

**AN ANALYSIS OF TURKEY'S PROSPECTIVE
ENTRY TO EUROZONE**

IBRAHIM HALIL ASLANTEPE

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ÖZET

Avrupa birliđi adayı olan Türkiye'nin gelecekte cevaplaması muhtemel sorulardan biri Avrupa Para Birliđi'ne girilip girilmeyeceđidir. 2008 finansal krizini takiben başlayan Avrupa Ekonomik krizinin bazı üye ülkeleri zor duruma düşürmesi ve para birliđinin net avantajlı ve net dezavantajlı üyeler oluşturması, üyelik kararının kritikliđini daha da net şekilde gözler önüne sermiştir. Üyelik kararları geçmiş tecrübelerden de bilindiđi üzere hem ekonomik hem de siyasi içeriđe sahiptir. Bu ikili yapı, bizim de hem ekonomik hem de siyasi argümanları içeren kapsamlı bir çalışma yapmamızı gerektirmiştir.

Cevaplanması gereken iki temel soru belirlemiştir. Birincisi, siyasi veya ekonomik savların baskınlığı fark etmeksizin Türkiye'nin kararının hangi yönde gelişmesi muhtemeldir. İkincisi ise muhtemel karardan bağımsız, hangi kararın Türkiye için doğru karar olacađıdır. Süreçler düşünöldüğünde bir hayli kompleks olan ilk soruyu cevaplamak için birçok teori kullanmak yerine çok nedenden beslenen tek bir teori olarak Liberal hükümetlerarasıcılık teorisini kullandık; ikinci soru için ise Türkiye'nin üyeliđinin ekonomik bağlamda ayakta kalıp kalamayacađını test eden optimal kur alanları teorisini kullandık. Liberal Hükümetlerarasıcılık teorisıyla sürece dahiliyeti olacak tüm çevreler için sürece etki edecek faktörleri, motivasyonları ve çıkarları inceleyerek hangi kararın ortaya çıkmasının muhtemel olduđunu inceledik. Optimal Kur Alanları teorisıyla ise hangi kararın olası olduđundan bağımsız; Türkiye için doğru kararın ne olduđunu inceledik.

Benimsediđimiz bütüncül ve çok nedenli tutumla elde ettiđimiz sonuçlar gösterdi ki; Türkiye, Avrupa Para Birliđi alanı nezdinde optimal kur alanları kriterlerini tam olarak karşılamamakta ve daha fazla yapısal yakınsamaya ihtiyaç duymaktadır. Bu duruma paralel olarak ele aldıđımız domestik çıkarlar ve siyasi motivasyonlar da gösterdi ki Avrupa Birliđi üyeliđi sonrası Para birliđine üyeliđin ertlenmesi Türkiye'nin alacađı muhtemel karardır ve üyelik için daha fazla ekonomik yakınsamaya zaman üretmiş olacaktır.

SUMMARY

One of the prospective questions that Turkey, as a EU candidate country, is going to answer is whether to join Eurozone or not. The negative effects of the Euro Crisis on particular members made the importance of the eurozone membership decision even more evident. As it is already known from previous entrances, membership decisions have economic and political content. This bipartite structure required us to make a holistic analysis including political motivations and economical arguments.

Two main questions needed to be answered. Firstly, whether it is dominated by economical arguments or political motivations, in which direction Turkey's decision may evolve? Secondly, Independently from what decision is likely, which decision will be the right decision for Turkey? To get results from these already complex questions, instead of turning our study to a clutter of numerous theories, we needed to use the right multi-causal theory to evaluate which factors may produce the decision and again the right theory which tests whether Turkey's membership will 'stand or fall' in economic terms. We used Liberal Intergovernmentalism to understand the factors, motivations and interests behind the likely decision about joining the Eurozone. LI provided us a holistic framework due to its multicausal manner and its synthesis understanding of useful theories. Independently from what decision is likely, to test which decision will be right for Turkey, we used Optimal Currency Area Theory.

This holistic and multi-causal manner we adopted showed us that Turkey does not completely satisfy the OCA criteria and is in need of further structural convergence. On the other hand, the domestic interests and political motivations showed us Turkey's decision about the Eurozone, in case of an EU membership, will generate enough time for further convergence with a probable postponement of entry to the Eurozone.

AN ANALYSIS OF TURKEY'S PROSPECTIVE ENTRY TO EUROZONE

CHAPTER.1

Introduction

In Europe, the most part of the last decade has passed under the shadow of the crisis and the euro, the common currency of 17 countries, has become a moot point while bringing the old debates about common currencies to light. The need to be a part of a greater market and a currency area for the prosperity of nations on a Ricardian perspective through more trade may have not been constructed well in the European example so that while the new members of the very last enlargement are postponing their prospective entry dates to eurozone further and further, the euro issue has and will become a huge question mark for EU candidate countries as well.

The history proves us the need for common currencies. The euro is not the first time we experience a multinational monetary union in Europe. The Latin monetary union created in 1865 and the Scandinavian monetary union created in 1873 (Bordo & Jonung, 1999, p. 34) prove us this fact. This particular need to establish greater markets with common currencies is an absolute need for prosperity but the decision to join an already established monetary union also involves critical relative factors depending on the candidate country's economical structure. The problem starts at this point. Regarding this problem, Ishiyama (1975, p. 370) indicates the vagueness of defending monetary integration since economists are capable of making a case either for or against joining a monetary union. Fleming (1971, p. 486) also touches upon this point as he says that advantages and disadvantages are incommensurable and exact quantification is infeasible. Furthermore, Ishiyama (1975, p. 369) characterizes the factors, which are

subject to examining before a decision, by their dynamic features and tells us that this dynamic nature of pros and cons makes assessment even more difficult. This feature also requires recurring dynamic analysis instead of one time static examining. This dynamic nature also means to take into account ex-ante and expected ex-post situation of a country. Alesina et al. (2002, p. 3) state the necessity for such a dynamic analysis as ‘allowing for the economic effects of currency union’. For these reasons, our analysis will not limit itself to stating current situation but will go beyond static test as we will consider trends to present a dynamic landscape.

This uncertainty in economic arguments, while also constituting a limitation on our study, also lets political agendas to get involved in the process as a main factor to decide whether to join or not. For some previous entrances to eurozone, political motivations even superseded economic arguments. Therefore we need to include political motivations. A comprehensive analysis should consider the position of interest groups with the power of political influence and the government as the aggregator of domestic interests and the protector of its own political capital. In this regard, Gilpin’s (2001, p. 3) claim of domestic economies being the principal determinants of economic affairs reminds us the importance of domestic actors. Milner (1992, p. 494) also claims that national preference is mainly based on the preferences of domestic interest groups and the sum of these interests, weighed by their capabilities of access to government, will form the national political stance. Eventually, as noted by Verdun (2002, p. 61), states represent a subset of domestic preferences. Moreover legal framework of EU, as Sandholtz (1993, p. 26) states, makes domestic politics, as mass opinion, a crucial factor for ratification of accepting euro.

For the case of Turkey, identity is another significant factor. While leaving aside the social aspects to other studies, any member of eurozone, up to a reasonable level, should be confident about the economic solidarity that other members will show in the form of transfer payments in case of an economic asymmetric shock. Examples from the EU bureaucrats such as the former European Commissioner for the Internal Market Frits Bolkestein’s warning about Islamisation of Europe and related perception of Turkey as a threat to European identity constitutes great doubts about the economic solidarity needed for a common currency area (Cited by Nugent, 2007, p. 482). Verde (2009, p.

122) also defines solidarity as a variable entering both side of benefit-cost equation of emu and Moravcsik (2012, p. 65) mentions about a relative weakness of solidarity in the Eurozone. This dimension of a prospective eurozone membership, as also noted by Nugent (2007, p. 481), indicates us that eurozone membership is 'not just weighing of costs and benefits' but in any case weighing cost and benefits is what any prospective eurozone member economy have to do.

This calculation is needed because Turkey's relationship with other eurozone members must be a positive-sum game. Dyson (2000, p. 134) asserts that this is partly because of the existence of a Lockian model of rivalry instead of a Hobbesian model of enmity. Turkey's membership will be in a framework of rival interests based on the expected relative capabilities of the Eurozone and Turkey. We hereby included the rational motivations of current and prospective members of the Eurozone. In this context, integration, as stated by Gilpin (2001, p. 11), mirrors individual states' motivation to realize their national interests and improve their relative capabilities which are in our case economic competence.

The significance of our study question for a prospective entry to the Eurozone for Turkey appears here. Despite the complexity and the uncertainty of economic arguments and the involvement of political agendas, Turkey has to turn this process into a positive sum game to realize her economic interests. The one problem is the distributional consequences of the Eurozone which creates members either with net benefits or net loss. On the top of this problem, countries with net loss actually do not have the option to leave the Eurozone due to the concerns about confidence loss in national economies and currency but also due to government debt which would be already turned into euro and as also stated by Layard et al. (2002, p. 28) the currency of debt cannot be changed back unilaterally. This possible negative scenario gives alarms about the significance of the decision and shows that it is actually a single shot decision.

The limitations on this study are the few number of similar analyses for Turkey's integration to a monetary area and the still ongoing uncertainty about economical arguments in the literature but independently from any limitation, this important question has to be answered in a way that will leave no room for an erroneous decision. One Market, One Money (1990, p. 5), a EU commission publication before the

establishment of emu, states: 'While the content of the agenda is both economic and political, the whole process will stand or fall on the basis of functional qualities of the economic and monetary union'. This bipartite structure requires us to make a holistic analysis including political motivations and economical arguments. The decision might be dominated by either economical arguments or political motivations but besides analyzing why the decision of Turkey may evolve in that direction, we also have to answer whether that direction will be right or wrong. Therefore to get results from this already complex question, instead of turning our study to a clutter of numerous theories, we need to use the right multi-causal theory to evaluate which factors may produce the decision and again the right theory which tests whether Turkey's membership will 'stand or fall' in economic terms. We will use Liberal Intergovernmentalism to understand the factors, motivations and interests behind the likely decision about joining the Eurozone. LI will provide us a holistic framework due to its multicausal manner and its synthesis understanding of useful theories. Independently from what decision is likely, to test which decision will be right for Turkey, we will use Optimal Currency Area Theory. The next chapter presents this convenient theoretical landscape of our study.

Chapter.2

Theoretical Framework

Liberal Intergovernmentalism

An abrupt introduction to liberal intergovernmentalism would leave the reader with very little knowledge about its roots and its evolution therefore we will use the door of realism to smooth our explanations and to lead the reader into liberal intergovernmentalism.

Realism is based on three main assumptions. States are the main unitary actors. States are rational and the habitat of states is anarchic. From the point of integration, states meticulously calculate the effects of cooperation on their relative capabilities. In this regard, Verdun (2002, p. 11) claims: ‘ integration would only happen if it were in the best interest of rational governments’ and if they choose to integrate, their rational behaviour forces them to calculate the benefits and the costs of alternative integration offers on the table. One condition Garrett (Cited by Verdun, 2002, p. 35) reminds us here is that for integration to take place, there must be converging interests. If interests start to diverge, the co-operation process will be stopped or even reversed. This also proves us that integration is an outcome of positive-sum games. In order to elaborate on what might be the ‘interest’ of states in realism, structural realist Waltz’s (1979, p. 118) frequently referred expression helps us, ‘states, at a minimum, seek their own preservation and , at a maximum , drive for universal domination’ . Despite Moravcsik himself admits that liberal intergovernmentalism shares the same basic assumptions with realism, this is the first reason why Moravcsik is not a realist and why we selected liberal intergovernmentalism. Realism primarily focuses on high-politics, security issues but Moravcsik’s liberal intergovernmentalism, as noted by Kenealy and Kostagiannis (2013, p. 229), looks ‘through a purely commercial lens that stresses economic power’. On the other hand, since we are examining the interest of Turkey to join a monetary union, this economic interests oriented nature of liberal intergovernmentalism makes it an apt choice for our study.

Forster (1998, pp. 349-350) says that origins of What Moravcsik presented to the literature has the same origins of neo-realism in which states first calculate their interests and then present a unified stance on an intergovernmental table. In relation to this, the second time Moravcsik (1993, p. 481) splits himself from the realist and neorealist tradition is with rejecting 'billiard balls', 'black boxes' depictions of states and instead he brings the domestic dimension to table. This is the second main reason why Moravcsik is not a realist. Moravcsik prefers a manner of synthesis of theories which he sees useful for his explanations. By doing this, he rejects a hierarchical structure of theories and criticizes the contemporaneous scholars who are offering an invalid synthesis way in which realism to be the main untouchable explanatory theory and other theories can help only for residual elements as a second class theory (Legro & Moravcsik, 1999, p. 51). Moravcsik understands that including the domestic issues, economic interdependence, the effects of ideas and international institutions is disturbing for realists and says that including these dimensions would be 'an intellectual coup for realists' (Legro & Moravcsik, 1999, p. 6). He also cares about the structure of realism and states that we cannot accept scholars who puts a new dimension on basic realist assumptions as a realist. He deems such action as degeneration of realism and summarizes this as realist degeneration into liberal, epistemic and institutionalist theories (1999, p. 22). Not only he rejects such degeneration for his respect to realists but also because he thinks such alterations 'stretches' the foundations beyond utility and recognition (1999, p. 53). Moravcsik, himself being aware of this degeneration and on the other hand with his needs of incorporating other theories for his multi-causal explanations and synthesis understanding, does not call himself realist or neorealist. And despite founding his theory on the same tripartite structure of realism, he is a liberal intergovernmentalist because for him the right way to reach distinction and crisper results is 'only through conceptual clarity, not conceptual stretching' (1999, p. 55). In this context, Forster (1998, p. 348) describes Moravcsik's manner as uniting systemic and domestic explanations, rather than forcing integration to 'the box of pre-existing theoretical approaches'. This differences and manner of Liberal Intergovernmentalism, in the spectrum of integration theories, puts it close to realism due to shared foundations but one step closer to neofunctionalism due to the inclusion of other dimensions.

The Spectrum of Integration Theories	Neofunctionalism
	Historical institutionalism
	Constructivism
	Epistemic Communities
	Advocay Coalition
	Policy Networks
	Laguna Beach
	Fusion Thesis
	Multilevel Governance
	Domestic Politics
	Two level games
	Liberal
	Intergovernmentalism
Intergovernmentalism	

Table.1: The Spectrum of Integration Theories (Verdun, 2002, p. 13)

Turning completely back to Liberal intergovernmentalism. Moravcsik (1993, p. 474) describes Liberal intergovernmentalism as ‘a liberal theory of how economic interdependence influences national interests, and an intergovernmentalist theory of international negotiation’. The three elements Moravcsik (1993, p. 480) thinks critical for liberal intergovernmentalism are ‘the assumption of rational state behaviour, a liberal theory of national preference formation, and an intergovernmentalist analysis of interstate negotiation’. Moravcsik is a synthesist. According to him (1993, p. 482), ‘liberal intergovernmentalism integrates within a single framework two types of general international relations theory often seen as contradictory: a liberal theory of national preference formation and an intergovernmentalist analysis of interstate bargaining and institutional creation’ therefore the underlying theoretical mechanism of liberal intergovernmentalism is as follows:

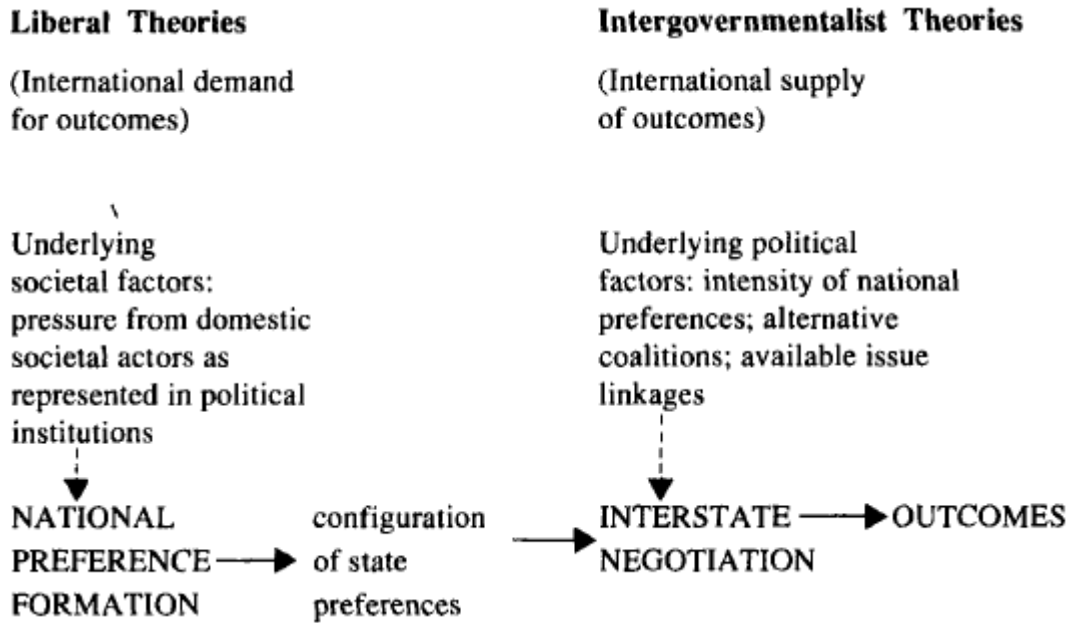


Figure.1:Liberal Intergovernmentalism (Moravcsik, 1993, p. 482)

Behind his ambition of synthesizing theories with explanatory capabilities, there is his rejection of theoretical reductionism. Moreover, he thinks that uni-causal theories are insufficient to produce comprehensive outcomes and to present the trajectory of integration in a holistic manner. In this regard, Moravcsik with his synthesis of theories sets forth a multi-causal environment of explanatory variables.

Turning our head to domestic factors of integration, we deem the major distinction of Liberal Intergovernmentalism. Moravcsik (1991, p. 55) says that ‘Domestic analysis is a precondition for systemic analysis not a supplement to it’. Even only from this phrase, it is enough for one to understand how much significance and weight domestic factors have in liberal intergovernmentalism. For Moravcsik (1991, p. 55), most of the integration theories have neglected domestic preference formation and used assumptions rather than examining. In relation to this, Talani (2014, p. 43) states that integrated domestic-international approaches does not take domestic interests as given and, by this manner, examines ‘where do state preferences and interests come from?’, ‘How does the state select the strategies to modify the international system?’ and ‘How will the state manage to ratify and implement internationally negotiated arrangements?’. Firstly, Liberal intergovernmentalism rejects the reductionism of international integration only to state interests and power. Moravcsik (1994, p. 64), in this regard,

says that there is a reciprocal effect between international integration and domestic factors. From this angle, he (1994, pp. 2-3) asserts that particularly the European example 'internationalizes domestic politics'. Therefore instead of using assumptions with no bond to reality, Liberal Intergovernmentalism deems policy aims of governments as outcomes which are changing according to the pressure of domestic groups. The interests of domestic groups are accumulated through the political structure of the state. In this context, Moravcsik (1993, p. 481) summarizes that 'National interests are, therefore, neither invariant nor unimportant, but emerge through domestic political conflict as societal groups compete for political influence, national and transnational coalitions form, and new policy alternatives are recognized by governments'.

Moravcsik's (1994, p. 4) theory recognizes two category of domestic actors. The first group, societal group, includes individuals, parties, civil servants, other cabinet misinisters, interest groups etc. The other category is for the executive body. He (1994, p. 5) further adds that the relative power of these groups is based on their ability of controlling four main channels of domestic politics: 'initiative, institutions, ideas and information'. The motivation to have power in these political resources for societal groups stems from the need to protect their interests.

International formations creates groups with benefits and losses and societal groups to steer the political direction of their states according to their own interests must maintain access to international policy area through their governments with using these four channels. In total, it is (Moravcsik, 1993, pp. 496-497) claimed that societal actors, with their actions to protect their interests and their ability to deliver their concerns to their governments, collectively form a bargaining space of viable agreements for the executives. On the other hand, as Moravcsik (1994, pp. 4-5) notes, domestic societal actors have two main action when faced with an undesired proposal by the government, they may either veto the proposal or may cause losses for the government in the next election. This mechanism defines us the 'win-set' which means the policy aims that can be pursued by the executives without sparking a veto or causing political costs in elections.

The other main group, executives, are the ones with proactive role to decide the international policy goals of the state but, as we explained above and from the way Liberal intergovernmentalism sees their position, they are embedded in domestic filters which are constraining their purposes. These filters are mainly based on the identity and interests of most influential groups. Considering the indispensable need to protect the political capital of the government, executives have to guard the interests of domestic groups. Therefore to keep themselves in the Office, Moravcsik (1993, p. 483) says, executives need the support of political parties, domestic voters, interest groups and bureaucrats whose influence and thoughts are effective in institutions and political representation.

In our case, to examine the likelihood of a eurozone membership of Turkey, we should look at domestic groups with clear benefits or losses because Moravcsik (1993, p. 483) states that ‘Groups that stand to gain or lose a great deal per capita tend to be the most influential’. He (1993, p. 487) further adds that such a process will urge groups with net losses to block cooperation even though that cooperation means net gains for the whole of the country. The same applies for the groups with net benefits. They will bring all the support they can to carry out the cooperation even though that cooperation means net losses for the country as a whole. Our case therefore requires proper identification of interest groups within issue-specific framework which means, as Schimmelfennig and Moravcsik (2009, p. 70) also state, for integration to the Eurozone we should examine groups with the dominance of economic interests. To accomplish this, we will ask questions similar to Moravcsik (1991, pp. 55-56) asked: ‘Which domestic actors take lead in promoting and opposing? Are they state or societal actors?, How do they perceive their interests? How do they influence one another? What is their relation to world economy?’. This whole mirrors the pluralistic framework of liberal intergovernmentalism. In short as Moravcsik (1993, p. 483) summarizes the mechanism: ‘Groups articulate preferences, governments aggregate them’. This is why we will include the interests of the societal domestic actors in Turkey.

Before closing this section, we should not miss the existence of an alternative scenario. We have already mentioned the vagueness of economic arguments regarding the monetary union. This may also cause confusion for domestic actors which can lead

them to stay neutral or avoid representing a position. Such a scenario is also very likely for Turkey's integration to the Eurozone. This will lead to loose constraints and minimal pressure over the government. Moravcsik (1994, p. 4) states that such a situation will give the government the chance to follow policies closer to its own preferences. He (1993, p. 494) summarizes such a scenario as follows: 'Liberal theory suggests that fundamental constraints on national preferences will reflect the costs and benefits to societal actors; where these are weak, uncertain or diffuse, governments will be able to pursue broader or more idiosyncratic goals'. This is like a warning for us from Moravcsik to include the preferences of the executives as a main explanatory variant. Therefore we have to examine the party programme of the ruling in Turkey with also considering the rhetorical vision, put forth by the government executives.

Liberal Intergovernmentalism due to its manner of synthesis and multi-causal nature constitutes the framework that will help us to analyze to which direction the decision of Turkey about joining may evolve. On the other hand, the next section will give us the clue to examine which decision will be right for the Turkish economy.

The Theory of Optimum Currency Areas

Especially after the Euro crisis, it is a cliché to start with stating that Europe or Eurozone is not an Optimal Currency Area. Leaving aside the relevant debates, Eurozone is a reaction to the unefficient regional economic structure which is based on the direction of the political evolution in the world in the last century. The number of the countries in the world has risen very sharply. Around 1940s, There were only 76 independent states, today this number is 196 (UN, 2014)(different sources may indicate different numbers due to differences in political recognition). As it is constituting a proof that politics and economics should never be analyzed separately, this political evolution has brought its economic consequences. Alesina et al. (2002, p. 4) note that 'In 1947, there were 65 currencies in circulation, whereas in 2001 there were 169. Between 1947 and 2001, the ratio of the number of currencies to the number of countries remained roughly constant at about 85 per cent. Twelve of these currencies, in Europe, have now been replaced by the euro, so we now have 158 currencies'. The

‘roughly constant’ ratio Alesina et al. speak of is the proof of how political course of the world deeply changed the mechanism of the world economy. In relation to this, Alesina et al. (2002, pp. 1-2) further add that this increase in the number of currencies happened, despite the expanding integration of the world economy. The extreme point of proliferation of currencies is having a currency for each individual which gives everyone an autonomous chance of managing their individual economy but this also turns the world economy into a barter system which lacks the efficiency of using a medium of exchange. Eurozone, in this regard, long before reaching such an economic distopia was a reaction to the unefficiency of numerous currencies. Apparently, the world has reached a threshold to understand the cost it applies over the real economy with issuing a large number of currencies and bounced back from that threshold with regional reactions such as the Eurozone. This reaction was also because the world understood, as also stated by Ishiyama (1975, p. 344) and many other scholars, ‘Oca may not necessarily correspond to national frontier’. In this context, Robert Mundell was a pioneer scholar who was aware of this contradiction between the political and the ideal currency map of the world. Mundell’s (1961, p. 661) first move was to relax the Ricardian assumptions of the world trade which correspond to internal factor mobility and international factor immobility.

His publication in 1961, *A theory of Optimum Currency Areas*, shed light on the preconditions of an optimal currency area. His study later expanded mainly by McKinnon (1963) (2004) and Kenen (1969). Following the questions, ‘Is a national economy an optimal currency area?’ and ‘Which countries should form a currency area if the optimal number of currencies is less than the number of countries?’ (Alesina, et al., 2002, p. 1), Mundell (1961, p. 657) simply asks ‘What is the appropriate domain of a currency area?’. A proper answer to this question is the only way to protect the members of currency areas from sub-optimal policies which correspond to either inflation or unemployment. For Mundell, the success criteria of currency areas includes price stability, full employment, and balance of payments equilibrium (Cited by Ishiyama, 1975, p. 346). To achieve this tripartite goal, in his theory, Mundell stipulated a main condition: ‘factor mobility.’ Likewise, he (1961, p. 661) defines the optimum currency area as a region with internal factor mobility and external factor immobility. The largest region without passing this threshold between factor mobility and factor

immobility correspond to the most efficient economical integration to achieve prosperity and here the requirement of factor mobility stems from the possibility of asymmetric shocks within the region. Mundell (1961, p. 658) uses a two-country example to draw the framework of a scenario of possible problems caused by a demand shift based balance of payments disequilibrium.

He first theorizes two countries (A-B) with their separate national currencies in a fixed currency regime. A demand shift from the products of B to the products of A results in a rise in the unemployment levels for B and inflationary pressures for the country A. If the prices of the country A can rise relatively to country B, then the country B will share some of the cost with the country A. But if A starts to implement a tight monetary policy to counter the inflationary pressures, then the country B will be alone to carry the cost of the disequilibrium. A reduction in the real income of B is what is needed to start balancing and if this is not possible, if B can not lower its prices compared to A, then B has to lower the total output and employment. This scenario is representing the effects of tight monetary policies of the surplus countries for the deficit countries. If these two countries were sharing a common currency and full employment policy. Again the shift of demand from the products of B to the products of A will bring unemployment to B and inflationary pressures to A. This would trigger monetary expansion in the country B to protect the employment levels but such a policy move of B will mean even more inflation in the country A. If this is allowed, the relatively higher prices in A with also inflation rising them further will help B to fix the unemployment.

If these two countries were in a flexible Exchange rate regime, a depreciation of the currency of B and the relative appreciation of the currency of A would improve the balance of payments disequilibrium which would also result in an acceptable unemployment level in country B and a reasonable inflation in the country A. The problem with currency areas including members with dissimilar economical structure is that a currency area cannot prevent both unemployment and inflation. In this regard, Mundell's (1961, p. 659) statement, 'The fault lies not with the type of currency area, but with the domain of the currency area', has critical significance which provides insights us to examine what should be borders of each currency area and which countries may form a currency area. In our case, the specific query, 'whether Turkey

should be a part of Eurozone?', matches this critical question. We keep our study question is partially independent from the much stated debate whether eurozone is an oca or not. For Mundell, an alternative definition of an optimal currency area is that oca is a region where the common currency benefits outweigh the costs and we will examine Turkey in this regard to understand which decision will be right but this will also relieve the answer that whether Turkey would be making the Eurozone closer to an optimal currency area or not because the diversity, Turkey will bring has an economical meaning. Verde (2009, p. 121) asserts that in an optimal currency area, net benefits are positive when N (the number of the member countries) is rather small and negative when it transcend a critical N^* value. The diversity of a currency area has the potential to threat the required level of factor mobility, Mundell stipulated for currency areas so that larger N means, more vulnerability to asymmetric shocks (Obstfeld, 1997, p. 299). Let's now take a closer look at Labour mobility.

Labour Mobility

According to Mundell, Factor mobility is like a cushion mechanism against the asymmetric shocks in a currency area. Mundell particularly emphasizes the function of labour mobility. In case of an asymmetric shock, work force in the depressed region can migrate to the surplus regions to find new jobs and this process will eliminate the need for monetary expansion in the depressed region because the unemployment will not appear.

One limitation put forth (Fleming, 1971, p. 485) on labour mobility is the heterogeneity in skill, language and education. Angeloni et al. (2007, p. 14) state that before an effective labour mobility to counter the asymmetric shocks, there have to be flexibility in the labour markets. Flexibility should not be limited only to skill and education but should also include culture and particularly language. The Eurozone, despite the institutional integration, is a huge question mark in terms of this flexibility of the labour markets. In relation to this, Eichengreen (1991, p. 12) states: 'The absence of legal restrictions is necessary but not sufficient for labour to move freely between regions'.

This statement, with also considering the already low labour mobility in Europe, points to the difficulties Turkish labour market may experience. One last thing to remember about the labour mobility is that it is a cost over economy. According to Corden (1972), the cost over migrating workers cannot be ignored.

Surrendering monetary autonomy and risk of asymmetric shocks and relevant negative experiences required optimal currency area theory to evolve and include broader aspects so that in addition to factor mobility two more main condition, openness of the economy (McKinnon, 1963) and product Diversification (Kenen, 1969) have been introduced.

Openness of The Economy

Ronald McKinnon (1963) introduced the openness of the economy to expand the scope of the optimal currency area studies and for the problems of balance of payments disequilibrium, price instability and unemployment. In relation to this, Angeloni et al. (2007, p. 379) state that the openness of the economy is one of the main factors that have to be examined in a detailed way for selecting exchange rate regimes but particularly to decide on a membership to a currency union. Related to currency unions, Angeloni et al. (2007, p. 380) underpin his statement with pointing to the fact that high openness results in co-movement of economic cycles in a currency area.

McKinnon (1963, p. 717) defines the openness of the economy as ‘the ratio of tradable to non-tradable goods’ and uses an example of a small country to show the effects of openness clearly because small country economies lack the self-sufficient characteristic of large economies and tend to be more open. For a small country with a high ratio of tradables to non-tradables, McKinnon (1963, p. 722) asserts that if the prices of the tradables are based on the foreign currency then fixing national currency to non-tradables will not be handy. Moreover, he claims that if such a country does not fix its currency to the currency of a larger economy, which it has a great amount of trade, the liquidity value of the national currency will be damaged and citizens will start to use

foreign currency for their savings. He introduces another scenario of a number of open economy countries trading with each other extensively, in this case, McKinnon (1963, p. 722) states that currencies should be pegged to each other. In relation to this, Ishiyama (1975, p. 351) states that the benefits, open economies will get from the fixed exchange rate regimes, are sound price stability and less income variation. Furthermore, in terms of the possibility of asymmetric shocks, openness of member economies of a currency union will also reduce this risk because the high volume of trade results in co-movement of economic cycles. This was also empirically presented by Frankel and Rose (1998, p. 1018).

For these clear reasons, openness of an economy enters to the calculation of decisions to join a monetary union and we will also examine Turkey from this perspective.

Product Diversification

The idea that product diversification in member economies is in behoof of currency areas belongs to Peter Kenen (1969). He deems obstacles for the labour mobility Mundell proposed as the mechanism to counter asymmetric shocks. Kenen asserts labour mobility can be effective only if there is a flawless homogeneity in the labour markets and instead he introduces product diversification as a better way to counter to asymmetric shocks. There are three main underlying reasons for Kenen's assertions. Firstly, he (1969, p. 49) claims that a national economy with diversified sectors will not have to change the terms of the trade as frequent as a single sector country. Secondly, in case of an asymmetric shock, the fall in demand will not affect all of the sectors in a well-diversified national economy and the unemployment will not rise so sharply. As Ishiyama (1975, p. 353) notes, this is simply because every sector in a diversified economy provides only a fraction of the total employment. The final main reason for Kenen is that the employment created by foreign investment will not be harmed as it would be in a single product country. This is because in a diversified economy, there is a weaker link between investment and export levels. Kenen with drawing this framework asserts that diversification in economies is reducing the negative effects of asymmetric shocks as it also reduces the possibility and therefore the frequency of

shocks. From this perspective, product diversification has both ex-ante and ex-post benefits for member countries of a currency area. Moreover for Kenen (1969, p. 54), diversification of economy means a large number of different sectors offering jobs for different skills and education, this also removes barriers for efficient and effective labour mobility.

In total, Kenen (1969, p. 54), due to the diversified structure of their economies, advises fixed exchange rates for the developed economies. On the other hand, the developing countries with dominant sectors in their economies should stick to a more flexible exchange rate regime to respond to probable demand shocks.

Two last criteria before finalizing this section are inflation and interest rates. The importance of inflation rates for optimal currency areas was particularly studied by Haberler (1970) and Fleming (1971). They claim that the similarity of inflation rates must be included in studies as a main factor. The underlying assertion of these scholars is that the disequilibrium of payments balance is caused by divergent national inflation and monetary policy differences. In addition to the statements above, divergent inflation rates deteriorate the stability of the fixed exchange rate regimes and the same is valid for common currency areas.

On the other hand, Ingram (1969, p. 96) states that the level of financial integration is one of the factors to determine the borders of an optimal currency area. In this regard, he uses the similarity of interest rates as a proof of financial integration. That's why we will also compare Turkey's inflation and interest rates with the corresponding rates of the Eurozone members.

Optimal Currency Area theory provides a reasonable and simple framework to assess a country's compatibility to a currency area on an economical basis. We will analyze Turkey from all of these aspects of this theory to provide an apolitical and holistic assessment and then we will unite this analysis with political motivations.

Chapter.3

Research and Analysis

National Aggregation of Economic Interests and Political Motivations

In this section, we will define the interests of the relevant economic actors within the framework of the pros and cons Euro will bring. The interest groups will include only economic actors due to the issue-linkage basis of liberal intergovernmentalism theory. Moreover for the possibility of an uncertainty in the interests of domestic economic actors, we will also examine the political vision of the ruling party for a prospective euro membership.

Advantages and disadvantages of euro area, in more general terms a common currency area, is a set of much-stated expectations. Advantages include controlled inflation, reduction in transaction costs, increased competition and efficiency which are expected to bring higher quality and lower prices, economical convergence and stability (Directorate-General For Economic And Financial Affairs, 1990, p. 61). We may also add the more advantageous position of member states to attract FDIs. The advantages are accompanied by some critical disadvantages including losing independent budgetary and monetary policy making (Feldstein, 1997, p. 24) and vulnerability to asymmetric economic shocks. Furthermore, as noted by Layard et al. (2002, p. 20), there are also some usually ignored structural one-off costs such as the ` investment costs of the transition to euro notes and coins` which has corresponded to the less than 0.8% of each member state GDPs so far. For Turkey, The main question of this cluster is – Whether the efficiency and stability gains will outweigh the costs of surrendering independent monetary policy making or not? To answer this question we have to examine the economical setting that Turkish economical actors are operating in.

Regarding the advantages and the disadvantages, Frieden helps us to define the main economic interest groups in the real economy and in the financial sector. He summarizes his classification for the real economy as follows:

`I expect division between economic actors who support and oppose fixed rates for real rather than monetary reasons. Cross-border investors and financial actors, as well as export-competing producers of specialized manufactured goods, will be in favor of fixed rates. Producers of standardized import-competing and export goods-those in favor of maintaining the national ability to depreciate the currency-will be against fixed rates` (2002, p. 840).

From this classification, We will particularly examine the position of the producers of standardized import-competing and export goods. The reason for this is that, for Turkey, we first have to remember that only a small proportion of exports is specialized products. Turkey, regarding the ratio of specialized, high-tech exports in total exports, has a similar characteristic with club med countries of the Eurozone who were severely affected by the euro crisis. The graph below shows this similarity and explains why we will particularly focus on the interest of the producers of standardized import-competing and export goods.

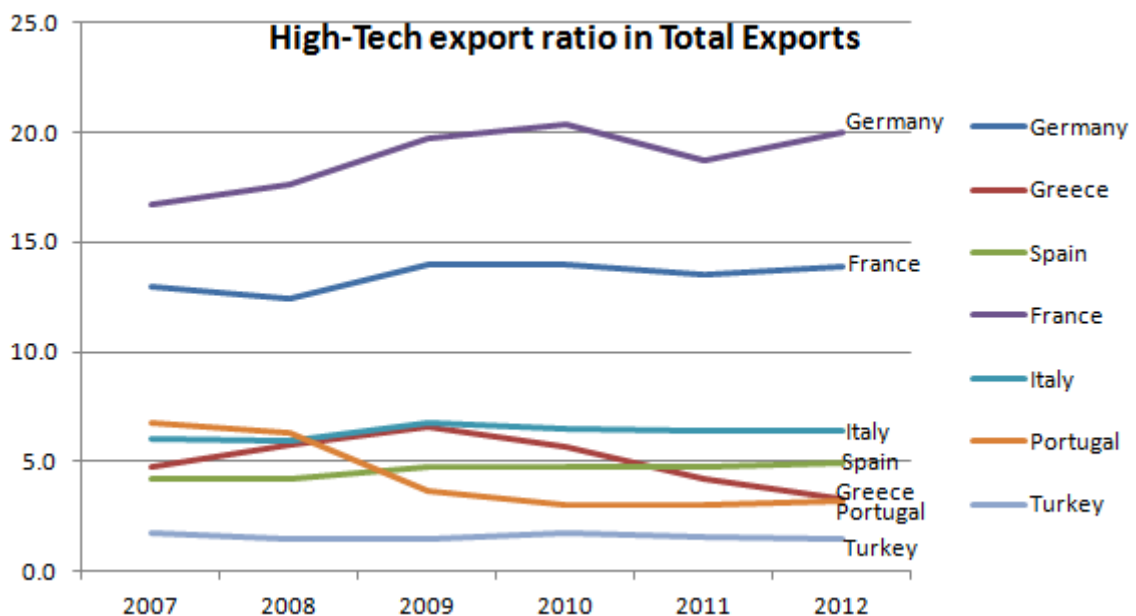


Figure.2: High-Tech Export Ratio

(Eurostat, 2013a)

This reminds us that price is still the foremost factor to stay competitive in the world markets for economies which are dominated by the producers of standardized import-competing and export goods. In this context, the value of Euro Currency is a question mark. Euro Area also has two clusters of countries. Frieden (1998, p. 32) notes that first there are the countries like Germany which focuses more on the price stability rather than the currency value because price is not the uppermost factor of exporters of unique products such as luxury cars, high-quality electronics. Secondly there are the countries like Greece who needs to be competitive with its prices due to the inability of exporting unique products. The first cluster of countries because of the demand they have for their products are pulling the euro value upwards while the second cluster of countries pulling the euro value downwards with decreased demand to their products due to the high value of euro. This mechanism makes countries of producing unique products even more advantageous because they have a currency rate lower than it would be if they were not a part of the Eurozone and for the countries exporting agricultural or standardized manufactured products they become even more disadvantageous because they have a higher currency rate than it would be if they were not a member of the Eurozone. Jager and Hafner (2013, p. 316) state that this structure causes sub-optimal policies and further economic divergence for the countries exporting standardized and agricultural products. Therefore in the case of Turkey, we should expect pressure from domestic firms over the government to keep the ability of depreciation which will mean rejecting or postponing the Eurozone membership. This is the main interest but on the other hand, we should note that these same actors are definitely in need of some financial qualities the euro will bring.

Turkish economy suffers from external geopolitical instability in the middleeast and in the eastern european regions which causes volatility of Turkish lira vis-a-vis euro. In the last year, as it can be seen below, this high volatility caused roughly a 28% appreciation of the euro and then a depreciation around 10% .



Figure.3: EUR/TRY Rate (ECB, 2014)

This unstable atmosphere complicates long term investment plans of Turkish companies. As also announced by credit rating agencies, this progress creates pressure over the credit ratings of Turkish firms (Fitch Ratings, 2014). What is more important this volatility causes debt based problems for firms with open positions in a foreign currency. As of second quarter of 2014, Turkish private sector holds a short term debt stock over 82 billion euro (The Central Bank of the Republic of Turkey, 2014). The depreciation of Turkish lira in the last year meant roughly a 15% increase of debt burden over Turkish private sector.

Moreover, the financing costs in Turkey is still high compared to the Euro Area. This causes lower investment and lower profit margins for Turkish firms. These two main reasons, the cost of volatility and financing, makes Euro attractive for Turkish firms but as we mentioned above, the risk of becoming uncompetitive in the world markets outweighs these benefits because even the firms operating with their own capital stock and making revenue in foreign currencies will lose their positions in the world market.

Here it should be definitely mentioned that the biggest problem and the most frequently criticized part of Turkish economy is its current account deficit. Considering the low ratio of specialized products in total exports. The only way to get rid of this problem is to stay competitive in the world markets so that the exports can at least balance the imports. For this particular need and also to cut the domestic demand for foreign products, depreciation remains as an inevitable option for Turkish economy until further

convergence to the economic structure of Northern members of the Eurozone which are specialized in high-tech products and remove the price from being the top priority. The relevant part of the Copenhagen economic criteria is actually states this very clearly: `the capacity to cope with competitive pressure` (Copenhagen European Council, 1993). This means until gaining the capacity to compete with the northern members of the Eurozone, due to its high value, euro is a luxury and risk for Turkey. To reach this threshold of competing capacity, there has to be further convergence in terms of the economical structure. Such a convergence will also result in co-movement of economic cycles and protect Turkey from asymmetric shocks.

On the other hand, If we look into the world of finance, we see another group with probable net losses, the owners of financial assets. Turkey with accepting Euro will be more integrated to Euro area and capital mobility will be even more facilitated and improved. Frieden (1991, p. 435) states that before capital mobility a country poor in capital and rich in labour has high interest rates and low wages. After capital mobility, the interest rates will decrease with inflow of funds and wages will increase. Therefore while local workers will get benefit of financial inflow, the local owners of financial assets will have to accept lower interest profits due to the convergence of interest rates to the global level. Therefore, we should expect pressure from financial asset owners over government to postpone the entry date to euro. These financial actors will get benefit of improved capital mobility due to flexibility it will provide them in terms of investment options but the loss of interest profits outweighs such benefits. For local workers, one thing has to be added that accepting euro may create a prosperous environment due to the financial inflow but if euro causes uncompetitive position for Turkish firms, as explained above, then they will again have to face a persistent unemployment situation. Therefore we cannot mention about net benefits for labour as we did not for the producers of standardized import-competing and export goods. For labour, any convergence other than the convergence in economic fundamentals, in real economy, constitutes a fragile and finite prosperity period. The divergence of interest rates and liquidity problems faced by some euro area members during the euro crisis proved us this fact very recently. The relevant interest rate divergence and the following income divergence can be seen below:

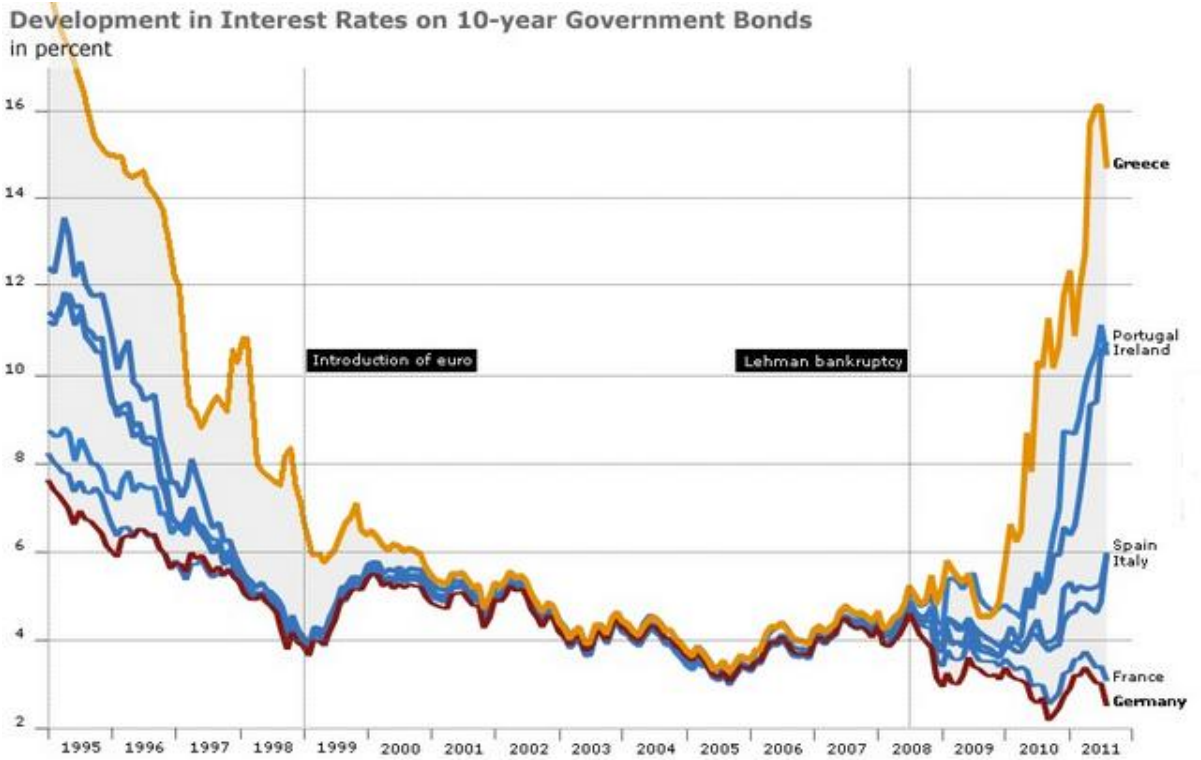


Figure.4: 10 year Government Bond Rates (Spiegel, 2011)

**GDP per capita change
2007-2013 (2007=100)**

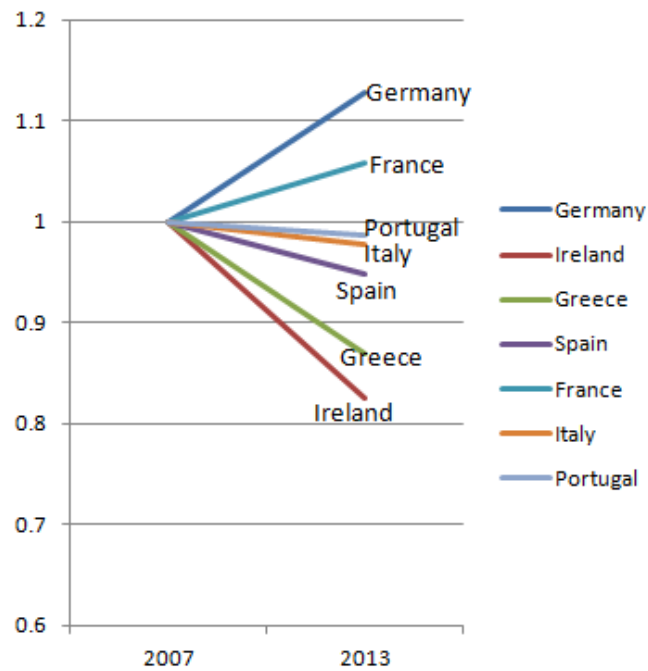


Figure.5: GDP per capita Change 07-13

Data: (Eurostat, 2014a)

Due to these reasons, we may expect pressure over government to postpone the date of entry to the Eurozone until further convergence from workers as well.

Finally, from the perspective of the government, there are two main interests: firstly, as also explained by the the voice opportunities thesis (Grieco, 1995, p. 24), acquiring influence power in the European Central Bank with accepting the euro and secondly, protecting the political capital for electoral concerns. In this context, putting the competitiveness of firms and employment levels at risk is not the best option to protect the political capital. When we examine the sensitivity of economic progress to election results, we found a clear correlation as it can be seen below:

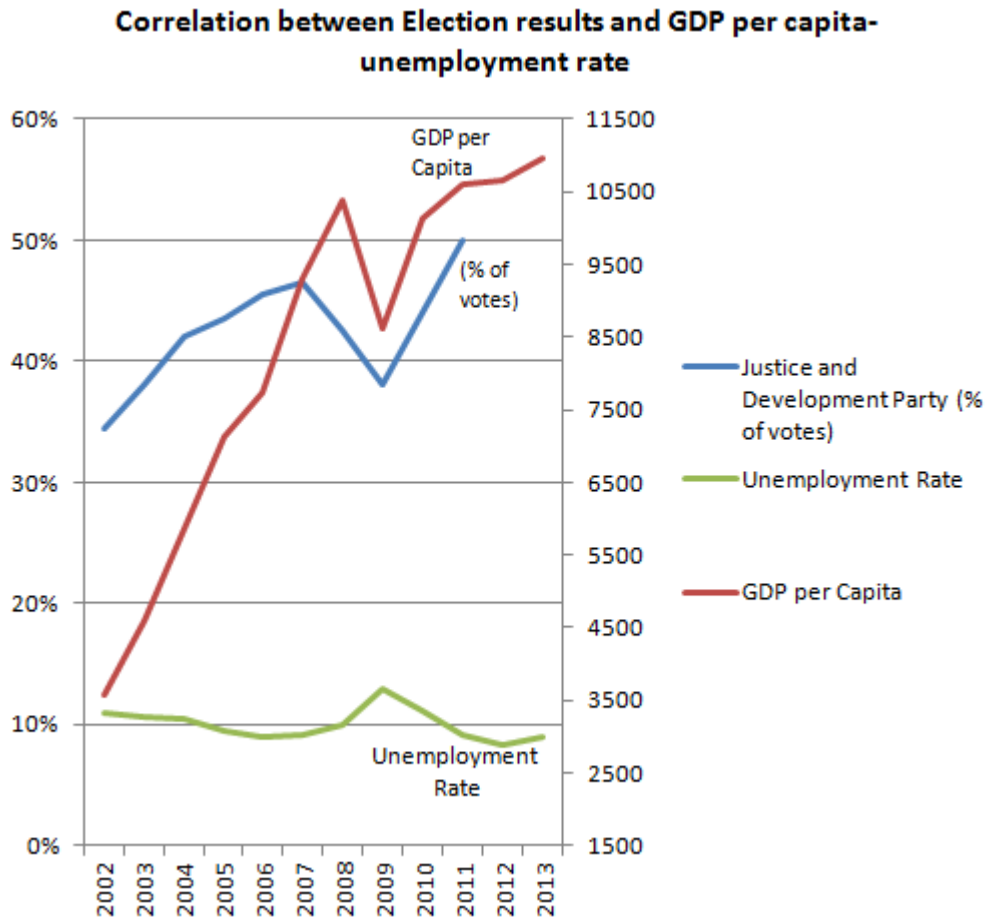


Figure.6:Correlation between Election Results and GDP per capita-unemployment rate

Election Results Data: (Karakaya, 2014);

GDP per Capita Data: (The World Bank, 2013a);

Unemployment Data: (Turkish Statistical Institute, 2014a)

These historical data indicate the borders for prospective government policies which will not spark an opposition and cause political capital loss. Therefore we should expect the ruling party, Justice and Development Party, to stay out of euro until further convergence. Also when we check the party programme of the ruling party (Justice and Development Party, 2014), it clearly sees European Union as an indispensable economic strategic partner but also clearly stipulates that `the relations must be maintained along the lines of the requirements of Turkish economy and Turkish national interests.` For these reasons, regarding our examination of national preference, interests of economic actors and the correlation between economic performance and election results, the most probable scenario is keeping the Turkish lira. Another proof for that is the political rhetoric of the executives. The prime minister Recep Tayyip Erdogan (Erdogan, 2012), to questions regarding the euro currency, answered that countries such as the United Kingdom which opted-out from euro are in better conditions than they would be otherwise; we may follow the same way and even a Turkish Lira zone can come into question. Therefore the political leadership and the party programme and vision papers proves us that the ruling party will maintain a parallel policy to the interests of domestic economic actors and is aware of the need for further convergence. This landscape of domestic interests and the parallel position of the government as the aggregator of these interests shows us the likely direction of the decision about joining eurozone. Whether this probable direction of postponing entry to the Eurozone is correct or not will be examined in the next section.

Does Turkey satisfy the Optimal Currency Area Theory Criteria?

In this section, Turkey`s economical structure will be tested within an apolitical framework to unveil whether Turkey satisfies the preconditions of OCA theory for joining the Eurozone. The test will be conducted under five titles including: labour mobility, openness of economy, diversification in economy, inflation rates and interest rates.

Labour Mobility

Labour mobility enables a currency area to fulfill one of its main purposes: full employment. This criterion appears to be one of the hardest for Turkey. Due to legal restrictions over labour mobility between Turkey and the Euro area, it is not practical to use the migration data of Turkey. Therefore for this condition, firstly euro area will be analyzed and then we will test where Turkey stands in terms of the problems current members face.

The level of labour mobility in Euro area is far from the desired levels to fulfill full employment purpose. To unveil this fact, we determined the margin between the the highest and the lowest unemployment levels in the Euro Area. In case of an effective labour mobility, the margin should be narrow because the migration of workers will balance the unemployment levels of different countries. Therefore while a narrow margin proves us the effective labour mobility, a wide margin means the contrary.

	2005	2006	2007	2008	2009	2010	2011	2012	2013
MAX	17.9%	13.9%	11.2%	11.3%	17.9%	19.9%	21.4%	24.8%	27.5%
MIN	2.6%	2.9%	2.3%	2.5%	3.2%	3.6%	3.3%	3.2%	3.5%
DIFFERENCE	15.3%	11.0%	8.9%	8.8%	14.7%	16.3%	18.1%	21.6%	24.0%

Table.2: Max&Min Unemployment Rate in the Euro Area

Data from: (Eurostat, 2014b)

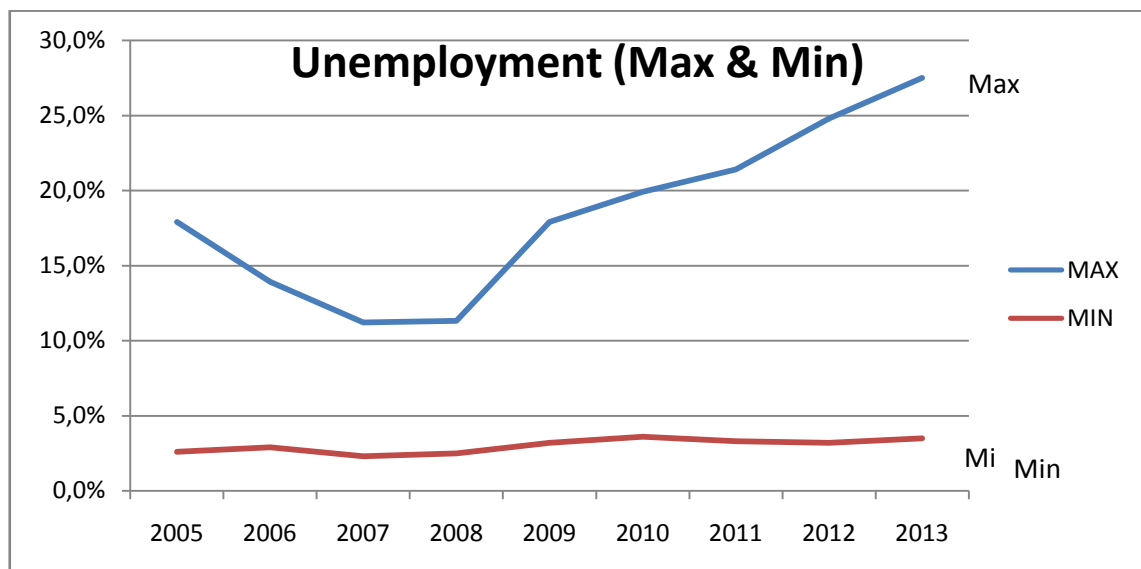


Figure.7: Max&Min Unemployment Rate in the Euro Area

Data From: (Eurostat, 2014b)

As it can be easily seen in the table above, the margin between the lowest and the highest unemployment levels is above the unacceptable levels for an optimal currency area so the question is – what are the obstacles for labour mobility?

The heterogeneity of skills and education is one factor but for Europe the main problems are lingual and cultural barriers. A European Commission report about the foreign language knowledge levels of Europeans reveals this problem. As it can be seen below %46 of Europeans do not speak a foreign language which automatically eliminates their chance of finding jobs in different euro area countries.

# of Foreign Languages	% of people who can have a conversation
At least 1	54%
At least 2	25%
At least 3	10%
None	46%

Table.3: Foreign Language Knowledge

Data From: (EU-Commission, 2012)

The same obstacles exist for Turkey as well. Also considering the lingual and cultural marginality, which is partially a result of geographical marginality, Turkey stands on even a harder position compared to many other Eurozone members. First of all, in Turkey`s education structure there is a clear dominance of English compared to other European languages which puts a limit on the prospective labour mobility in geographical terms. The proportions of foreign languages in Turkish education system reveal this fact:

	Primary School	Secondary School	High school
English	99.95%	99.36%	91.94%
German	0.04%	0.51%	5.96%
French	0.01%	0.11%	0.64%
Russian	0.01%	0.02%	0.02%
Japanese	0.00%	0.00%	0.01%
Latin	0.00%	0.00%	0.02%

Table.4: The proportions of foreign languages in Turkish education system

Data From: (Tok & Aribas, 2008, pp. 209-210)

Moreover, The English Proficiency Index also shows this lingual obstacle as follows:

Country	Proficiency
Sweden	69%
Norway	67%
Netherlands	66%
Estonia	66%
Denmark	65%
Austria	63%
Finland	63%
Poland	62%
Hungary	60%
Slovenia	60%
Belgium	59%

Table.5: English Proficiency Index

Germany	58%
Latvia	58%
Switzerland	58%
Portugal	58%
Slovakia	55%
Czech Republic	54%
Spain	54%
Ukraine	53%
Russia	51%
Italy	51%
France	51%
Turkey	50%

Data from: (EF, 2012)

This index reflects some lingual facts working against Turkey`s labour mobility. The four out of top five countries in this index are sharing the West-Germanic Language Family structure while the other languages are also a part of the greater indo-European language family. The family structure is below:

Language Family	Sub-Group	Branch	Languages
Indo-European	Germanic	West	English, Dutch, German, Flemish
		North	Danish, Swedish and Norwegian
	Italic		French, Italian, Portuguese, Spanish
		Hellenic	Greek
	Slavic		Russian, Bulgarian, Polish
	Indo-Iranian		Persian, Hindi, Bengali
	Baltic		Lithuanian, Latvian
Non-Indo-European			Turkish

Table.6: Language Families

Data from: (Kim & Lee, 2010, p. 2351)

Turkish is not a part of this family and lacks the natural links to European languages. Linguistic barriers cannot be even compared to other obstacles for labour mobility. In this context, Alesina et al. (2002, p. 9) and Bordo and Jonung (1999, p. 24) state that common language is one of the main and critical preconditions of labour mobility and optimal currency areas. As a result of this comprehensive examining, linguistic barriers are clear problems for Turkey. For these reasons, Turkey does not satisfy the labour mobility criterion for now but the problem is not insurmountable but requires a larger proportion of education budget to be used for this matter. Regarding this, accepting

Turkey to the schengen area will definitely be helpful for lingual improvement and cultural integration.

Another problematic aspect for Turkey is that ideological barriers between different private capital groups and rent-seeking behaviour in public sectors still remain as a problem for the flexibility of the labour markets. This aspect was particularly mentioned by Eder (2010, p. 225). In this context, LaGro (2007, p. 94) states that rent-seeking behaviour is the only obstacle before Turkish economy and Moravcsik and Vachudova (2003, p. 48) connect such behaviour to limited pressure for economic reforms. The lack of flexibility leads to a total unefficiency and therefore to decline in labour productivity growth as it can be seen below:

Real GDP per hour worked, annual compounded growth rate	
Country	2007-2012
Turkey	0.1
Euro Area	0.5

Table.7: Labour Productivity

Data from: (OECD, 2013)

Additionally, the legal restrictions and gender issues still remain as factors reducing the flexibility in the Turkish labour market (Voss, 2011, pp. 5-6) and as it was also mentioned in the last progress report (EU-Commission, 2013, p. 19), the undeclared work remain as a barrier for necessary actions. This whole is working against the required labour mobility.

For these reasons, Turkey needs further convergence before becoming a member of the Eurozone but meanwhile, as also advised by the latest progress report, Turkey should continue to prepare the necessary legal basis for the prospective free movement of Turkish workers.

Openness of the Turkish Economy

Openness of the economy is a main pre-condition for the optimal currency area theory. Openness of the member economies of a currency area results in co-movement of economic cycles which protects members states from asymmetric shocks. In this regard, the table below shows us the openness levels of the Eurozone countries:

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Austria	93%	99%	104%	108%	112%	113%	96%	104%	112%	111%	110%
Belgium	142%	147%	153%	158%	161%	168%	144%	157%	169%	171%	170%
Cyprus	95%	98%	99%	100%	102%	102%	85%	87%	91%	90%	88%
Estonia	146%	153%	162%	156%	143%	146%	122%	152%	177%	181%	175%
Finland	71%	73%	79%	86%	87%	90%	73%	79%	83%	82%	80%
France	51%	52%	53%	55%	55%	56%	49%	53%	57%	57%	56%
Germany	68%	72%	77%	85%	87%	90%	80%	90%	96%	98%	95%
Greece	54%	57%	56%	58%	62%	63%	50%	54%	58%	60%	61%
Ireland	151%	152%	151%	149%	152%	158%	164%	181%	184%	191%	190%
Italy	48%	50%	52%	56%	58%	58%	48%	55%	59%	59%	58%
Latvia	97%	104%	110%	111%	105%	99%	89%	109%	121%	127%	121%
Luxembourg	250%	280%	286%	309%	320%	336%	293%	311%	326%	325%	319%
Malta	157%	159%	157%	178%	181%	177%	158%	173%	186%	190%	183%
Netherlands	120%	125%	131%	138%	140%	144%	130%	149%	159%	168%	167%
Portugal	62%	64%	65%	70%	72%	75%	63%	70%	76%	78%	80%
Slovakia	154%	152%	157%	173%	175%	169%	143%	164%	176%	188%	189%
Slovenia	108%	117%	125%	134%	141%	137%	115%	130%	142%	148%	150%
Spain	55%	56%	57%	59%	61%	59%	50%	57%	63%	65%	66%
EU18 AREA	107%	112%	115%	121%	123%	124%	108%	121%	130%	133%	131%
TURKEY	47%	50%	47%	50%	50%	52%	48%	48%	57%	58%	58%

Table.8: Openness of the Economy

Data From: (The World Bank, 2013b) & (The World Bank, 2013c)

Compared to EU-18 Average, Turkey`s level of openness is quite low but the reader should be reminded that small countries tend to be more open because they lack the self-sufficient characteristic of large economies therefore we should make a comparison between Turkey and eurozone members with similar sized economies.

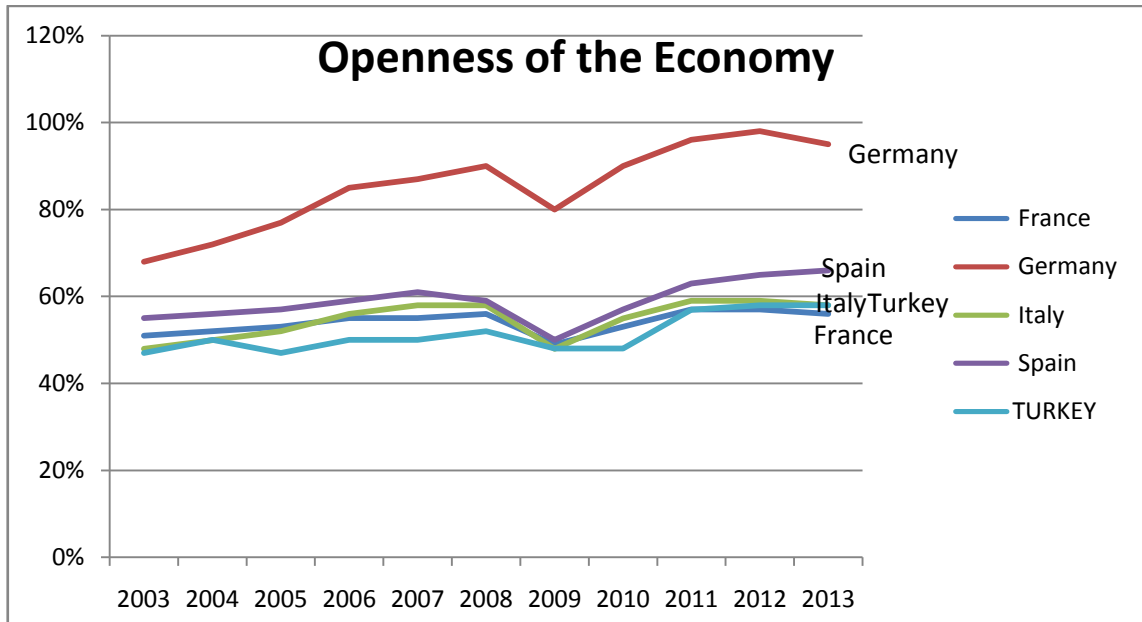


Figure.8: Openness of the Turkish Economy

Data From: (The World Bank, 2013b) & (The World Bank, 2013c)

From this more convenient testing perspective, the openness of the Turkish economy, excluding Germany, matches the large countries of Europe and positions itself within the acceptable range.

Diversification in the Turkish Economy

Diversification in member economies of a currency area is helpful to reduce the frequency and the negative effects of asymmetric shocks. To clarify whether Turkish economy presents an acceptable level of diversification, we will compare it with the the diversification in the Euro Area. For such a comparison, the best way is to examine the diversity and the balance of classification in exported goods and services because this reveals how much a demand shock can harm a country`s economical stability. The table and the graphs reflecting the data shows us the proportions of each classification in the total exported goods and services.

	2010		2011		2012		2013	
	% of Total Exports (Euro Area)	% of Total Exports (Turkey)	% of Total Exports (Euro Area)	% of Total Exports (Turkey)	% of Total Exports (Euro Area)	% of Total Exports (Turkey)	% of Total Exports (Euro Area)	% of Total Exports (Turkey)
Total - All products	100%	100%	100%	100%	100%	100%	100%	100%
Food and live animals	9%	9%	9%	9%	9%	8%	10%	9%
Beverages and tobacco	1%	1%	1%	1%	1%	1%	1%	1%
Crude materials, inedible, except fuels	3%	3%	4%	3%	4%	3%	3%	4%
Mineral fuels, lubricants and related materials	7%	4%	8%	5%	10%	5%	10%	4%
Animal and vegetable oils, fats and waxes	0%	0%	1%	1%	1%	1%	1%	1%
Chemicals and related products, n.e.s.	18%	6%	18%	6%	18%	6%	18%	6%
Manufactured goods classified chiefly by material	16%	29%	16%	30%	15%	27%	15%	28%
Machinery and transport equipment	32%	28%	32%	28%	31%	25%	31%	27%
Miscellaneous manufactured articles	11%	17%	11%	17%	11%	16%	11%	18%
Commodities and transactions not classified elsewhere	2%	2%	1%	1%	1%	9%	1%	2%

Table.9:Diversification in the Turkish Economy

Data from: (Turkish Statistical Institute, 2014b) & (Eurostat, 2014c)

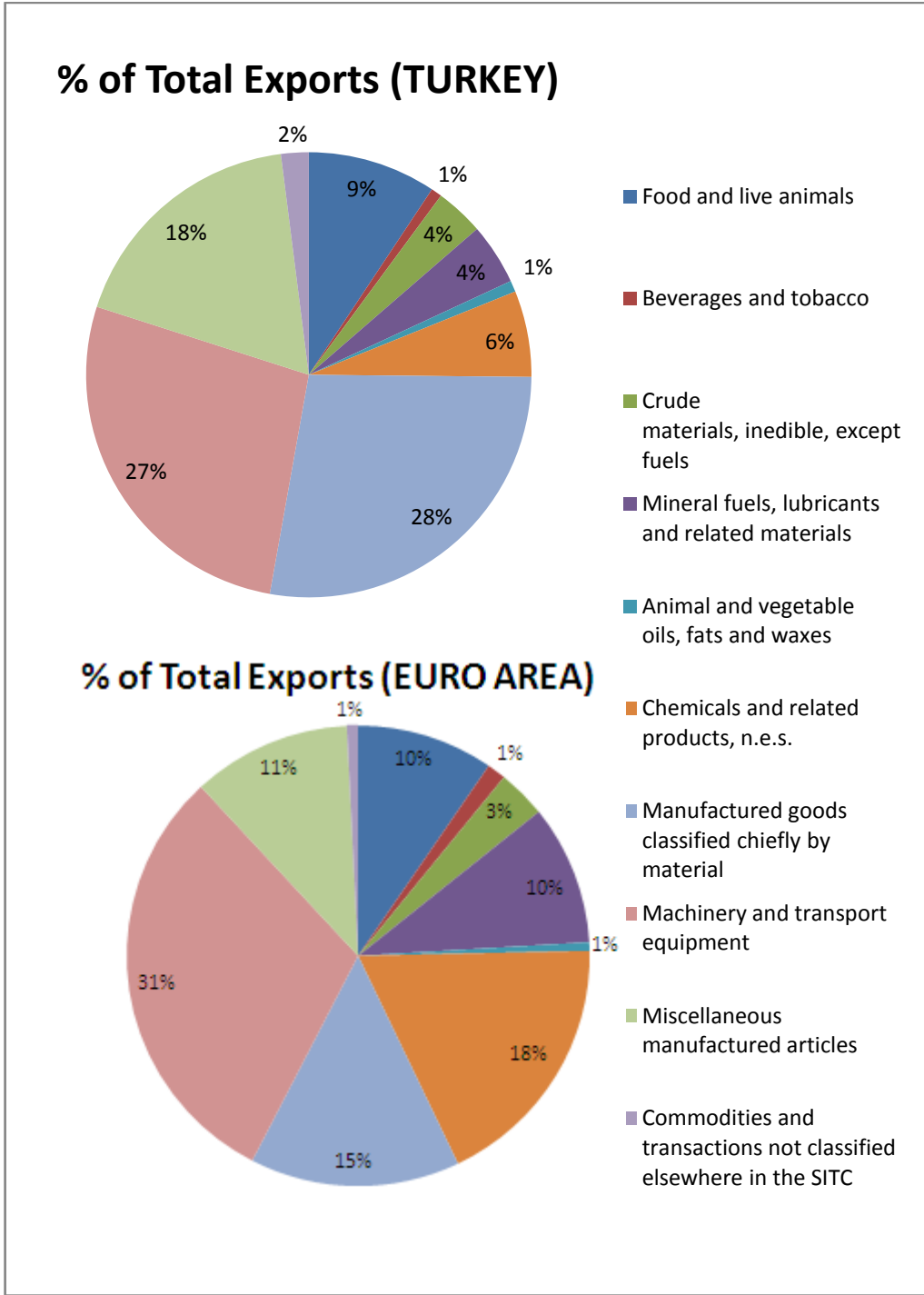


Figure.9:Diversification in Exports

Data from: (Turkish Statistical Institute, 2014b) & (Eurostat, 2014c)

While the chemical products class is a main export sector in Euro-Area, the proportion of this class is not that high in the total exports of the Turkish economy. Moreover the higher proportion of Mineral fuels and lubricants class is another factor in favor of the

Euro Area diversity. Turkey presents a less-diversified economical structure than Euro Area but this is by no means a large difference. For Turkey, one problem that should be mentioned here, regarding the data above, a convergence trend for more diversification cannot be detected. The proportions of export categories have remained roughly the same. This data, therefore, while showing the need for further convergence to Euro area in terms of economic diversification, also shows Turkey has an acceptable diversity in its economy. We should also note that the diversity of Turkish economy has always been seen as a strength also by the credit rating agencies. The latest country report from Moody's (2014) is an adequate example.

Similarity in the Inflation Rates

As explained under previous titles, similarity of inflation rates in a currency area protects members from disequilibrium of payments balance. This convergence criterion helps the Eurozone to reach one of the main purposes of optimal currency areas: price stability. This precondition is also a part of the Maastricht criteria so that any prospective member has to have a converged inflation rate before joining the Eurozone. The relevant Maastricht criterion states that members should have an 'inflation of no more than 1.5 percentage points above the average rate of the three EU member states with the lowest inflation over the previous year' (Cited by EU-Commission, 2014).

Regarding Turkey's performance, There has been a steady inflation rate after the 2001 crisis. This is also partly due to the political stability in Turkey but the inflation rate, despite its steadiness, remained high compared to the Euro Area average. The trend of inflation rates can be followed below:

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Euro Area	2%	2%	2%	2%	2%	2%	3%	0%	2%	3%	3%	1%
Turkey	47%	25%	10%	8%	9%	9%	10%	6%	9%	7%	9%	8%

Table.10: Inflation Rates 2002-2013

Data from: (Eurostat, 2014f)

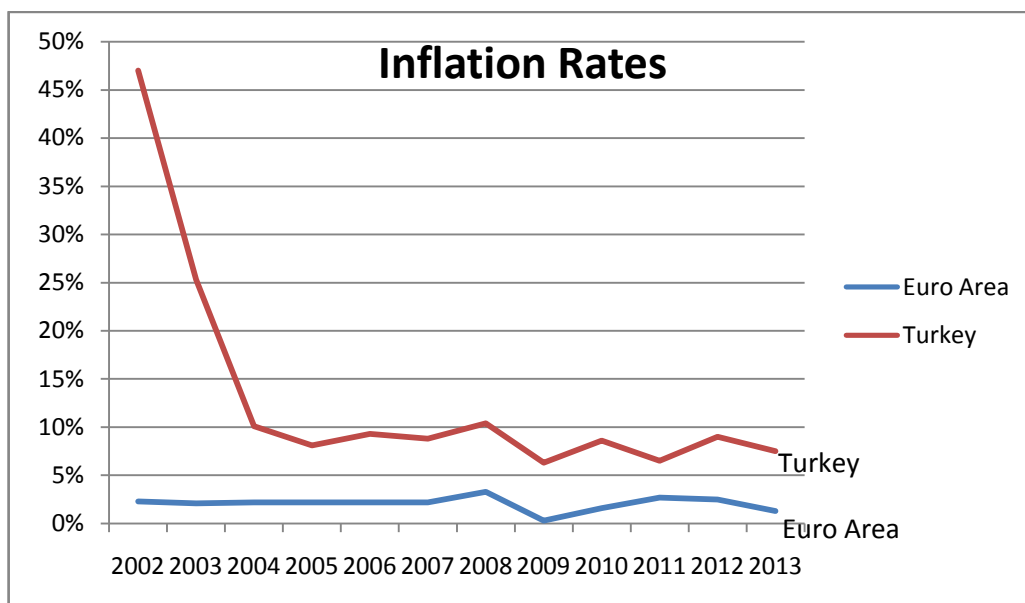


Figure.10: Inflation Rates Turkey-Euro Area

Data from: (Eurostat, 2014f)

Turkish economy remains vulnerable to capital outflows because of the need of `hot money` to finance its current account deficit. This structure occasionally results in depreciation of the currency. Especially after the global crisis monetary expansion period, any signal from the developed economies to return back to tighter monetary policies causes financial outflows from emerging markets which then leads to depreciation and then to inflation. Therefore Turkish economy needs to become less vulnerable and converge more to satisfy this criterion.

Similarity in the Interest Rates

Ingram (1969) introduced the level of financial integration as a critical factor to define optimal currency areas. According to this view, regions with integrated capital markets do not need flexible exchange rate regimes because even a slight difference in interest rate levels will trigger a sufficient capital flow and balance disequilibriums without needing an alteration in exchange rates. It should be noted here that Ingram makes the same mistake with Mundell (1973, p. 115) with partly ignoring the speculative capital movements and with relying on the balancing mechanism of private capital flows

excessively. The euro crisis proved us the inability of private capital flows to balance a disequilibrium. Despite this negation, financial integration can be a mechanism of balance when it is regulated accordingly and there is no better indicator than the similarity of interest rates to show the level of financial integration.

In this regard, Our comparison of annual yields of bonds with 10 year maturity shows us Turkey has a higher interest rate than the Euro Area average. The data and the trend can be followed below:

	2006	2007	2008	2009	2010	2011	2012	2013
Euro area (EA11-2000, EA12-2006, EA13-2007, EA15-2008, EA16-2010, EA17-2013, EA18)	3.84	4.32	4.31	3.82	3.61	4.35	3.88	3.00
Turkey	16.19	16.81	18.93	12.94	9.61	9.28	8.46	7.77

Table.11: Interest Rates 2006-2013 Data from: (Eurostat, 2014d) & (Eurostat, 2014e)

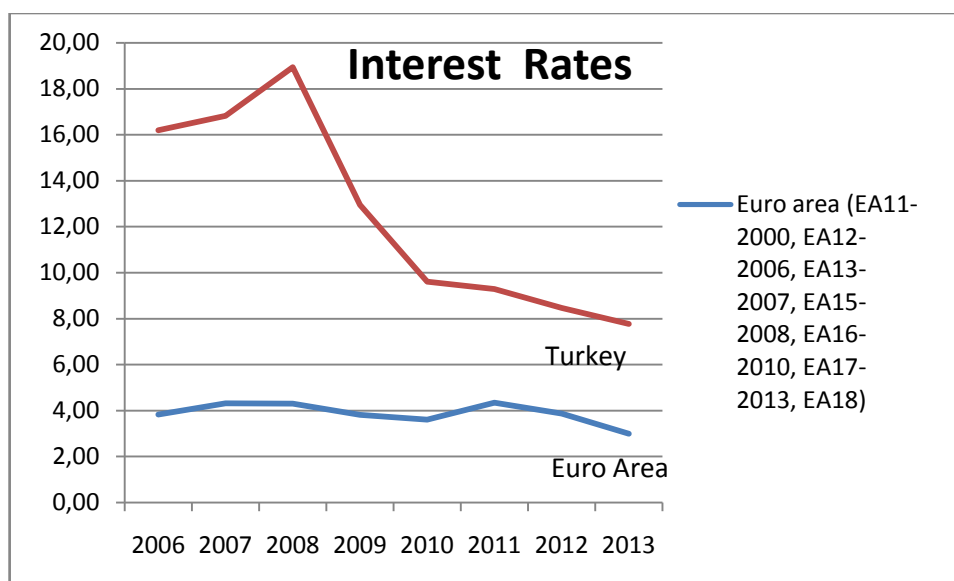


Figure.11: Interest Rates Turkey-Euro Area Data from:(Eurostat, 2014d)&(Eurostat, 2014e)

The convergence since 2007 is clear but there is still need for further convergence and this is not only to fulfil this criteria theoretically but also to fulfil the relevant Maastricht criterion: `Long term interest rates- not more than 2 percentage points above the rate of the three best performing Member States in terms of price stability` (EU-Commission, 2014).

Optimal Currency Area Test Results

The table below summarizes our examination of Turkey under five main criteria and with a score of 3 out of 5 Turkey requires further convergence before joining the Eurozone. This is particularly necessary to be protected from asymmetric shocks ex-ante and also to have the ability to respond back in case of an asymmetric shock ex-post but the executives should also bear in mind that OCA criteria, as Frankel (1999, p. 30) says, `might be satisfied ex-post`. This is because of `a symbiotic relationship between economic and monetary integration` (Bayoumi & Eichengreen, 1997, p. 769).

OCA Theory Test Results for Turkey's prospective membership to Eurozone	
Labour Mobility	no
Openness of the Economy	yes
Diversification in the economy	yes
Similarity in the inflation rates	no
Financial market integration	no

Table.12: OCA Theory Test Results

Chapter.4

Conclusion

The decision to join the Eurozone has great importance and the last financial crisis made it even more evident. Turkey also, to protect itself from economical marginalizing, is in need to join regional economic formations. In this context, the Eurozone constitutes the best option for Turkey due to already established and improving trade relations.

With focusing on groups with clear gains or losses, we examined the pressure over the government. The aim was to define the viable policy options for the Turkish government. We also examined the stance of the government to issue what may be the policy in case of loose domestic constraints. Briefly, we examined in which direction the decision of Turkey for the Eurozone membership may evolve. Then Optimum currency areas theory gave us the chance to put forth which decision is right for Turkey.

This holistic and multi-causal manner we adopted showed us that Turkey does not completely satisfy the OCA criteria and is in need of further structural convergence. On the other hand, the domestic interests and political motivations showed us Turkey`s decision about the Eurozone, in case of an EU membership, will generate enough time for further convergence with a probable postponement of entry to the Eurozone.

The political stability and the economical reforms in the last decade resulted in high growth rate in the Turkish economy. This economic success is Turkey`s biggest strength for further convergence but we should also note that to finalize its reforms, Turkey, as every other candidate country should get the same financial help from the EU. Turkey, despite the rights of its candidate status, has acquired the least financial help per capita and some financial grants, which Turkey has been entitled to, have been blocked on political grounds. Turkey must keep its reformist understanding and protect its economical progress but meanwhile the EU should be more willing to build the economic solidarity. For Turkey, this whole will result in further convergence and a smooth transition option to the Eurozone.

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