

## Attitudes of Turkish Firms toward European Customs Union

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**Abstract:** Turkey-European Customs Union (CU) relations started after (signing) Ankara agreement in 1963. There were some stages to reach final stage in 1996 when the Customs Union agreement signed. There have been discussions both of the advantages and disadvantages of becoming a member of the Customs Union for Turkey. One of them was firms. Arguments were based on how the CU is going to affect Turkish firms. The main aim of this study is to analyze the attitudes of Turkish firms toward Customs Union which have trade relations with EU countries and how they are effected after CU.

The results based on the analysis of data relating to 70 responses indicate that Customs Union has a contribution to Turkish firms in terms of competition, quality improvements, technology etc.

The survey instruments focused on the following areas.

- a- The effects of CU on Turkish trade
- b- The effects of CU on individual firms
- c- The effects of CU on Foreign Direct Investment (FDI)

Research evaluations were discussed and some conclusions were drawn.

**Keywords:** European Customs Union, Trade, attitudes of firms

### Introduction

The Customs Union was widely discussed in the sense that the Turkish economy would not adapt itself very well to new and highly competitive environment of Europe. Many studies were made whether or not entrance to Custom Union is beneficial for the Turkish economy.

Turkey has a long history of trying to become a member of the European Union. In order to become member of EU there are many criteria's to meet. One of them is the Customs Union. The Customs Union is the economic mainstay of EU integration. Turkey signed the Customs Union agreement in 1963 named Ankara agreement. The aim of this agreement is to prepare Turkey for full Custom Union membership. The final aim after Custom Union became full membership to EU. Turkey's full membership has three steps.

**Preparation Stage (1964-1969):** During this period of time, EU members decreased custom duties of some products like cotton and figs, which made a large part of Turkish export.

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**Transitory Stage (1973-1996):** Transitory stage of 22 years, during which essential measures were put in to force toward trade liberalization, and great reliance on market forces, parties decided that conditions have been fulfilled for the establishment of the customs union. EU decreased customs duties of Industrial products to zero, except olive oil, sugar, sauce and some other goods. Turkey's industrial goods entered EU countries without any customs duties after 1971.

**Final Stage:** By the Association Council Decision of March 1995, the Custom Union came into force on 01.01.1996. This final stage is the most important step for the modernization of Turkish Economy and its integration in to the world trade system.

The main idea of the Custom Union is that industrial goods could move freely between the EU and Turkey without being subject to customs duties or quantity restrictions. With the entry in to force of the Customs Union, Turkey has eliminated all customs duties and changes having equivalent effect, as well as quantities restrictions applied on imports of industrial products from the community. For products imported in to the Turkey from third countries, Turkey started to apply the rates of protection specified in the communities common customs tariff, except for those products classified sensitive. Customs duties on sensitive products are eliminated from 01,01,2001.

### **Literature review**

The Customs union (CU) has been the subject of economists for 50 years. Economic integration did not become a separate subject in economic theory until Viner published his pioneering work in 1950. After that until 1965 economic integration (EI) had 2 different periods Krauss 1972). In the first period (Viner 1950), the impact the CU was investigated on production and consumption and trade flows (Meade 1955, Lipsey 1957). According to Lipsey (1960), there are five possible sources of welfare gain or losses from forming CU. 1) Specialization according to comparative advantage, 2) Economies of scale, 3) Change in terms of trade 4) Change in efficiency due to foreign competition, 5) Change in economic growth. In the second period after the 1960 economists started to ask themselves what the real objectives are of those entering an integration scheme; since some time earlier, with the development of the second best theory, economists reached the conclusion that a priori any agreement for the regional liberalization of trade must not be necessarily positive from a normative viewpoint, even for the partners themselves. Lipsey 1957 and others asserted that some trade-diverting customs union would be beneficial for its members. Work by Johnson 1965, Cooper and Massell 1965 and later Berglas 1979 were the most significant in this respect.

In the 1980s the scale economies argument has been progressively linked to new models of international trade under imperfect competition, drawing abundantly from industrial economics (Krugman 1979, Ethier and Horn 1984, Helpman and Krugman 1985, Smith and Venables 1988, Krugman 1991). The interesting question is to know if customs union creation is a substitute or a complement to competition policy. It used to be thought that trade liberalization could replace competition policy insofar as local monopolies would be kept in check by international competition. The argument is back in fashion in connection to the expected benefits of completing the EC's internal market (Smith and Venables 1988).

The impact of Custom Union on the foreign trade of Turkey are analyzed, and the existences of these impacts are searched by using econometric methods. When looking over the foreign trade statistics between Turkey and European Union, It is clear that both Turkish exports to European Union, and imports from European Union, are increase after the Customs Union. But the growth of imports is bigger than the growth of exports. This condition creates a negative effect on net exports. The Customs Union does not cause a trade deviation from Turkey to European Union (Ismail Seki, 2005). ( Utkulu and Seymen, 2004) confirm that distortions are at reasonably minimal levels. Due to the implementation of the CU especially, there are no tariffs and quotas on industrial commodities between Turkey and the EU. The former one, however, increases its comparative advantage in the world market while decrease in the EU market which is presumably caused by the CU.

Since the EU had already abolished its tariffs for imports from Turkey since 1971, the customs union did not bring about a significant liberalization for Turkey's exports to the EU. On the contrary, Turkey's gradual elimination of tariffs against EU caused slight increases on EU imports to Turkey. But as can be seen from the statistics, changes in import figures were not as drastic as expected. The Customs Union constitutes a very important step towards Turkey's full integration with the EU (Sertoglu & Ozturk, 2003).

According to (Ulgen and Zahariadis, 2004) owing to the EU-Turkish customs union, there is already a considerable degree of convergence between Turkey and the EU in the area of trade. In fact, Turkey is the only candidate country that has a customs union with the EU. At least with respect to the trade in goods, Turkey is almost part of the Single Market. The challenge of enhancing the present state of trade integration could be approached in two ways. First, the Customs Union could be deepened by refining the arrangements and addressing its shortcomings. Secondly, the degree of trade integration could be enhanced by incorporating areas such as services and agriculture – thus widening the Customs Union – which is also explored in detail.

(Neyapti, and Ungor) observed that the income elasticity of both exports and imports are lower in the EU countries, and especially in the CU period. The effect of the RER on Turkey's exports is stronger for the CU period, though not earlier. For imports, we observe just the reverse: real appreciation of TL has had a positive impact on imports especially for the EU countries, though not in the CU period. The amplified effect on imports of the *rer* for the EU country group probably captures the increased imports during the periods of largely overvalued TL, especially in 1993 and 2000. In addition, they observe that countries with higher political instability and better governance have had more trade with Turkey than others. According to them customs union agreement has contributed to the increasing volume of trade between Turkey and the EU. In addition, income effect on trade has decreased over the CU period. However, our exports to the EU have become more responsive to the real exchange rate misalignments during the CU period, though not imports. This implies that periods of overvalued TL have come to carry a greater destabilizing risk for Turkish trade with the EU for it leads to a larger fall in exports than before.

Ercakir (2005) mentioned that becoming member of the CU affected Turkish producers to improve the quality of products because of high competition in Europe. (Mercenier and Yeldan1997) found that Turkish economy was likely to suffer welfare losses from CU. In contrast Harrison explained positive welfare gains from CU. (Astrid-Marina Lohmann) examined Turkey's intra-industry trade with the EU in the 1990s.( Harrison, Rutherford, Tarr, 1997) used computerable general equilibrium model, the impact of the Customs Union between Turkey and the European Union. (Toksoz, Mina, 1996) found that the Customs Union will give a major boost to EU exports to Turkey as tariffs are reduced on thousands of industrial products. (Togan) explained liberalization of trade in industrial commodities and agricultural commodities.

### **Data collection and the respondents**

The study was conducted among 70 firms, from Istanbul, Denizli, Ankara, and Samsun, in March and April, 2005. Respondents were selected through convenience sampling. 150 questionnaires were distributed and 70 of them returned and response rate was 47 percent. The response rate was reasonable, because the researcher expected a low response rate. Overall a "typical" response rate is about 50 percent; a "good" one is 60 percent to 70 percent (Kervin, 1992). Therefore, a "drop-off, pick-up" method of survey administration was found very suitable for the purpose of this study, and it was adopted. Before the survey administration, a pre-test of the questionnaire was conducted with a small group of respondents, and the result was satisfactory. One of the reasons for not returning paper is the behavior altitude of the firm's owner.

A survey was conducted by Firm's owner; representatives of the firms who have trade relations with European Countries and have an idea of the CU took part in the survey and got the questionnaires filled.

The answers of the questions depend on how they are affected by the CU agreement. If their benefits are more than their losses they mostly answer that the CU has a positive impact on Turkish trade. If their loss is more than gain they answered CU has a negative effect on Turkish trade.

Data were collected by means of self-administered questionnaires, each lasting for approximately 15 minutes. The questionnaire was first developed in English and then translated into Turkish for Turkish firms. Then, a business professor and a Turkish language professor, who are also fluent in English checked the Turkish translation. Finally, the Turkish translations of the questionnaire were retranslated back to English by four students in order to ascertain that it was conveying the exact meaning as originally designed. Surveys were based on a questionnaire consisting of two parts: the first asked a series of questions focusing on the effects of the CU on Turkish trade; the second comprised some questions about the effects of the CU on their business. A special effort was made to keep the questionnaire as simple as possible in terms of structure, wording, and scaling. A five-point Likert scale was used to search attitudes of firms towards the CU.

The survey instrument focused on the following areas:

- The effects of CU on Turkish trade
- The effects of CU on individual firms
- The effects of CU on foreign Direct Investment (FDI)

As it is mentioned above, there were many obstacles to CU. Some of them are;

- Small enterprises will be affected because of low technology and lack of knowledge
- Import from third countries will decrease
- Turkish firms will be affected with the high competition
- The firm's profit will decrease
- If encouragements will not be like EU, EU's support for its producers will influence Turkish producers in a negative ways
- Labor costs in Turkey will increase, and one of the advantages of Turkish producers will disappear.

## Evaluations

**Table 1. Mean Scores for Each Attitude toward Customs Union .**

| Factors                                                                                                                                        | Mean Scores |
|------------------------------------------------------------------------------------------------------------------------------------------------|-------------|
| Labor costs in Turkey increased, and one of the advantages of Turkish producers disappeared after CU                                           | 2.94        |
| Turkey became a center for those EU firms which would like to move products to central Asia, Black Sea Region and Middle East.                 | 2.93        |
| The benefits of firms increased after CU                                                                                                       | 2.91        |
| CU weakens Turkish firm's competitiveness                                                                                                      | 2.84        |
| Access to the EU market will bring huge trade opportunities to Turkish producers                                                               | 2.71        |
| Foreign direct investment increased after CU                                                                                                   | 2.69        |
| Small enterprises are affected because of low technology and lack of knowledge                                                                 | 2.67        |
| Custom Union agreement created more trade opportunities between European Union and Turkey                                                      | 2.64        |
| Turkey's infrastructure developed by financial cooperation and also increased cooperation between EU and Turkish firms through joint programs. | 2.64        |
| Custom Union is a big lie                                                                                                                      | 2.63        |
| EU's support for its producers influences Turkish producers in negative ways                                                                   | 2.53        |
| After Custom Union agreement the competitiveness and quality of Turkish products increased                                                     | 2.36        |
| Becoming member of CU before Full membership was a big mistake                                                                                 | 2.31        |
| CU will provide more positive effects after full membership of Turkey                                                                          | 2.21        |
| <b>Overall Average</b>                                                                                                                         | <b>2.07</b> |
| Mean scores are based on a five-point scale ranging from 1= Strongly agree to 5= Strongly disagree                                             |             |

Table 1 displays the results of mean scores for each environmental impact statements used in the study. The statements in Table 1 have been arranged in order of the magnitude of the mean score. The highest mean score (2.94) was for the statement that labor costs in Turkey increased, as this statement shows us that firms suffered from labor increased cost. The answer to above statement shows that the qualification of workers increased which effected labor cost. Another statement is, the advantage of Turkish producers disappeared after CU and CU weakened Turkish firm's competitiveness (2.84) got relatively higher scores. It supports the arguments of CU which affected small and medium enterprises (SME) in a negative way. Many SME collapsed after this agreement. The representatives of the firms think that Turkey became a center for those EU firms which would like to move products to central Asia, Black Sea Region and Middle East (2.93) and the statements "Foreign direct investment increased after CU (2.69). Table 1 implies that foreign firms come to Turkey to invest more after the CU agreement. In 1995 EU's share of foreign direct investment (FDI) was 62.91 %, in 1996 85.28, in 1997 % 60.92. There is a sharp decrease in 2002 which is the result of 2001 crises in Turkey.

It is found that the benefits of firms increased after CU (2.91) and access to the EU market will bring huge trade opportunities to Turkish producers (2.71). Many firms entered to Turkey after CU. Turkish firms made an agreement with them and increased the quantity of the products exports. On the other hand, they disagree that CU will have more positive effects after the full membership of Turkey (2.21). This statement is one of the most interesting results. A higher score was expected for this question, among researchers in Turkey and Europe, there is a belief that CU is a big step to becoming a full member of EU. In the scale, becoming member of CU before Full membership was a big mistake (2.31), has also got relatively lower scores. This statement has been discussed by researchers; some of them agree on this statement some of them do not. But businessmen mostly stated that it was a mistake signing CU agreement without becoming a full member of the EU. Owners of firms argument is, Turkey must accept the rules accepted by EU countries, which will be used by Turkey where Turkey does not have any contribution to those decisions.

The statements “Access to the EU market will bring huge trade opportunities to Turkish producers (2.71)” . That might be because Turkish firms increased the quality of products. The above statement and high scores imply that Turkish producers got some more trade opportunities and started to improve the quality of the products. In order to meet EU’s criteria, many firms renewed themselves. For example some sectors became more popular and started to produce high quality products. The automotive sector showed a sharp production increase. The production of color Television increased from 1.8 million to 8.8 million items in between 1996-2000. The textile and ready made clothes sector in 1998 had a 19 % in total manufactured goods, in a total production 5.5 % and 21 % , and it increased to 39 % shares in total export of Turkey. As result of CU, input costs decreased in Electronics industry. Production between the years 1996-2000 increased by 14%, and exports by 38% (from 500 million dollars to 1.2-1.3 billion dollars).

Between 1995-2000, the production of refrigerators increased from 1.7 millions to 2 million items, washing machines from 866000 to 1.3 millions, vacuum cleaners from 879000 to 1.2 million, automobiles from 222000 to 306000, buses from 12000 to 47000.

## Factor Analysis

**Table 2 Factor Analysis of Attitudes toward Customs Union**

| Factors                                                                                   | Factor Loadings |       |       |       |
|-------------------------------------------------------------------------------------------|-----------------|-------|-------|-------|
|                                                                                           | 1               | 2     | 3     | 4     |
| <b>Factor 1: Pessimistic approach to Custom Union</b>                                     |                 |       |       |       |
| EU’s support for its producers influences Turkish producers in a negative way             | .749            | .191  | .058  | .112  |
| CU weakens Turkish firm’s competitiveness                                                 | .713            | .076  | -.026 | -.057 |
| Small enterprises are effected because of low technology and lack of knowledge            | .604            | .028  | .107  | -.020 |
| Custom Union is a big lie                                                                 | .602            | -.209 | -.322 | .367  |
| Becoming a member of CU before Full membership was a big mistake                          | .576            | -.074 | -.202 | .539  |
| <b>Factor 2: Optimistic approach to Customs Union</b>                                     |                 |       |       |       |
| Custom Union agreement created more trade opportunities between European Union and Turkey | .083            | .829  | .107  | -.089 |
| After Custom Union agreement the competitiveness and quality of products increased        | -.140           | .806  | .290  | -.009 |
| The benefits of firms increased after CU                                                  | .342            | .542  | .231  | -.128 |
| CU will have more positive effects after full membership of Turkey                        | .141            | .501  | -.208 | .404  |

| Factors                                                                                                                                        | Factor Loadings |       |       |       |
|------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------|-------|-------|
|                                                                                                                                                | 1               | 2     | 3     | 4     |
| <b>Factor 3: Opportunistic approach to Custom Union.</b>                                                                                       |                 |       |       |       |
| Access to the EU market will bring huge trade opportunities to Turkish producers,                                                              | -.008           | .010  | .784  | .032  |
| Foreign direct investment increased after CU                                                                                                   | -.198           | .280  | .705  | .118  |
| Turkey became a center EU firms would like to move products to central Asia, Black Sea Region and Middle East.                                 | .193            | .136  | .623  | -.050 |
| <b>Factor 4: Cooperation seekers</b>                                                                                                           |                 |       |       |       |
| Turkey's infrastructure developed by financial cooperation and also increased cooperation between EU and Turkish firms through joint programs. | -.043           | .093  | .380  | .765  |
| Labor cost in Turkey increased, and one of the advantage of Turkish producers disappeared after CU                                             | .030            | -.078 | -.021 | .521  |

**Note:** Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

Factor analysis produces hypothetical constructs, called factors, which represent sets of variables (Harman, 1967). The principal component method of factor analysis was used with a varimax rotation. The resultant Varimax rotation factors are given in Table 2.

The first factor in Table 2 consists of: "EU's support for its producers influences Turkish producers in negative ways (.749)", "CU weak Turkish firm's competitiveness (.713)", "Small enterprises are influenced because of low technology and lack of knowledge (.604)".

"Custom Union agreement created more trade opportunities between European Union and Turkey (.829)" and "After Custom Union agreement the competitiveness and quality of products increased (.806)", "The benefits of firms increased after CU (.542), and "CU will have more positive effects after full membership of Turkey (501).

The third factor in Table 2 delineates a cluster of "Access to the EU market will bring huge trade opportunities to Turkish producers (.784)", "Foreign direct investment increased after CU (.705)", "Turkey became a center for those EU firms which would like to move products to central Asia, Black Sea Region and Middle East (.623)",

The fourth factor delineates a cluster of "Turkey's infrastructure developed by financial cooperation and also increased cooperation between EU and Turkish firms through joint programs. (.765)", "Labor cost in Turkey increased, and one of the advantage of Turkish producers disappeared after CU (.521).

**Table 3. Factor analysis results- Attitudes toward Customs Union**

| Factors                                          | Eigenvalues | % of Variance | Cumulative variance% |
|--------------------------------------------------|-------------|---------------|----------------------|
| Factor 1: Pessimistic approach to Custom Union   | 2.372       | 16.944        | 16.944               |
| Factor 2: Optimistic approach to Customs Union   | 2.086       | 14.901        | 31.845               |
| Factor 3: Opportunistic approach to Custom Union | 1.998       | 14.271        | 46.116               |
| Factor 4: Cooperation seekers                    | 1.503       | 10.735        | 56.851               |

**Notes:** \*Rotation Sums of Squared Loadings of Total Variance Explained

### Reliability Analysis

Cronbach's coefficient alpha was used in this study to assess the reliability of the measures. Nunnally (1976) suggests a reliability coefficient of 0.60 or larger as a basis for acceptance of the measure. A Cronbach alpha coefficient of 1 would indicate perfect



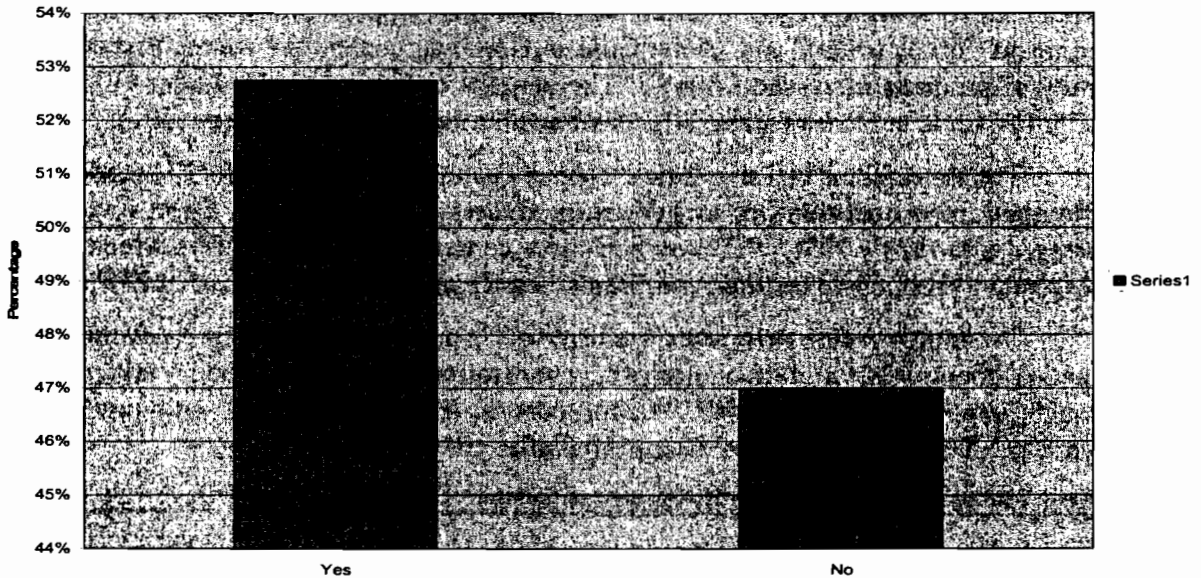
uni-dimensionality within a scale. When Cronbach alpha was computed for all the fourteen scale items this was found to be 0.653. This indicated the possibility that the entire scale was uni-dimensional. Cronbach alpha coefficient of 0.653 can be considered a reasonably high reliability coefficient. Based on this, it can be assumed that all 14 items used are measuring the same construct (Attitudes toward Customs Union) and, therefore, a summative measure can be used to represent the Attitudes toward Customs Union score of the respondents (see Table 4).

**Table 4. Reliability statistics**

|          | Cronbach's Alpha | N of Items |
|----------|------------------|------------|
| All      | .653             | 14         |
| Factor 1 | .721             | 5          |
| Factor 2 | .637             | 4          |
| Factor 3 | .620             | 3          |
| Factor 4 | .348             | 2          |

Factor 1 consists of five items with internal consistency reliability of 0.653; factor 2 had four items and reliability of 0.637; factor 3 consists of three items with reliability of 0.620, and factor 4 consists of two items with reliability of 0.348. Even though a reliability of factor 4 is relatively low, the factor coefficients of the items are highly polarized (see Table 4).

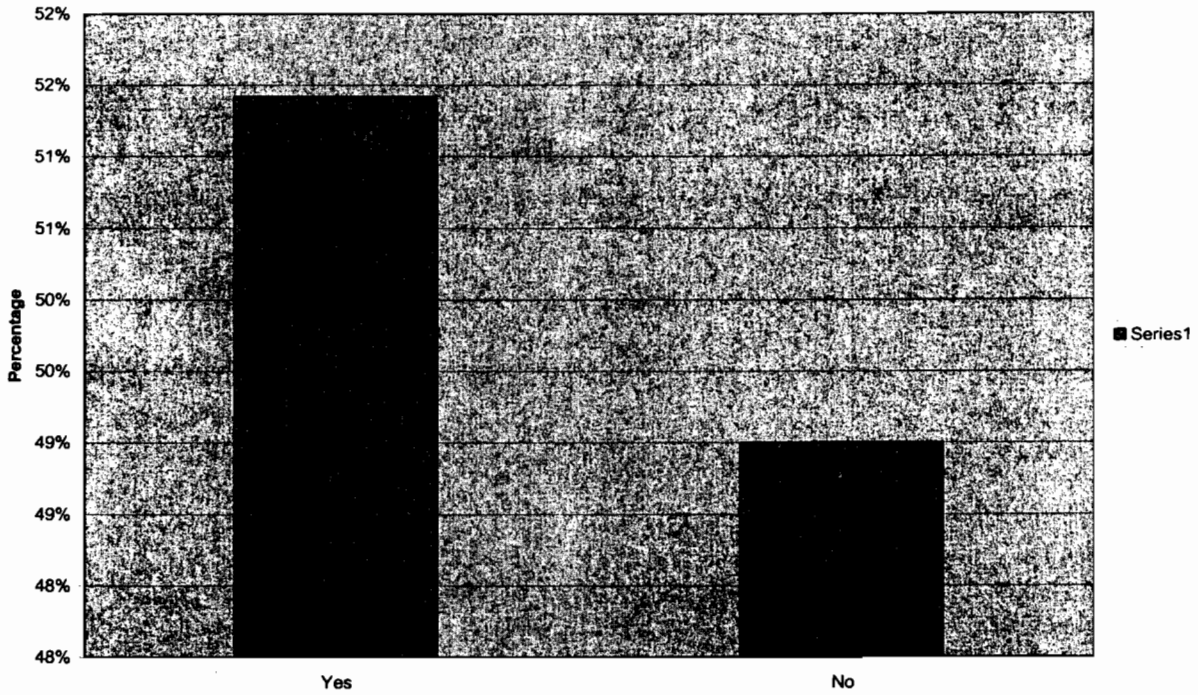
**Graph 1. Firm's export increased after Custom Union**



As we see from graph 1 among 70 firms questionnaire, 53 % (37 firms) firms owners or representatives answered that their trade volume increased after CU, but 47 % (33 firms) disagreed. This result implies that more firms increased their export to European Counties after Custom Union agreement.

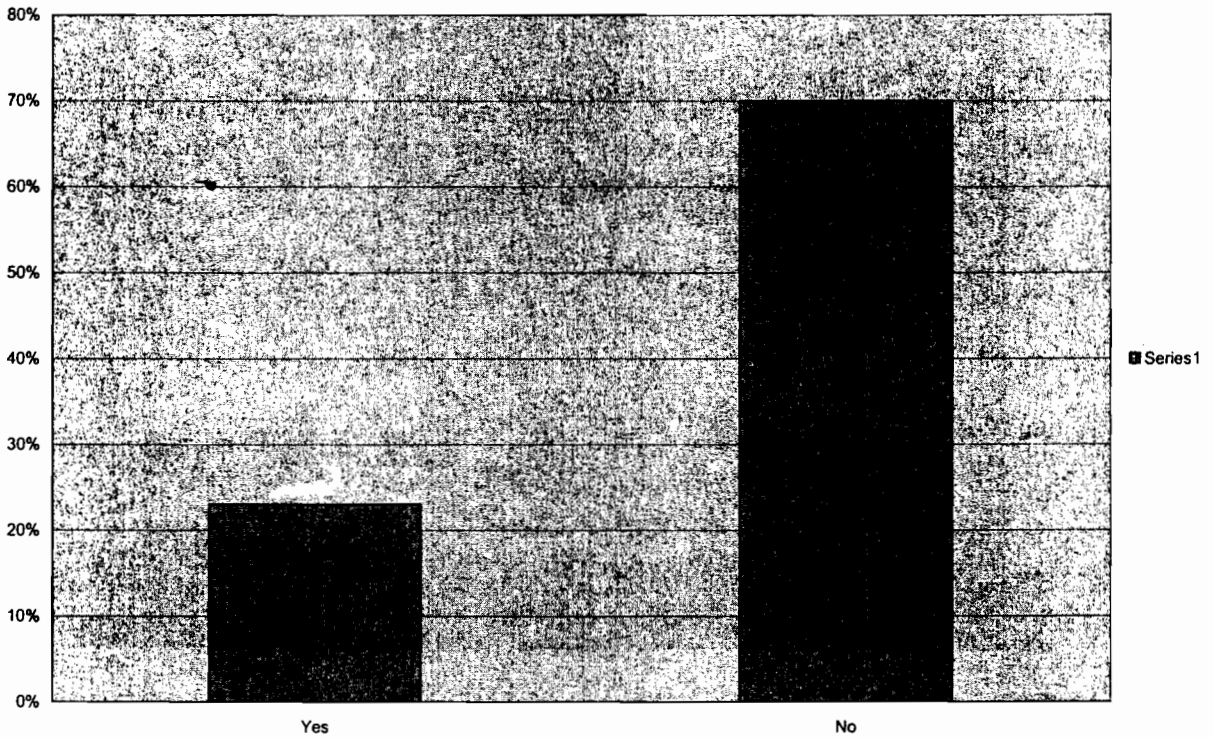


**Graph 2. Firm's import increased after Custom Union**



Graph 2 shows that 51 % (35 firms) of firms owners or representatives of the firms answered that import increased after CU, but 49 % (29 firms) disagreed. It can be concluded that import increased after CU agreement. As a result of these two graphs, it can be said that trade volume between Turkey and EU increased after CU.

Graph 3. Financial aid after CU



One of the main problems of entering CU is the conditions of agreement on Small and Medium Enterprises. It is believed that this agreement hugely affects these kinds of firms. In order to support these firms EU grants them in some expenses. Therefore, we added this question “We take financial aid after CU”to the questionnaire to see how many firms took grants from EU. Graph 3 shows that 23 % (16 firms) got financial aid after CU and 77 % (49 firms) said no.

### Conclusion

EU-Turkish relation has been the subject of the member countries and Turkey for many years. There has been conducted many researches have been conducted to analyze the importance of EU membership for Turkey and vice versa. EU membership is the final aim of Turkey. There are many sub-titles which Turkey must meet, such as economic and political requirements. The Customs Union is one of the most important one among under the economical criteria.

In the research it is observed that 16 % of applicants are pessimists toward to Custom Union. Optimistic approach to Customs Union is 14 percent. Opportunistic approach to Custom Union 14 percent and Cooperation seekers are 10 percent. According to those results, it can be said that firms are eager to become member of CU. Besides that, there were some surprise results like “ Becoming member of the CU before Full membership was big mistake” got 2.31 mean score and “The CU will have more positive effects after full membership of Turkey” and mean score is 2.21, which were expected high scores, got low scores.

As a result, the attitude of Turkish firms towards the CU is positive. Even they lose in short run, they are thinking, they will earn more in the future.

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