

TURKISH SME POLICY ON THE EVE OF EU NEGOTIATIONS "Lessons from the Experiences of Last Enlargement"

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Abstract:

The main objective of this study is to provide an analysis on the degree of convergence of Turkish SMEs Policy with that of the EU in the light of the negotiation experience of the last enlargement as regards to SMEs. Moreover, it sheds a light to possible key challenges for SME sector that Turkey can face in the forthcoming negotiation process of the EU. In this sense, the study draws some lessons before negotiation process starts. It analyses not only the derogations taken under SME policy but also screens other derogations taken under different related chapters like competition including state aids, industrial policy and taxation. It will be based on a qualitative evaluation, adopting a compare and contrast methodology regarding negotiation experience of the new member states including Bulgaria and Romania in the SME related policy fields. The study draws attention to probable advantages and disadvantages in the process of adjustment of the acquis related to SMEs and firmly underlines the high possibility that Turkey would face serious challenges as a form of opening benchmarks, especially under competition chapter due to lack of any legal framework and monitoring agency for state aids and under industrial policy regarding incomplete restructuring of the steel sector. Taking all these aspects into account, the study suggests that in order to supervise whole process in a complementary manner, chapter of Enterprise and Industrial Policy should be carried out simultaneously with the negotiation processes of competition and taxation policies.

Key Words: SMEs Policy, Negotiation, Derogation, European Union.

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Özet:

Bu çalışmanın temel amacı, Avrupa Birliği'nin son genişlemesinde yer alan ülkelerin KOBİ'lere ilişkin müzakere deneyimleri ışığında, Türkiye'nin KOBİ politikasının AB KOBİ politikasına yakınsama derecesini değerlendirmeye yönelik bir analiz sunmaktır. Çalışmada, yaklaşan Jüli müzakere sürecinde Türkiye'nin karşılaşılabileceği muhtemel kilit sorun alanlarına ilişkin öngörülerde bulunmaktadır. Bu yaklaşımla, müzakereler başlamadan önce bazı önemli noktaların altı çizilmektedir. Çalışmada yeni üye ülkeler ile 2007'de üye olmaları beklenen Bulgaristan ve Romanya'nın KOBİ politikası, devlet yardımlarını içeren rekabet politikası, sanayi politikası ve vergilendirme gibi konu ile ilgili farklı müzakere fasılları altında aldıkları geçiş dönemleri, benzer ve farklı yönleri ile irdelenerek, karşılaştırmalı bir yaklaşımla ele alınmaktadır. KOBİ'lere ilişkin AB müktesebatının uyumlaştırılması sürecinde, Türkiye'nin muhtemel avantaj ve dezavantajlarına dikkat çekilmekte ve devlet yardımları alanında düzenleyici bir kurumun ve yasal çerçevenin olmaması ile sanayi politikası alanında demir çelik sektörünün yeniden yapılandırılmasının tamamlanamamış olması sebebiyle, bu hususların ilgili müzakere başlıklarında Türkiye'nin karşısına açılış veya kapanış kriteri olarak çıkma ihtimalinin yüksek olduğu özellikle vurgulanmaktadır. Çalışmanın sonunda, bu iki husus dışında, özellikle yakın dönemde Türkiye'nin KOBİ tanımını AB ile uyumlaştırmasının yarattığı olumlu ivme de dikkate alındığında, İşletme ve Sanayi Politikası faslının müzakerelerinin Türkiye açısından bir sorun oluşturmayacağı değerlendirilmektedir. Bu değerlendirmeler dikkate alınarak, Türkiye'nin bu başlık altındaki ilgili müktesebatı üyelik ile birlikte üstlenebileceği belirtilmektedir. KOBİ'lere ilişkin alanlarda müzakerelerin bütüncül bir yaklaşımla yönlendirilebilmesi için, İşletme ve Sanayi Politikası faslının müzakere süreci çalışmalarının, rekabet politikası ve vergilendirme fasıllarının müzakere süreçleri ile eşanlı bir şekilde yürütülmesinin gerekliliğine işaret edilmektedir.

Anahtar kelimeler: KOBİ'ler, KOBİ Politikası, İşletme ve Sanayi Politikası, Müzakere, Avrupa Birliği.

1. Introduction

Turkey has formally fulfilled the conditions for starting the accession negotiations on 3 October 2005. The application of the, sometimes multifaceted, EU legislation on the certain negotiation chapters opened after

screening process will create a serious challenge for Turkey as a candidate country. It is important that Turkey's legislative, administrative as well as economic capacity can successfully respond to this challenge by the date of accession. Small and Medium Enterprise (SME) policy, which will take place under the chapter of Entrepreneurship and Industrial Policy¹, is one of the most crucial policy fields of the forthcoming negotiation process. During the negotiations on this chapter, Turkey will be requested to make credible commitments and undertake necessary actions to harmonise its system with the EU.

In this framework, this paper aims at providing analysis on the degree of alignment of SMEs and SME policy in Turkey with the EU by fully utilising negotiation experience of the last enlargement as regards to SMEs. It underlines possible key challenges for Turkish SME sector in the forthcoming negotiation process of the EU. In that context, for Turkish case, emphasis will be directed to draw some lessons before negotiation process starts. This study will analyse not only the derogations taken under SME policy but also screening further derogations taken under other related chapters like competition including state aids, industrial policy and taxation. It will be based on a qualitative evaluation, adopting a compare and contrast methodology in the light of the negotiation experience of the new member states including Bulgaria and Romania in the SME related policy fields.

It should be indicated that a clear assessment of the effects in the field of SMEs is rather difficult at this distance from the possible start of negotiations with the EU. Any assessment must necessarily be based on a solid economic impact analysis of the *acquis*. Real effects will also depend on the further development of Turkish SMEs as well as evolution of SME and industrial policies during the long pre-accession period. Moreover, this analysis can not be limited only to these two policy areas. The process and outcome of the negotiations on the state aid policies under competition policy and taxation will have direct impacts on SME policy negotiation process. It is quite certain that Turkish SME policy still differs from that of the EU in certain aspects, notably as regards the recently unified but not yet applied common definition of SMEs and lack of any clear policy and institutional framework for state aids. Lastly, decision on the areas to be subject to derogations would require a deeper regulatory impact analysis. Although these limitations exist, this study aims at reaching some broad

¹ According to Framework Document for Negotiations, SME policy and Industrial Policy, previously separated chapter were united under the chapter of Entrepreneurship and Industrial Policy, see EC (2005a).

qualitative lessons for Turkey by providing an analysis on negotiation experience of the last enlargement and screening of the current *acquis* related with SMEs.

The paper is organized as follows: After this introduction, following section identifies negotiation experience of the last enlargement under the chapters on SMEs policy, industrial policy, competition policy and taxation. Section 3 provides a gap analysis regarding recent situation in Turkish SME policy *vis a vis* possible negotiation agenda with the EU. In the light of these analysis and reform trends in both side, following section underlines possible striking issues that Turkey would face during the negotiation process. Section 4 concludes.

2. Negotiation Experiences of New Member Countries: Chapter Analysis

SME policy is horizontal in nature and cross-cuts many other policy domains. Considering this dynamic and wide-ranging character, it is necessary to analyse the subject matter not focusing only on SME policy under 16th chapter, but covering other chapters related to SMEs like industrial policy, taxation including value added tax (VAT) and direct tax as well as competition policy covering state aids. Within each chapter, there is direct reference to the SMEs through transition periods taken for specific areas.

Acquis includes both 'hard' law, which creates legal obligations; and 'soft' law, which composes measures that are not binding but complement application of hard law.² Since soft law does not require any legal obligations, it is not necessary to be transformed or adapted into the legislative system of the candidate countries.³ The *acquis* related to SMEs comprises mainly soft measures and also limited number of hard measures.

2.1. SME Policy Chapter

As the main chapter on SMEs, chapter of SME policy comprises mainly soft type of legislation. It includes decisions setting up consultation procedures and Community programmes, or recommendations in the areas of enterprise policy, distributive trades, tourism and social economy. In that sense, it does not require transposition of Community legislation into the

² Hard law covers regulations, decisions and directives of the Council and the Commission. Soft law includes Commission recommendations, Council resolutions, Commission reports and communications, Commission staff working papers.

³ For the list of soft measures see, EC (2004b).

national legal system or implementation of measures. With one exemption, experience of last enlargement countries on SME policy illustrates that there was no requirement for legal transformation or adaptation of enforcement measures. Directive on tourism statistics was the only exception of hard law applied to new members. All countries accepted to apply the *acquis* as of accession without any request for transition periods.⁴

When we examine current hard law of the Community under the chapter of SME policy, it is seen that there are six main legislations which require legal action are summarised below.

1. *Council Decision on a multiannual programme of Community measures to intensify the priority areas and to ensure the continuity and consolidation of policy for enterprise, in particular SMEs, in the Community*: It focuses on implementation of the Community programme with the priority measures to ensure the continuity of an enterprise policy (European Council, 1993). It specifies following two objectives with respective measures attached to them:

A. Intensifying the priority measures for enterprise policy in order to stimulate growth within the Community:

- To improve administrative and legal environment of enterprises including the area of indirect taxation (administrative simplification, promotion of follow-up measures)
- To provide better access to Community information for enterprises (adaptation and dissemination of Euro Info Centres and the European Economic Area (EEA) networks, development in existing network through stabilization of funding)
- To improve business-partner-search network (qualitative improvement of the non-confidential partner-search network (BCC), adaptation of the system of charges for the confidential business-partner-search network (BC-NET))
- To continue development of instruments permitting direct contact between entrepreneurs and to promote transnational subcontracting (Improvement in performance of the Europartnership and Enterprise programmes; increase in knowledge of subcontracting markets, support for

⁴ Negotiation process on this chapter was completed with all acceding countries as of December 2002 as well as Bulgaria and Romania as of December 2004. For more details see EC (2004a).

harmonized certification, standardisation procedures and cooperation between large and small enterprises)

- To ensure consideration of the interests of SMEs in the various Community initiatives and policies (mobilisation of Community instruments, structural funds and research programmes, simplification of participation procedures for SMEs to these programmes)

B. Ensuring the continuity and consolidation of enterprise policy in order to encourage the Europeanisation and internationalization of enterprises, especially SMEs:

- To encourage SMEs to adapt to structural changes and to changes brought about by the internal market (Identification of the needs of SMEs, development of pilot projects for small business and craft-industry enterprises, commercial and distributive trading enterprises, cooperatives, mutual societies and associations and foundations, enterprise creators and young entrepreneurs, enabling them to adapt to structural changes and internal market regarding especially standardization, certification and public contracts)

- Promoting a better financial environment for enterprises (Providing SMEs with access to credit and guarantee sources like mutual guarantee systems and risk capital, development of secondary markets, facilitating access of SMEs to financial instruments of the EU)

- Promoting better observation of the economic development of enterprises as part of the dynamic of effective implementation to of the internal market (European observatory for SMEs, improvement in statistics on SMEs)

- Evaluation and development of enterprise policy (Evaluation of existing policy and actions, development of proposals for new Community measures for enterprises)

2. *Council Directive on the collection of statistical information in the field of tourism:* This directive aims at establishing an information system on tourism statistics across the EU. Each member state is required to collect, compile, process and spread harmonized Community statistical information on tourism supply and demand (EC, 1995). Data for tourism statistics should cover the capacity of collective tourist accommodation

establishments⁵, guest flows in collective accommodation establishments under internal tourism⁶ and tourism demand across country.⁷

3. *Commission Decision on approving a support mechanism for the creation of transnational joint ventures for SMEs in the Community*: This decision formulates supports SMEs to establish transnational joint ventures within the EU. Under this decision, certain expenses of setting up a joint venture are financed as the Community contribution. The maximum contribution per project can be € 100,000 (EC, 1997).⁸ SMEs can apply to one of the financial intermediaries in the transnational joint ventures network through specific selection procedure designed for obtaining a positive opinion of the Commission to be eligible for contribution (EC, 1997).⁹

4. *Council Decision on a multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises (2001-2005)*: Multiannual programme provides SMEs with € 450 million for realization of the objectives of the European Charter for Small Enterprises. It includes implementation of measures designed to enhance growth and competitiveness of business in a knowledge-based internationalised economy; to promote entrepreneurship; to simplify and improve administrative and regulatory framework; to improve the financial environment for SMEs; to provide SMEs with easier access to Community support services, programmes and networks and to develop coordination.¹⁰

5. *Council Regulation on the Statute for a European Cooperative Society (SCE)*: It aims at creating a uniform legal framework within which cooperatives and other entities (customers, employees or suppliers or those involved in the activities of the SCE) and natural persons from different Member States should be able to plan and carry out reorganisation of their

⁵ Hotels and similar establishments, other collective accommodation establishments like tourist campsites, holiday dwellings and other collective accommodation.

⁶ For both domestic tourism of domestic residents and inbound tourism of and non-residents traveling within the given country.

⁷ Domestic and outbound tourism indicate residents of a country traveling in another country, with trips for holidays or business including at least one or more successive nights spent away from the usual place of residence.

⁸ Up to 50 % of the eligible expenses, with a maximum of € 50 000; up to 10 % of the total investment made See Article 2.

⁹ See Article 3. For the list of intermediaries in the JEV network, see also Article 4.

¹⁰ For further information on implementing measure, see EC (2001), EC (2003b) and EC (2002).

business in cooperative form in the Union.¹¹ It requires limited interest on loans and share capital, distribution of net assets and reserves as well as profits according to business done with the SCE and needs of members.

6. *Council Directive on supplementing the Statute for a European Cooperative Society with regard to the involvement of employees:* To support social objectives of the EU, it regulates involvement of employees in the affairs of SCE to ensure that establishment of an SCE does not cause any loss or decrease of practices in employee involvement within SCE. Since there is no unified approach across the Union regarding the rules of participation of employees in decision-making process of cooperatives, it is not possible to form a single European model of employee involvement applicable to the SCE. In that sense, it requires functioning of information and consultation procedures at transnational level in setting up a SCE.¹²

2.2. Industrial Policy Chapter

Industrial policy is another area directly related with SMEs. The key aim behind the EU industrial policy is to promote competitiveness of the industry and economy as a whole and to improve overall business environment for SMEs. It also addresses privatisation and restructuring (EC, 2005d: 97). Similar to the previous case, the *acquis* under this chapter is, in general, rather soft. It consists of industrial competitiveness policy guidelines and principles as well as industrial policy communications with horizontal and sector-specific aspects. Negotiation experience of the last enlargement illustrates that industry restructuring strategies constitute a significant concern under this chapter. In the process of screening, adaptation of below stated decision would play an important role in the fields of privatisation and restructuring (EC, 2004a).

Council Decision on "the Implementation of a Community Action Programme to Strengthen the Competitiveness of European Industry" (EC, 1996): The key objectives of guidelines in the action programme are modernisation of the industrial role of public authorities to ensure legal and administrative simplification for enterprises and to support emergence of learning society through continuous training. It also aims the creation of competitive environment for SMEs in both internal market (through standardization process and coordination of national initiatives) and external markets (in Central and Eastern Europe, the Baltic States and the CIS countries, the Mediterranean and Latin America, Asia, the ACP and

¹¹ SCEs have legal personality. For details of SCE, see European Council (2003a).

¹² For employee involvement, see European Council (2003b).

Southern Africa); to reinforce industrial cooperation between the EU and the US under the Trans-Atlantic Business Dialogue; support for intangible competitiveness factors and establishment of a database for each specific market to diagnose the impediments affecting European companies in third countries. In this regard, decision requires implementing initiatives for intangible investments, industrial cooperation and competition and modernization of the role of the public authorities.

As a horizontal policy area, industrial policy has direct relationship with other chapters, like SME policy, competition policy, free movement of goods and services, social policy. Significant part of transitional periods related with industrial policy was held under the negotiation agenda of these chapters. For this reason all countries agreed to implement the *acquis* as of their accession.¹³

2.3. Competition Policy Chapter

Competition policy is one of the key policy area covering quite differentiated sub-policy fields.¹⁴ In order to evaluate adequacy of the countries in complying with the competition *acquis* and Copenhagen economic criteria, the Commission assesses capacity of their undertakings operating in the EU internal market. All candidate countries took over the *acquis* under this chapter as from the date of accession with the exception of time and scope-specific transitional arrangements in the fields of incompatible fiscal state aids, operating aids and state aids to regional investment and environmental protection, as seen in Table 1.¹⁵

¹³ Negotiation process on this chapter was completed with all candidate countries as of December 2002 and for Bulgaria and Romania as of December 2004. EC (2004a).

¹⁴ The competition *acquis* is based on Article 31 (state monopolies of a commercial character), Articles 81-85 (rules applicable to undertakings), Article 86 (public undertakings and undertakings with special or exclusive rights) and Articles 87-89 (rules applicable to State aid) of the EC Treaty. Provisions of the EC Treaty are available at <http://europa.eu.int/eur-lex/lex/en/treaties>.

¹⁵ EC (2005b). Negotiations on this chapter for Bulgaria and Romania were ended in June 2004 and in December 2004 respectively while the others ended in December 2002.

Table 1. Transitional Arrangements in Competition Policy			
Countries	Transition Arrangement		Time and Scope Limit
	Transitional Field	Beneficiary	
Hungary Malta	Phasing-out of incompatible fiscal state aid	SMEs	by the end of 2011
Poland		Small enterprises	
Cyprus Hungary		Medium-sized enterprises	by the end of 2010
		Offshore companies	by the end of 2005
Malta	Phasing-out of operating aid under the Business Promotion Act	SMEs	by the end of 2008
Hungary Slovakia	Conversion of incompatible fiscal state aid into regional investment aid*	Motorvehicle manufacturing sector	For aids up to 40% of the maximum aid ceiling
Poland			For aids up to 30% of the eligible costs, regardless of the regional aid ceiling for other type of investment
Poland	State aid to investments in environmental standards protection	For aids granted transition period under the Environment Chapter	Aid intensity is limited to the regional aid ceiling with a 15% supplement for SMEs.

Source: EC (2005b).

* When the maximum aid ceiling is reached, fiscal aid will not be provided.

It is important to note that for Romania, Accession Treaty categorised existing aid and new aid separately. This mechanism can be applied, only if state aid enforcement performance of the country is found as satisfactory by the Commission. If not, then, the Commission has the right to review all state aids provided between 1 September 2004 and accession date. In case of detecting any illegal aids, the Commission can impose reimbursement after accession (EC, 2005e).

2.4. Taxation Chapter

As regards to taxation, limited number of derogations regarding indirect taxation (including VAT and excise duties) and direct taxation were provided especially for socially sensitive goods and services as well as maintenance of fiscal aids, as seen in Table 2. They mainly serve for postponement of the adjustment of indirect taxes levels to the requirements of the *acquis*. Except these, all countries were agreed to comply with the Code of Conduct for Business Taxation and implement the *acquis* as of accession date.¹⁶

Under current *acquis*, two directives of the Commission on VAT regarding invoicing and tax representative will also directly affect the SMEs through facilitating cross-border trade and decreasing their burden in fulfilling VAT invoicing requirements.

Table 2. Transitional Arrangements on Taxation

Countries	Transition Arrangement		Time or Scope Limit
	Transitional Field	Beneficiary	
Cyprus, Poland, Hungary, Slovenia	Continuation of the reduced VAT rate	Restaurant services	until the end of 2007
Czech Rep., Poland, Slovakia		Construction	until the end of 2007
Slovenia			until the end of 2007
Czech Rep., Latvia Estonia, Hungary		Heating	by 2004
Slovakia			by 2008

¹⁶ Negotiations on this chapter were completed with all of the countries in December 2002, except for Bulgaria and with Romania whose negotiations were completed in December 2004.

Table 2. Transitional Arrangements on Taxation (Continues)

<i>Countries</i>	<i>Transition Arrangement</i>		<i>Time or Scope Limit</i>
	<i>Transitional Field</i>	<i>Beneficiary</i>	
For all acceding Countries	Exempt from VAT	SMEs	Continuation of a higher turnover threshold than the level of the <i>acquis</i>
Romania¹⁷	Continuation of a royalty exemption on the basis of the Law on Free Trade Areas	Undertakings with commercial contracts before 1 July 2002	Until 31.12.2011
	Continuation of corporate tax exemption for new investments on the basis of the Government Emergency Ordinance on Deprived Areas	Undertakings with permanent investor certificate taken before 1 July 2003	Until 31.12.2010

Source: EC (2005b) and EC (2005e).

Council Directive 2001/115/EC of 20 December 2001 amending Directive 77/388/EEC with a view to Simplifying, Modernising and Harmonising the Conditions laid down for Invoicing in respect of Value Added Tax: This directive envisages new harmonised rules on the content, transmission and storage of invoices. (EC, 2002: 24) In this way, administrative cost of producing and archiving invoices of SMEs, whose administrative cost of invoicing is comparatively higher than big companies, can be significantly declined thanks to the opportunity of outsourcing and dematerialisation of invoicing obligations.

¹⁷ The state aid provided to regional investments and the aid net intensity must not exceed the rate of 50% Net grant equivalent (up to 65% for SMEs provided that the total net aid intensity does not exceed 75%). For undertakings active in the motor vehicle sector, the total aid shall not exceed a maximum of 30% of the eligible investments costs.

Council Directive 2000/65/EC of 17 October 2000 Amending Directive 77/388/EEC as regards the Determination of the Person Liable for Payment of Value Added Tax: The Tax Representative Directive will decrease administrative cost of VAT on foreign companies and SMEs engaging in cross-border activities. It eliminates cost of the obligation of appointing a tax representative in member states where they are not established. (EC, 2000b: 44)

In addition to these, the Commission is currently drafting a decision for modernisation and simplifications of VAT obligations especially regarding registration, declarations and payment of the SMEs. Moreover, proposal of the Commission regarding harmonisation of the rules governing the right to deduct the input VAT (for cars, restaurant services, hotels, fuel) and providing cross border right for the traders to keep back the input VAT have long been discussing by the Council. If this proposal is adopted, it become possible for SMEs to deduct input VAT incurred in another Member State in their own VAT return and to submit it to the Member State where they are set up. This will certainly decrease the administrative burden on SMEs arising from the 8th Directive refund procedure (EC, 1979:11). Lastly, the Commission has proposed a Directive to apply a uniform threshold of € 100 000 determined in annual turn-over for VAT exemption and to set up a VAT One-Stop Shop system for simplification of VAT obligations and increase in the share of SMEs in intra-EU trade. It also requires from member states to review direct taxation system in order to ease burden on SMEs.

3. Key Points for Turkey

As clearly stated before *acquis* crosscutting SMEs is rather soft one. For many of the agenda item under these chapters, it is high probability that Turkey will accept the *acquis* on SMEs as from the date of accession. However, depending on the sectoral profile and regulatory impact analysis, need for certain transitional arrangements for SMEs can be arisen for Turkey. The key point is that economic and social implications of significantly raising harmonisation costs, not only in economic terms but also social and political aspects especially in the areas of state aids granted to SMEs and taxation will play a decisive role for transitional measures. Transitional periods have to be limited in time and fully justified in the position papers of Turkey. The question of whether transitional measures can be accepted or not depend on unanimous decision of the Commission and approval of the Council. The Commission side will scrutinize the need to safeguard proper functioning of the internal market as well as the

political, economic and social implications for Turkey. In that sense, the impacts of the adaptation of the *acquis* on competition or on the internal market as well as social need should be clearly explained. This requires correct diagnosis on needs and sound regulatory impacts analysis for chapters related to SMEs. State Planning Organisation as a sectoral and regional strategy planner can take a leading role by coordinating preparation of regulatory impact analysis and position papers for negotiations by taking contributions of all related institutions.

At this point, an evaluation on the current situation of Turkey *vis a vis* hard *acquis* on SMEs will be useful. As a part of the hard *acquis* under the chapter of SME Policy, Council Directive on the collection of statistical information in the field of tourism is important. Currently, there is no classification of tourist accommodation establishments or services as well as data pool and monitoring mechanism for supply and demand of tourism services. This is a costly and time-needed requirement for which Turkey should be prepared for. Moreover, it is highly possible that the Commission will ask whether Turkey will be ready for adopting following legislations: Commission Decision on support mechanism for the creation of transnational joint ventures for SMEs, Council Regulation on the Statute for a European Cooperative Society and Council Directive on supplementing the Statute for a European Cooperative Society with regard to the involvement of employees. Turkey has not yet been involved in formulation of such a cooperative framework with specific arrangements on employees nor have a support mechanism for transnational joint ventures for SMEs. Turkey will be invited to participate to this mechanism, which requires participation contribution and co-financing for each of the proposed project. In this sense, absorption capacity of Turkey in that area and available financial resources should be examined by doing analytical studies. On the other hand, regarding Council Decision on a multiannual programme for SMEs for the period of 2001-2005, there is no need to take further action because Turkey has already taken part in this multiannual programme under the coordination of Small and Medium Industry Development Organization (KOSGEB).¹⁸

When we come to the legislation regarding SMEs under the chapter of industrial policy, it should be indicated that Turkish industrial policy is

¹⁸ See European Council (2000a). As stated in Article 6, programme is open to the participation of Malta and Turkey.

largely in conformity with the principles of the EC industrial policy.¹⁹ In line with the industrial strategy of the EU, Turkey prepared a strategy called as "Industrial Policy for Turkey" in 2003 (SPO, 2003). During the screening process of the negotiations, Turkey will be invited to present its industry policy and restructuring strategies in order to compare the compliance degree of industrial policies and principles of Turkey with the EU. In line with the spirit of the Council Decision on the implementation of a Community Action Programme to strengthen the competitiveness of European industry, Turkey has been in a reform process for modernisation of the industrial role of public authorities to achieve legal and administrative simplification for SMEs. Restructuring of KOSGEB through modifications in the related law envisaged under Medium Term Programme is an important part of this process.²⁰ Establishing a database on the basis of each market regarding the problems faced by European companies in third countries is another challenging topic which requires strong domestic statistical network and international data exchange for Turkey. Privatisation, restructuring of steel industry, improvement in the business environment and SME policy will be the other key topics of the negotiation agenda. Last Progress Report underlines existence of limited progress in privatisation, restructuring, business environment and SME policy (EC, 2005d: 97). At this point, restructuring of steel industry prioritised under both 2001 and 2005 Accession Partnership²¹ but not fulfilled by Turkey so far, is worthy of note because it would be another challenge that Turkey can face as opening or closing benchmark for this chapter.

Among all these chapters, competition policy will be one of the most difficult chapters which horizontally crosscuts SMEs. It is highly possible that this chapter can impose serious challenges for Turkish authorities. On the basis of a Commission recommendation referred to shortcomings in Turkey's fulfilment of specific conditions under the Customs Union Decision 1/95 related to competition policy, it is very high probability that opening benchmark can be proposed by the Commission regarding establishment of state aid authority. Its absence is seen as a critical deficiency and thereby the major delaying factor for the adoption of implementing rules for competition and obligations arising from the Customs Union Decision. Taken into account experiences of the last enlargement, Turkey should set up a reliable state aids system and monitor

¹⁹ Progress report found industrial policy implementation in Turkey as satisfactory, see (2005d).

²⁰ For further information on Medium Term Programme, see SPO (2005).

²¹ For the provisions stated in last Accession Partnership see EC (2005c).

all state aids granted to SMEs including regional investment aid, environmental protection aid, incompatible fiscal aid as well as operating aid. There are many institutions providing different types of state aids to enterprises in Turkey as seen Table 3.²² Those key institutions should form a platform where they analyze current state aids provided directly to SMEs and possible adaptation need and time period for specific items.

Ministry of Industry and Trade	Regional aid, R&D
Ministry of Culture and Tourism	State aid for cinema film production
Undersecretariat of Treasury	State aid for investments, financial transfers to public enterprises, state guarantees, regional aid, SMEs
Undersecretariat of Foreign Trade	Horizontal state aid (De minimis, training, R&D, SMEs)
Turkish Revenue Administration	Tax exemption and exceptions, public land sales, regional aid
KOSGEB	State aid for SMEs
TUBITAK	State aid for R&D
Türk Eximbank	Export credit insurance

One of the real problems in that area is lack of clear knowledge among the related institutions regarding the type and amount of aids provided to the enterprises by the other institutions. It is an urgent necessity for Turkey to portray the "real map" of state aids through effective communication among institutions. In this area, there are significant ambiguity and opaqueness. In that sense, negotiation process with the EU will create a political anchor which force all relevant institutions to work together to draw current situation in Turkey regarding state aids and awareness raising about what has been done by the other institutions. This will certainly improve transparency and motive for abolishment of state aid transfers which no longer have any economic and social rationale behind. In that regard, it will be useful for Turkey to revise and simplify various state aid rules especially those on encouraging risk-taking and innovation in SMEs through adopting more flexible approach for SMEs.

²² State aids are provided not only directly but also indirectly financial aids provided for SMEs as loans offered by Halk Bank with convenient terms.

State aids and other financial transfers to SMEs are highly important because in Turkey and in the EU, SMEs have a large part in economy.²³ To promote entrepreneurship and competitiveness of SMEs, structural funds have allocated € 21 billion to SMEs in the period 2000-2006 (EC, 2005f; EC, 2003a). As depicted in Table 4, under the EU funded regional development programmes financed by MEDA (Eastern Anatolia Development Programme, South Eastern Development Programme) and pre-accession assistance programmes (Kastamonu, Samsun, Trabzon, Erzurum, Agri, Konya, Kayseri and Trabzon NUTS II level regional development programmes), totally € 64,590,000 were allocated as direct grants to SMEs in Turkey.²⁴ Turkey should enforce further projects to lessen burden on SMEs and to address critical needs.

In the area of taxation, on the other hand, it can be indicated that invoicing and tax representative directives can also be adoptable as of accession date as a part of improvement in business environment and simplification of legislation prioritised under the heading of "Enactment of Better Laws and Legislation" in the SME Strategy and Action Plan.

²³ There are 23 million of SMEs in the EU, providing around 75 million jobs and accounting for 99% of all enterprises. In Turkey, SMEs constitutes 99.8% of total enterprises and 76.7% of total employment. See, SPO (2004a:8) and EC (2005f).

²⁴ Project evaluations have been continuing in most of these programmes designed for creation of micro-enterprises, diversification of the rural economy, technological development, business support services and strengthening cooperation between SMEs. For more information on ongoing grant programmes see <http://www.dpt.gov.tr/bgyu/abdbkpu/abdbkpu.htm>

Table 4: Grant Projects with SME Components Only			
<i>Project Name</i>	<i>Beneficiary Institution</i>	<i>Year</i>	<i>Budget</i>
MEDA Programme			
Eastern Anatolia Development Programme	SPO	2001	8,500,000
South Eastern Development Programme	GAP Administration	2001	7,590,000
			TOTAL: € 16,090,000
Pre-Accession Financial Assistance Programmes			
Samsun (Amasya, Corum, Samsun, Tokat), Kastamonu (Cankiri, Kastamonu, Sinop) and Erzurum (Erzurum, Erzincan, Bayburt) NUTS II Regional Development Programme	SPO	2003	14,800,000
Konya (Konya, Karaman), Kayseri (Kayseri, Sivas, Yozgat), Malatya (Malatya, Bingol, Elazig, Tunceli) Kastamonu (Cankiri, Kastamonu, Sinop), Erzurum (Erzurum, Erzincan, Bayburt) and Agri (Agri, Igcir, Kars, Ardahan) NUTS II Regional Development Programme	SPO	2004	24,500,000
Trabzon (Trabzon, Rize, Giresun, Ordu, Artvin, Gumushane) NUTS II Regional Development Programme	SPO	2005	9,200,000
			TOTAL: € 48,500,000
GRAND TOTAL (MEDA + PRE-ACCESSION) = € 64,590,000			

Besides all these the possible challenges arising from legislative framework of the EU, it will be useful to underline the particular areas important in the context of harmonisation of the administrative, legal and regulatory environment. It is highly possible that below-stated three points will be the main agenda items under the negotiations for the chapter of Enterprises and Industrial Policy. For each item, current situation in Turkey is summarised as follows:

1. Formulation and implementation of overall enterprise and SME policy: Since *acquis* related with SMEs examined so far is rather soft one, convergence of policies and institutional system will constitute a key role in negotiations. As regards to the policy formulation, SME Strategy and Action Plan is the main national policy framework. Priorities set out in the Strategy are in full compliance with European Charter for Small Enterprises, as seen in Table 5.

Education and training on entrepreneurship (SPO, 2004a)	<i>Opening up to new market</i>
Faster and cheaper business start-up	<i>Finance and supports</i>
Training of skilled labor	<i>Technology and innovation</i>
Sharing best practices	<i>Improving on-line access and transactions via internet</i>
<i>Enactment of better laws and legislation</i>	<i>Better representation of SMEs</i>

Source: SPO (2004a)

In order to enhance competitive power of SMEs in the process of harmonization with the EU, it specifies main weaknesses of Turkish SMEs as insufficient know-how, low level of technology, disadvantaged financial and legal environment (SPO (2004a). Implementation, revision and monitoring of the strategy will be provided by the steering committee composed of all relevant institutions under the auspices of Ministry of Industry and Trade.²⁵ The Commission closely follows SMEs' performance in the economy in the negotiation process and strength of coordination policies towards SMEs to ensure effectiveness of the Community and national programmes designed to improve competitiveness of SMEs.

As regards to institutional framework, Ministry of Industry and Trade is the responsible body for the formulation and coordination of enterprise and industrial policies. The State Planning Organisation is in charge of programming of investment projects funded by either national funds or the EU pre-accession funds. KOSGEB is public legal entity providing around 22 different support schemes for SMEs in the manufacturing sector. Administrative capacity of KOSGEB should be strengthened to increase effectiveness of the implementation of activities especially in the areas of technology and enterprise development.²⁶ At local level, establishment of regional development agencies will increase effectiveness of implementation of enterprise and industrial policy.

²⁵ According to the decision of the High Planning Council dated 01.05.2005 numbered 2005/20.

²⁶ KOSGEB related Euro Info Centres provides information, advice and technical support to SMEs as a first stop shop on access to EU markets, marketing and business operation. Innovation Relay Centres provides support regarding technology transfer and R&D activities.

2. General business environment in the country: In order to improve investment environment and promote entrepreneurship in line with the Lisbon agenda of the EU, Turkey has undertaken significant reforms, summarised as follows:²⁷

- Law on Company Establishment entered into force in 2003 under the Reform Programme to Improve the Investment Environment in Turkey reduced establishment process of a company (from 19 to 3 stages). Currently, it is possible to establish a company within 1 day.

- Law on Foreign Direct Investments accepted in 2003 abolished the requirements of minimum capital and preliminary permission to make a foreign direct investment in Turkey.²⁸ Furthermore, definitions of the foreign direct investment and local and foreign investor were reformulated to eliminate difficulties in establishing a firm. Investment allowances, as a key instrument for the promotion of investments, were allowed to be automatically offered to the investor without requiring an investment promotion certificate in 2004.

- Law on Inflation Accounting was adopted in 2003 to increase effectiveness of accounting system. Law on trademark and patent rights was enacted in 2003 to strengthen the administrative infrastructure for the system of intellectual property rights.

- Laws on SME Exchanges and Venture Capital Investment Partnerships were adopted to provide modern financing opportunities to SMEs. Regulation on venture capital has been prepared to build institutional capacity in actual operation.

- As a governmental policy, administrative and legal simplification in start up and business development as well as benchmarking with best practices in the world were prioritised under the headings of "Enactment of Better Laws and Legislation" and "Improvements to be made in Taxation and Financial Matters" of the SME Strategy and Action Plan. (SPO, 2004a: 41-45)

- Decentralisation and transfer of procedures to set up a business to local Commercial Registry Offices is a positive development for improving the investment environment.²⁹

²⁷ For further information on the attempts to improve the investment and business environment in the process of accession to the EU see SPO (2004b:33-35)

²⁸ Instead of getting a permission, informing related authorities is required.

²⁹ They are supported by the local Chambers of Commerce or Industry.

In general, it can be indicated that there has been significant attempts for improving business environment improved. However, we can not consider these as adequate, on the contrary, further additional attempts are necessary to eliminate the institutional opaqueness problem as well as simplification of the taxation system to increase predictability and stability of economic decisions. Moreover, more efforts are necessary to respond the problems of high energy costs and lack of working capital for SMEs.

3. Adoption and enforcement of the SME definition: Until very recently in Turkey, there have been different organisations with activities related to SMEs use different SME definitions within the framework of their job descriptions, target groups and resources allocated for their operations. Formulation a common SME definition has been needed in order to establish a standard in developing, executing and monitoring policies for SMEs. As a respond to that need, the regulation issued by the Ministry of Industry and Trade to align the Turkish "SME definition" with the EU definition was adopted as seen in Table 6.³⁰ The regulation brings common definition for SMEs in Turkey complying with the EU definition adopted in 1996.³¹

< 10		< 50		< 250	
≤ €2 m	< 1 m YTL	≤ €10 m	< 5 m YTL	≤ €50 m	< 25 m YTL
		≤ €10 m		≤ €43 m	
≤ €10 m	---	No more than 25% of the capital or voting rights held by one or more enterprises, which are not SMEs			

Source: EC(2003c) and Turkish Official Gazette 2005/9617 dated 18.11.2005.

However, on 6 May 2003, the Commission adopted a new Recommendation regarding the SME definition which replaced Recommendation adopted in 1996.³² The new definition has been in force

³⁰ This Regulation, to be in force on May 2006, is available at www.rega.gov.tr

³¹ For examining previous Commission Recommendation in 1996, see EC (1996).

³² For further details of current SME definition of the EU, see EC (2003c).

since 1st January 2005. New definition increases financial ceilings for SMEs in line with price and productivity rise in the EU since 1996 but not introduce any change in headcount ceilings. It also introduces a model for self-declaration to be filled out by the SMEs themselves to eliminate administrative burden and uncertainties in the interpretation of the definition. It also adopts the typology of enterprises with three category headings: Autonomous enterprises, partner enterprises and linked enterprises. In this new definition, apprentices or students in professional training are excluded in the calculation for headcount to encourage vocational training as well as the exemptions for research institutes and venture capital funds were broadened to promote the equity financing of SMEs and research facilities.

Since Turkey align its SME definition in line with the previous recommendation belonging to year of 1996, there will be need to revise its definition in time according to the revised SME definition in force in the EU since 2005. For the time being, the regulation brings common definition for SMEs in Turkey complying with the EU definition adopted.

4. Conclusion

SMEs have positive contributions in providing and maintaining balanced economic and social development. They also play an important role in decreasing the level of unemployment and creating new employment opportunities and with their flexible production structure they can follow the changes in the market conditions more effectively. Due to their key role in the economy, it is of vital importance to formulate new policies to encourage establishment, expansion and development of SMEs. Negotiation experience of the last enlargement under four chapters directly related to *acquis* on SMEs (SME policy, industrial policy, taxation and competition policy including state aids) will be enlightening in that context.

Gap analysis for Turkey *vis a vis* possible negotiation agenda suggest that it would be proper for Turkey to open Enterprise and Industrial Policy chapter in the immediate term especially considering the impetus driven from recently unified definition of SMEs. However, Turkey will need to revise its definition over time according to updated SME definition of the EU, in force since 2005.

There will be no complicated legislative framework for harmonising SME policies. However, depending on the sectoral profile and regulatory impact analysis, certain transitional arrangements for SMEs can be necessary. In the case of participation to the multiannual programmes as

well as support mechanisms (as in the case of joint ventures for SMEs), it is necessary to analyse absorption capacity of Turkey in that area and availability of financial resources. Turkish industrial policy, in principal, complies with the EC industrial policy but monitoring of the strategy is still a necessity. Restructuring of the steel sector can be an opening benchmark that Turkey would face for negotiation under Industrial Policy. In the field of business environment, simplification of administrative and tax system and better access to finance for SMEs should be strictly pursued.

Since Turkey has not yet fulfilled its obligation under the Customs Union Decision 1/95 with regard to the adoption of state aid legislation or the establishment of an operationally independent state aid monitoring authority, this delay would be a critical problem for Turkey. That delay hinders the implementation of a state aid control regime and results in distortions of competition in markets via the allocation of public aid and loss of transparency of financial transactions between the state and undertakings. I believe that this point will be the most critical concern that Turkey would face as a benchmark, possibly as an opening benchmark for the negotiations under the Competition Policy. This is also important because of the power of Community to review the state aid enforcement performance of the candidate countries in their pre-accession period, as in the case of Romania, and imposing reimbursement after accession when there is any irregularity. In that sense, in order not to carry the burden of cost of reimbursement after the membership, Turkey should avoid from any disorganised structure and irregularities in state aids.

In general, there is a need for improving the administrative capacity in both central and local for the leading institutions in enterprise and industrial policy. Enactment of the law regarding regional development agencies will have a positive impact for implementation of industrial policies at regional and local level. Besides formulation of a strategic framework for industry and SME policies, Turkey should activate these policies through mature projects and speeding up legislative process. As a final remark, it should be indicated that except these challenges that may pose difficulties for negotiations related with SMEs, negotiation process for Turkish SME policy under the chapter of Enterprise and Industrial Policy would not pose any serious problem for aligning to the *acquis*. However, in order to supervise whole process in a complementary manner, chapter of Enterprise and Industrial Policy need to be simultaneously undertaken with the negotiation processes of competition and taxation policies.

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