides a good fit of Turkey's trade patterns, and (ii) despite the 1963 Association agreement and the customs union launched in 1996, there is no evidence of additional trade between Turkey and the EU.

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1. Introduction and motivation

Turkey trade openness has been on the rise in the last decades, especially after import-substitution policies were abandoned in favour of trade integration measures since the 1980s. The sum of export and import as a share of GDP increased from 18% in 1980 to 48% in 2001, when a severe financial crisis led to a contraction of 7.5% in GDP after a period of sustained growth.¹

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¹ Less severe GDP contractions were, however, registered in 1994 and 1999, while high growth rates prevailed during the rest of the 1990s. On the economic developments and growth strategies adopted in Turkey in the last decades, see, among others, Togan (2002), Utkulu and Ozdemir (2003), and Dervis et al. (2004).

The European Union (EU) is by far Turkey's most important trading partner, accounting for slightly more than half of its exports and slightly less than half of its imports. Since 1963, Turkey has been given a preferential trade status by the EU, with the Ankara Association agreements leading to a progressive reduction in import tariffs (especially on the EU side), the adoption of parts of the EU regulatory body (the so-called *acquis communautaire*) by Turkey, and the provision for the gradual creation of a customs union. In 1970, an additional protocol to the Ankara agreement was signed, which fixed the end of the transitional period before the establishment of the customs union in 22 years' time. Finally, and after several delays, the customs union was launched at the end of 1995 and became operational in 1996. In the meantime, Turkey had also submitted its application for EU membership in 1987, which was initially rejected but has thereafter been reconsidered, leading to the official start of negotiations in October 2005.

There are two main perspectives on the current state of merchandise trade relations between Turkey and the EU. Although recognising that many steps towards preferential integration have been made, some authors place the emphasis on the trade potential that could emerge from full EU accession because of three main reasons. Administrative barriers will be progressively reduced to levels consistent with the Internal Market. Moreover, technical barriers to trade are likely to decrease considerably through harmonization or mutual recognition of standards and regulations. Finally, uncertainty related to political risk and macroeconomic instability should decrease, thus fostering a more favourable environment for trade and (foreign) investment. This argument also rests on econometric research based on different versions of the "gravity model" approach: according to the estimates, bilateral trade between Turkey and the EU could rise from about 34% (Lejour et al., 2004) to 46% (Flam, 2003) after accession.²

Other scholars underline that a high degree of trade integration has already been achieved thanks to the Association agreements and eventually to the EU–Turkish customs union. As mentioned before, the EU has progressively opened its markets to Turkey long before the actual negotiation of the customs union, gradually reducing tariffs on a large number of industrial products. Turkey has also adopted a significant portion of EU regulations and even the Common External Tariff imposed by the EU on third trade partners. The customs union was in fact the outcome of long-standing and progressively more intense merchandise trade relations between the two parties. Quoting Ülgen and Zahariadis (2004), "with respect to trade in goods, Turkey is almost part to the Single Market", hence the relevant question is not "by how much will merchandise trade rise?", but "when and how will trade be liberalized also in agriculture and services?"

In this paper, we try to assess empirically whether trade relations between Turkey and the EU, which is its most developed economic neighbour and its politico-economic "attractor", are already so "special". In order to do this, we analyse Turkey's merchandise trade over a long time span (1967–2001) with the so-called gravity model in a panel-data framework. Provided that the gravity benchmark fits, we want to assess whether Turkey already has a special trade relation with the EU, namely whether actual trade volumes have been significantly larger than predicted ones.

The paper is organised as follows. A brief review of studies providing theoretical background and empirical applications for the gravity equation is presented in Section 2. Section 3 illustrates

² These figures are not limited to trade in merchandise, but also include services. The working of the gravity model and its previous use in the current context are reviewed in Section 2.

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