

EUROPEAN MONETARY UNION, EURO AND IMPACTS OF EURO ON TRNC ECONOMY BASED ON A POSSIBLE MEMBERSHIP OF TRNC TO EMU

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ABSTRACT: EURO is in the use of European Union economy since 1/1/2002. Although England is against the EURO; the majority of the member nations of European Union is supporting heavily the use of the EURO. For the time being TRNC (Turkish Republic Of Northern Cyprus) doesn't have it's own printed currency and it's using the currency of Turkish Republic. The main aim of this study is to figure out the possible impacts of Euro on TRNC economy if TRNC becomes a full member of the European Union hence European Monetary Union.

Keywords: *EURO, Northern Cyprus, European Union, European Monetary Union.*

ÖZET: EURO, Avrupa Birliği ekonomisinde tek para birimi olarak 1/1/2002 tarihinden itibaren yürürlüğe girmiş durumdadır. İngiltere EURO'ya karşı durumda olsa bile yine de Avrupa Birliği üyesi birçok ülke EURO'nun güçlü bir şekilde savunulduğunu yapmaktadırlar. KKTC'nin (Kuzey Kıbrıs Türk Cumhuriyeti) şu an için kendisine ait bir para birimi bulunmamaktadır ve para birimi olarak Türkiye Cumhuriyeti'nin para birimini kullanmaktadır. Bu çalışmanın amacı eğer KKTC bir şekilde AB'ye ve buna bağlı olarak Avrupa Para Birliği'ne üye olursa ekonominin ne yönde etkileneceğini ortaya koymaktır

Anahtar Sözcükler : *EURO, Kuzey Kıbrıs, Avrupa Birliği, Avrupa Para Birliği.*

INTRODUCTION

In the European Union (EU) EURO is on the screen with an irreversible case since 1/1/2002. EU is on the way of being a super power and its main target is to establish European United States. Although it's not an easy target; still it's the dream of many European Union member countries.

It is a luxury question for the EU to search for an answer for EURO as yes or no; because if the EU is aiming to be a super power just like United States; then it has to use a single currency for all of its macroeconomic activities. Because a single currency is the main issue for establishing a single market hence a single country. With the divided financial sectors it's not possible for the EU to be an alternative super power against the United States.

TRNC at the moment is a non-recognized state. Although its existence, all countries except Turkey insistently rejecting the existence of the TRNC. At the moment as a republic; TRNC doesn't own it is currency and using the currency of Turkish Republic. In other terms, TRNC doesn't have an efficient working central bank hence efficiently working monetary policy. A high level of inflation has been imported to TRNC because of the high inflation in Turkey since 1974.

If TRNC after a possible solution in the island becomes a full member of EU hence EMU, then it will have a chance to use EURO in its economy. This will bring a lot of differences to the TRNC economy; where it has been struggling with high inflation imported from Turkish Republic. Starting using the EURO will mean no inflation and no risk of devaluation for TRNC economy. As TRNC doesn't have its own currency, then TRNC will not have the costs of changing its currency with EURO just like many other candidate countries to EMU (European Monetary Union). For TRNC there will be only the huge advantages of starting to use EURO for its economic activities.

I. WHAT IS EUROPEAN MONETARY UNION (EMU)

The main aim of the European Monetary Union (EMU) is integrating the real economic and monetary sectors of the member nations. For the European Union adjusting an economic union has always been a main target. The Maastricht Treaty (1992) is completing the missing parts of EMU. In technical terms, a "Monetary Union" consists of an arrangement between participating countries in which: a) bilateral exchange rates (the exchange rates between one member state and another) are permanently fixed, with no margins for permissible fluctuations; and b) there are no institutional barriers (such as legal controls) to the free movement of capital across frontiers. (Baimbridge, Burkitt, Whayman, 2000: 20).

For an efficient working of monetary union these conditions must be fulfilled. For example, before the German reunification in 1990, the domestic currency of the German Democratic Republic (East Germany) had been fixed at a 1: 1 exchange rate against German Federal Republic's Deutschmark since 1949, but this arrangement can not be accepted as a monetary union. The determined exchange rate was only applied within the East Germany, as its known the export and import of Ostmark was prohibited.

In addition to irrevocably fixed exchange rates and the abolition of all capital controls (which have already been removed under the EU's 1992 programme- see (Echini, 1988)- the structure of monetary union in Maastricht Treaty involves changing the national currencies with a common currency, which is named as "Euro". The adoption of a single currency in the European Union will help to make the monetary union more permanent, by increasing the costs to participating states of withdrawing from the arrangement (Delors, 1989).

II. THE EXPECTED BENEFITS OF EUROPEAN MONETARY UNION IN EURO-ZONE

The major of EMU can be classified as there will be no more exchange rate uncertainty on intra- EU trade transactions costs on cross- border trade will be eliminated, there will be a greater price transparency and also based on the stability commitment of European Central Bank (ECB) the future monetary stability will be guaranteed. (see also Eichengreen, 1990; Begg, 1991; Barell, 1992; Emerson, 1992; Ackrill, 1997; de Graume, 1997).

2. 1. Greater Nominal Exchange Rate Stability

EMU would end the uncertainty that nominal exchange rate fluctuations presently bring to intra- EU trade and investment (de Graume, 1988; Krugman, 1989). While it is true that increasingly sophisticated financial institutions provide a form of insurance against exchange rate uncertainty these "hedging" facilities are not costless and their cost reflects the potential saving to the EU adopting Euro. These savings are likely to be greater for the smaller member states whose currencies are not widely used in international trade.

Similarly, the savings are likely to be greater for small and medium- sized enterprises (SMEs) than for large multinational corporations, which can hold diversified currency portfolios and support dedicated treasury department to manage exchange rate risk (Baimbridge, Burkitt, Whyman, 2000 : 21).

Moreover, for long-time horizons, so-called 'forward' facilities are not universally available. Such considerations have a special importance for members of the EU, the raison d'être of which is to facilitate cross-border movements of goods, services, labour and capital. Advocates EMU argue that the potential gains from membership of the EU cannot be realized in the long-term unless countries are able to exploit their own, unique comparative advantages fully (Jenkins, 1977; Britton, 1991). To achieve this, economic resource- land labour, capital and enterprise- must be transferred from relatively less, to relatively more efficient sectors and the commercial decisions which make such reallocations possible depend critically upon expectations of the future. To the extent that uncertainty about the future course of intra- EU exchange rates may inhibit the restructuring of production by which the potential gains from greater trade are translated into reality, EMU should therefore accelerate economic integration- and so economic growth- within the EU (Emerson, 1992).

Euro-skeptics argue that, although as a single currency 'Euro' will eliminate exchange rate risk from intra-Euro itself will still have some fluctuations against US dollar and the Japanese yen. Table 2. 1 shows that, for each of the member states, trade with other EU countries dominates their trade with the rest of the world. For the EU as a whole, intra-EU trade (measured by imports) amounts to an average of 14.1 percent of GDP, with extra-EU trade amounting to 8.5 percent of GDP (Intra EU trade is nearly double compare with the extra-EU trade). The trade between EU countries will be also in a higher stability as Euro will eliminate the exchange rate uncertainty. Specially, the stability of Euro against U. S. D dollar and yen will play a major role for the stability of the imports and exports of EU. Here ECB must have a co-operation with the central bank of USA and Japan for a stable Euro against dollar and yen.

Table 2. 1 Intra-EU and extra-EU imports (1995)

	Intra-EU Imports (% GDP)	Extra-EU Imports (% GDP)
Austria	21.4	8.4
Belgium/Luxembourg	40.2	12.8
Britain	12.9	10.6
Denmark	16.4	7.6
Finland	14.0	9.7
France	11.3	6.4
Germany	10.5	8.3
Greece	14.5	6.9
Ireland	27.5	21.7
Italy	12.0	6.2
Netherlands	26.1	14.2
Portugal	24.3	8.5
Spain	13.1	7.1
Sweden	17.7	10.6
EU 15	14.1	8.5

Source: European Commission, **European Economy**: 1999 review; p.96.

2. 2. Reduced Transaction Costs

All the business and leisure travelers are very familiar with the transaction costs involved in changing currencies. These charges are made by banks to reflect their deployment of resources (such as personnel and equipment), as well as the opportunity costs of holding stocks of foreign exchange. For those who are tourists and are dealing in small retail amounts, these charges can easily amount to 10 percent of the value of the currency charged. For the multinational business the transaction costs of switching between currencies are much smaller. According to the estimated suggestions, by Euro as the single currency in the EU as a whole, will eliminate transaction costs which will yield savings of between 2-3 percent of total EU Gross Domestic Product, but at the moment there is general belief that, the more likely savings will be between 0.25 percent and 0.5 percent of GDP (Artis, 1991)

2. 3. Greater Price Transparency

When Euro will replace the national currencies in 12 EMU member states, then all the goods and services in 12 member states will be charged by Euro. In this case the consumers will have a chance to compare the prices of the products across national markets, so the price differences will be easily justified. There is no doubt that the competition will be more efficient in the Euro-zone (for an example, see Table 2. 2).

Table 2. 2 Average price differences (net of taxes) of same automobile (cheapest country=100)

	1993	1995
Belgium	116	122
Britain	120	120
France	121	121
Germany	124	128
Ireland	115	112
Italy	100	102
Netherlands	115	121
Portugal	108	108
Spain	108	105

Source: European Commission, **European Economy**: 1999 review; p.122.

2. 4. Low and Stable Inflation.

European Central Bank, which is designed by the architects of the Maastricht Treaty, is the guarantor of low and stable inflation in the Euro-zone.

Table 2. 3 Average inflation rates (private consumption price deflator)

	1961-70	1971-80	1981-90	1991-97
Austria	3.5	6.3	3.6	2.6
Belgium	3.1	7.2	4.6	2.4
Britain	3.9	13.3	6.0	3.7
Denmark	5.8	10.4	5.8	1.9
Finland	4.7	11.5	6.4	2.5
France	4.3	9.8	6.2	2.1
Germany*	2.8	5.2	2.6	3.0
Greece	2.5	13.2	18.3	11.9
Ireland	5.1	14.0	7.1	2.2

Italy	3.8	14.6	10.0	5.0
Luxembourg	2.5	6.5	5.0	2.4
Netherlands	4.1	7.6	2.3	2.3
Portugal	2.8	173	17.3	6.1
Spain	5.8	15.0	9.3	4.8
Sweden	4.1	9.6	8.2	3.8
EU 15	3.9	10.6	6.5	3.6

* West Germany only 1961-91

Source: European Commission; **EU Economy**: 1999 review, p.106.

Table 2.3 shows average inflation rates over the last four decades. It reveals that Germany has successfully achieved low inflation over the period since 1961 and that those countries (Netherlands, Belgium, Luxembourg, Denmark, Austria and more recently France) which have pegged their currencies to the Deutschmark, so effectively using the Bundesbank to set their national monetary policies, have imported similar inflation performance. On the other hand countries like Britain and Italy together with Spain, Portugal and Greece have suffered persistently records and EMU offers them to cover up their poor inflation position.

2. 5. Interest Rate Harmonization.

In Euro-zone all the banks will use Euro in their financial activities. In this case, the banks in the Euro-zone will supply the credits with single currency. Normally, this will rise up the credit competition between the EU banks. As a result, there will be a downward pressure on the interest rates. Obviously a fall in the interest rates in the Euro-zone will lower the cost of investments so the economy will boom. According to the econometric studies made by the European Commission; in the Euro-Zone there will be approximately 30% economic growth by the introduction of Euro.

It's very important to point out here that, all the expected positive impacts of Euro cannot take place in EMU member countries within a short-time period. The adaptation of Euro in EMU member countries will require at least 2-3 years. We should know that, Euro is the currency of twelve EMU members, which are realizing 20 percent of the world trade and production; because of this for a stable world economy, Euro doesn't have any chance to fluctuate in international money markets.

III. THE GENERAL COST ANALYSIS OF EMU

The general cost of introducing EURO will be the main change in the accounting units and the cost of converting outstanding financial and other long-term contracts into the single currency. The introduction of the common currency will come after a period of stable exchange rates, and all the conversing rates applied to existing contracts in order to convert payment obligations from national currencies into euro will be equal to the market rates of exchange. The introduction of euro will therefore not lead to any wealth distribution. It will be redenomination, but it will not make anybody richer or poorer. (Gros and Thygesen, 1998: 299)

The main argument against EMU, namely that 'pooling' "monetary sovereignty" (transferring the power to change interest rates and the exchange rate from national governments to the EMU) will prevent governments from stabilizing their national

economies has great force, but it is often overstated and widely used without reference to the well-known costs of the alternative uncoordinated monetary policy making. (Baimbridge, Burkilt, and Whyman, 2000: 30)

It's important to draw a distinction between utilization policy and growth policy. On the other hand if a member nation of EMU is hit by a shock that does not affect the rest members in the same way, then the nation will fight the shock with itself alone, and the member nation will not have a chance to set its interest rates.

For example, if there is a fall in the demand of some products; then this will cause a rise in the unemployment level due to lower level in the production. With a floating exchange rate it could re-invigorate demand by cutting interest rates-which would itself stimulate domestic demand, as well as lowering the value of its currency so that the demand for exports recovered. But under single currency the member nation will not have a chance like this.

How serious a problem in the absence of this policy lever? It is exactly the same as the problem facing say California. If the demand for computer falls, than the negative impacts of this on California will be greater than rest of America. But in a such a case Federal Reserve will show a very little respond to the problem that is limited to California? Now the question rises, which is; what happens to California?

If the shock is permanent, then in California the unemployment will rise. Then real wages will fall, thus improving competitiveness, and in addition some workers decide to leave. By contrast, if California had its own currency and a flexible exchange rate, then it could devaluate its currency so restring competitiveness without so much fall in unemployment level. This would have certainly been preferable. Similarly, if the shock is temporary, California goes through a period of unemployment, which could have been sharpened if California had control of its own interest rates.

The same argument also applies in reverse. California experiences a rise in demand for its goods, so in this case it does not have a chance to resolve its currency so as to reduce the upward pressure on domestic prices. Instead, it has to experience higher prices, which eventually reduce its competitiveness and bring its economy back into balance.

But still, nobody advise that California should have its own currency. This suggest that the real problems caused by regional shocks one not generally intolerable.

However, some people say that the US analogy is not relevant to Europe, because Americans are much more willing to move between region than Europeans are between countries. This is certainly true, and it eases the change in real wages that would otherwise be needed in response to a permanent stock. In addition the Federal budget provides greater transfers when a states economy is in difficulty, which would hardly happen in Europe.

On the other hand the US states are more prone to region-specific shocks than the states of Europe. This is because there is much more regional specialization in the US than there is Northern Europe-with many industries concentrated in a very few

US states. By contrast the economies of Northern Europe are much more similar to each other (see table 3.1) and therefore less vulnerable to localized shocks.

There has however been one huge regional shock, from each Europe is still recovering-the shocks of German re-unification. The rebuilding to East German enormously increased the demand for German output. One solution would have been to allow an appreciation of the D-Mark relative to the French Franc so that foreigners found German goods more expensive and bought less of them, thus reducing the overheating of the German economy. This would have solved the problem of inflationary pressure on prices inside Germany.

However the French government would not accept the idea of German appreciation (thus behaving as if the Franc and the D-Mark were already one currency). In consequence German prices inevitably rose in response to excess demand.

Table 3.1 Distribution of car production across four main regions (%)

Within USA		Within Europe	
Midwest	67	Germany	38
South	25	France	31
West	5	Italy	18
North-East	3	UK	13
Total	100	Total	100

Source: European Commission, **European Economy**, 1999 review, p.56.

The Bundesbank was unwilling to accept this inflation, and therefore raised interest rates. This eventually imposed enough deflation on Germany to bring inflation under control. But it caused serious unemployment in France. This is a clear example of how the linking of currencies can cause problems when there is a shock to one country and not to others in the same currency area (Baimbridge, Burkitt and Whyman, 2000: 60-61).

As a conclusion the introduction of Euro would offer important benefits to member states, most notably the elimination of exchange rate risk and transactions cost , greater price transparency and the guarantee of future monetary stability. The costs of EMU to member states are much less certain and lie primarily in the costs of sacrificing monetary sovereignty and adopting a common, non-inflationary monetary policy. While the convergence of national inflation performances prior to EMU would minimize the transitional unemployment costs of adopting a single currency, the likelihood of future asymmetric shocks and the continuing segmentation of national economies imply that certain member states may be disadvantaged by adhering to a common monetary policy. Nevertheless, lucas critique-type considerations suggest that these costs may diminish, perhaps sharply, after the introduction of the Euro. Moreover, the risk of beggar-thy-neighbour policies implies that, in any event, EMU may provide a better framework for dealing with asymmetric shocks than independent monetary policies. The EMS upheavals of 1992-3, far from undermining the case for EMU as a widely supposed, simply highlight the shortcomings of interdependent nations attempting to make monetary policy for narrow, national ends without taking into account the impact on their neighbours (Baimbridge, Burkitt and Whyman, 2000:39-40).

IV. POSSIBLE IMPACTS OF EMU ON TRNC ECONOMY IN RELATION WITH POSSIBLE EU MEMBERSHIP OF TRNC.

4.1. Possible Impacts of EMU on TRNC Investment.

The biggest obstacle for investment possibilities in TRNC economy is high interest rates for credits. The average nominal interest rate for credits is about %130-160 a year. This unacceptable high interest rates for investment credits more than an obstacle is causing the investment opportunities to be disappeared in TRNC economy. Many firms in TRNC because of very high interest rates for credits are being closed because the firms can't be able to pay in return not only the main part of their credits; but the interest rate they are allowed to pay for their debts. This is directly creating huge macroeconomic problems for TRNC economy. As long as the required level of investment can't be held in an economy, then the economy can't reach to its macroeconomic targets, which are; growth rate of GDP; a rise in per capita income, stability of prices; and achieving the full employment level.

If we realize that, TRNC is a developing country; then we can understand more clearly the importance of investment opportunities for TRNC economy.

When "Euro" will start to be used as a single currency in EU; then all the bank of EU countries will perform their functions with EURO; which will create a perfect competition among the banks; and the perfect competition among the banks will cause the occurrence of an impression on the banks to lower the interest rates of credits. The lower rate of interest rates will directly lower the cost of the production and GDP will tend to rise. Obviously a rise in GDP will increase the per-capita income and the economy could achieve the full employment target.

Regarding all these positive changes in the economy due to a fall in the cost of investment will lower the price of the goods and services sold in the economy. In general the price levels of the economy will be directed and controlled with a stable price structure and at the same time; the possibility of keeping the general level of prices at low levels of prices at low levels will be more efficient.

It's something sure that; TRNC in the possibility of being a member of EU and EMU will gain all the positive impacts on its investment and economy as mentioned above. This opportunity will create a great chance for TRNC to shift itself out from its critical economic structure.

It is not realistic to expect positive impacts on the TRNC's economy due to the introduction of the Euro in the short run. The reason for this is that the high real interest rates are not the only negative factors that undermine investment. Attracting the foreign investors to TRNC is a long-term target. Even if the TRNC were to join the EU, it would still have to market itself effectively. Accordingly, the TRNC administration should paint a promising picture regarding the future prospects of the economic and political stability that the country lacks. A membership to the EMU may lower the real interest rates; but there still is a need for a political stability. Political stability is a kind of guarantee of the economic stability. Especially in TRNC the politicians should struggle to gain the trust of the public.

It is also very important to mention here the migration history of TRNC in the 60's. During this decade, as a result of the policy of the Greek Administration, a lot of

Turkish Cypriots have left the island to settle primarily in England, and also in other countries.

Unfortunately, the Turkish Cypriot policy makers failed to facilitate the return of their citizens, and this deprived the TRNC from the future investments that could have been undertaken by these people.

A possible solution in the island and parallel EU membership of the TRNC will play a very important role for the establishment of political and economic stability, which will create a new chance for those Turkish Cypriots to return.

Beside the positive impacts of EU and EMU membership, also the negative impacts must be mentioned. All the enterprises or the business organizations in TRNC are classified as small or middle size. It is for sure that most of the firms in the TRNC will be faced with negative shocks, and even bankruptcy, when they face the huge, efficient, and highly competitive EU companies. Because of this reality, the government in TRNC, with the coordination of the EU, must undertake some of the important reforms for protecting the business environment in TRNC until they become competitive.

As a result, in the short-run it is not possible to expect the positive impacts of EU and EMU membership for TRNC; but if TRNC can move parallel in realizing the required reforms with EU membership in politics or economics, than, TRNC will have a lot to gain from this course of action.

4.2. Analysis of Benefits and Costs of EMU on TRNC Economy.

The benefits that TRNC will gain parallel with the membership of EMU can be distinguished in three major categories. These are microeconomic efficiency, macroeconomic stability and external dimensions.

Microeconomic efficiency means the following:

- a) Transaction cost saving
- b) Reduction of exchange rate volatility and uncertainty
- c) Dynamic efficiency gain

The establishment of a monetary union with a single currency immediately eliminates foreign exchange transactions costs between member states. Thus, there is a strong efficiency gain. There are two contributions to the efficiency gain; one is the "visible savings" which households and firms achieve by not being charged with foreign exchange commissions. The second one is "invisible savings" obtained when the trouble of recalculation or control and evaluation or debts occurred. Thus the accounts receivable in various currencies is eliminated.

The volume of these savings depends on the extent of payments among the union countries. It means that the more intense the trade is among the union, the bigger is the potential for efficiency gain (Nielsen, Heinrich, Hansen : 132). Moreover, the establishment of a monetary union removes exchange rate uncertainty between the member countries.

Exchange rate uncertainty causes friction in the free movement of goods; and resources among countries. Thus, the member countries achieve further efficiency

gain. In addition, upon the elimination of interest rate uncertainty among member countries, complete equalization results in more efficient capital allocation. In the evaluation of the gains from reduced exchange rate variability two types of modification are considered.

Firstly, the internal exchange rate volatility among member countries is eliminated. But, far exchange rate uncertainty still remains. Secondly, although, nominal exchange rates uncertainty is eliminated within monetary union, there are still fluctuations in. Therefore, there is an uncertainty in regards of real exchange rates within the monetary union. However, stabilization of nominal exchange rates usually implies reduction of real exchange rate uncertainty.

Secondly, one category of the benefits of the EMU is macroeconomic stability, which means price stability. It is agreed that the European Central Bank determines monetary policy in EMU (European Economy: 132). The most important aim of the Euro fed is price stability because price stability brings economic benefits. Euro fed is responsible for the aggregate monetary policy or EMU should follow the appropriate anti-inflationary policy. Besides, strict monetary policy would also reduce the costs of deflation. However, in order to achieve credible monetary policy, to maintain price stability, community needs a number of instruments. One of them is its constitution and the budget policy which member states follows. Therefore, the achievement of the policy is partly on the behaviour of the Central Bank. Two constitutional features of a Central Bank are important, one is statutory duty to assure price stability and political independence (European Economy, 1990, pg. 15). The emphasis on price stability will give EU members "Central Bank a clear direction for its policy, later it's believed that independence is a necessary for price stability, because unanticipated inflation has the potential to stimulate, if even temporarily, economic activity and reduce the real value of public debt. (European Economy: 7).

The biggest costs that the member states of EMU will pay can be classified in two categories.

- a) Loosing the seignior age income; which is gained by printing the currency.
- b) Not to be able to use anymore the devaluation or revaluation policy for balance of trade.

Two costs as mentioned above is not validity for TRNC, because TRNC doesn't already print its own currency for its economic activities. So as it's not printing its own currency; then it won't have any cost like loosing seignior age income after the full membership of EMU. Again; as TRNC doesn't have its own printed currency; then it's not also possible to apply any devaluation or revaluation in its economy, at the moment.

As TRNC doesn't have its own printed currencies it has the following disadvantages.

- a) It's not possible for TRNC to use its monetary tools in economy which are essential for building an efficient and stable economic structure.
- b) TRNC can't have a real struggle against inflation; it can not be possible for TRNC to have a real determination on its wage policy, full employment policy, foreign trade policy and all other macroeconomic policies which are inevitable not

only for TRNC economy but also for all economies for establishing the growth and stability.

It seems at the moment TRNC is having a bit disadvantage as it doesn't have its own printed currency; but still we can surely say that; as TRNC won't have the two main costs by the membership of EMU; it has more advantages in comparison with many other potential member states who are candidate but not still full members of EMU.

4.3. The Possible Impacts of "EURO" on the Banking System of TRNC.

In a country it's not possible to take into consideration separately the banking and economy. Banks and economy is always affecting each other. As the developments in the economy effect banking; then developments in the banking will affect economy. This is also a real fact in TRNC. Before we work on the possible impacts of Euro on TRNC banking system; it's more beneficial to have a look at the current situation for the "Bank Sector" in TRNC.

There is a Central Bank, which is not independent. As long as a central bank is not independent, then it can't implement monetary policies to influence banking and economy of the country.

- a) There is a huge State Budget Deficit.
- b) The medium of exchange is Turkish Lira. So; there is no local currency.
- c) There is no efficient monetary policy application and because of this there is no price stability. And without the price stability there is no any chance for its economy to establish its macroeconomic policies efficiently.

Lets now analyze what will be the possible impacts of EURO on banking system of TRNC

- a) "Euro" will be accepted as a medium of exchange, which will be a stable currency.
- b) There will be no initial cost of accepting a local currency.
- c) The banking legislations will have to be synchronized with European Union legislations.
- d) With a stable currency the interest rates bankruptcies will go down hence less debt for the banks. In other words there will be lower losses for the banks.
- e) Businesses will be doing better with low and stable interest rates and with a healthy small business sector.
- f) The acceptance of "Euro" as the currency will exclude the need of "inflation accounting".
- g) We very deeply need a stable currency and "Euro" is the answer. The banks will also benefit from this.
- h) We expect an increase in Foreign Trade with EU members. As it's known foreign trade is facilitated and financed by banks; then the business activities for banks will rise.
- i) With the increase of trade, there will be an increase of demand for "Euro" funds.
- j) The Central Bank will be independent and will work with European Central Bank for the synchronized monetary tools.
- k) There will be a strict control on the commercial banks. Controls will make sure banks are fundamentally financially sound.
- l) With a stable currency there will be an increased economic activity and most of the economic activity will be financed by the banks, hence increased business for the banks as well.

- m) With low interest rates some banks may not stay profitable anymore. This may push them to join and merge with other banks.
- n) With mergers of the banks some people may lose their jobs. However this will be offset with opportunities in other sectors.

4.4. Possible Impacts of EMU on Foreign Trade of TRNC

The general trend in world trade is towards liberalization. Although there are certain countries which support and apply protectionist policies in trade but general trend is more liberal trade. Starting with the GATT (General Agreement on Tariffs and Trade) and going on today as WTO (World Trade Organization) large steps had been taken on the way to abolish many obstacles to trade. Until today 135 countries signed the GATT agreement (who later on became the member of WTO). This general agreement suggests nearly %80 reduction in all types custom duties by the year of 2002 and furthermore lowering one third of any other protectionist tools or completely abolishing some of them.

Both EU as union and each member states as individually are the members of WTO and they declared as well to decrease the level of custom duties as well as to lower other protectionist policies (quotas, subsidies, export credits etc.). All these actions are for the more liberal trade. Economic theory suggests that more free the trade higher the general welfare of the societies. According to the studies going on liberalized trade will have both dynamic and static effects on involved parties.

The whole world is somehow involved in this liberalization movement either through bilateral agreements or through WTO agreements and grasping the benefits of it. But on the other side of the coin we have TRNC economy, which is also trying to liberalize its trade but not being subject to any agreement because of non-recognition. Therefore without any recognition or becoming a member of union, TRNC's liberalization movements will be unilateral and will not have the full effect of welfare increase. In that sense EU membership seems to be the best alternative for TRNC economy. Both from the aspect of welfare increase through trade liberalization and as a result of the advantages that membership will provide to the whole society. When the foreign trade of TRNC is analyzed it can be seen that share of imports instead of exports took a large share, which means that large trade deficits exist. Share of imports reaches to nearly half of the GNP figures. There are certain reasons behind the high share of imports and for the low share of exports. So it is possible to consider the TRNC's foreign trade from two aspects: One from export side, the other way is from import side.

TRNC's export patterns of commodities are mainly agricultural origin, especially citrus, followed by potatoes, carob and some by products of these. Beside agricultural origin, goods textile products, coke and some alcoholic drinks exports can be listed. When the export markets of TRNC are considered two major market comes out: Turkey and EU markets. Especially United Kingdom is the major export market within the EU. Then comes the Germany and Holland. But TRNC exports do not have a stable structure; figures may show high variations from one year to another.

There are some reasons for the high variations of trade figures and for the dominance of imports which causing large trade deficits. One of the major problems faced by TRNC exporters is the high cost of production. That is due to inefficient and backward technologies. Because of insufficient natural resources and raw

materials which has to be imported and makes production very expensive at North Cyprus. Relatively high transportation costs; finally the disadvantages of being non-recognized. But after the court decision of European Union Justice Court's (ABAD) in 1995, exports to European market had fallen down drastically. Another disadvantage of TRNC exporters is that, they are selling mostly agricultural goods to EU, which is a highly protective market for agricultural products. EU has high standards and very low production costs because of high technologies used in the production and because of subsidies paid to the European farmers. Therefore beside non-recognition low quality standards and the high unit production costs of TRNC products makes our exports uncompetitive in EU markets.

When we consider the import side of the TRNC's foreign trade, commodity pattern looks more diversified than exports. TRNC imports are mainly consumption goods, followed by raw materials and investment goods with a very low share. Machineries and mechanical appliances, food items, manufactured and vehicles are the major import commodities. When the destination of imports considered again the high share of Turkey and EU countries can be noticed. Again there are certain reasons behind this high share which are both political and economical constraints.

One of the main reason for this tendency of Turkish origin and EU origin imports is that TRNC import duties are consisting of three different categories : The first which is the lowest valued consider Turkey the most favoured country status, the second category is for the goods origin from EU member countries and have higher rates for some goods and finally the highest rates category for all other countries outside of the two above categories. This categorization makes Turkish origin imports together with lower transportation costs more advantageous.

Beside custom duties differences, there is a dependency on imports for certain goods that are vital both for daily consumption and production. Diseconomies of scale in production size of the domestic market forces many producers to import goods instead of producing domestically. Beyond that, technologies used in the production are out of age or inefficient and renovation needs too much investment which does not seem profitable at the moment. But together with the EU membership, producers may find reasonable opportunities for their technologies as well as cheaper raw material supplies for further production.

CONCLUSION

The introduction of the EURO and establishment of EMU will be a very big experiment not only for the member countries of EMU (European Monetary Union) but also for all the countries which are in trade relation with Euro-zone

The trade relation of TRNC is very limited with the Euro-zone countries because of the embargo decision of justice of court in EU. But it's for sure that the Cyprus problem can not continue forever. After a solution in the island there is no any doubt that the island as a whole will become the part of the European Union. TRNC doesn't have its own currency then there will not be a big cost for TRNC to start using the Euro for all of its economic activities. TRNC will share the huge benefits for its economy with the use of EURO. Although it's a big disadvantage that TRNC doesn't have its own currency for the moment, but it will be a big advantage to replace Euro in its economic activities and will not have any cost by the use of EURO just like other candidate countries to European Monetary Union.

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