the negotiations or the subsequent ratification process, the relations between EU and Turkey must ensure that Turkey remains fully anchored in European structures."[6] Consequently, despite the insistence of some member state governments that Turkey is ready for full membership, and Turkey's frequent declarations that it will accept nothing less, the relationship could ultimately be configured in the form of a Privileged Partnership or Extended Associate Membership. The possibility of unrealistic expectations and related disappointment should be avoided by establishing at the outset that the negotiation process, if it begins, is open-ended.

### Conclusions: The Primacy of Geopolitics and Security

The "primacy of economics" in world affairs[7] that had effectively begun on 9 November 1989 ended on 11 September 2001. Geo-strategic and security concerns now constitute the dominant paradigm. Although the EU recognised Turkey as a candidate in 1999, it was not until late 2001 that Turkey began to implement a serious reform agenda of political and economic change. This coincided with a revolutionary transformation in global security, strong American encouragement for the Turkish democratisation process and intensified pressure on the EU to begin accession negotiations.

In this perspective, "EU membership for Turkey" is a strategic-foreign policy project. The goal of "political union" will be rescinded in favour of the vague vision of a "global power Europe". If such a development occurs, the EU may degenerate into a "European United Nations" or elevated free trade zone, in the framework of which interstate coordination increases and integration cores, variable according to national interests, will form. Not more, rather less security in Europe, could be a consequence. On grounds of self-preservation the EU should first pursue its own consolidation, undertaking enlargements only gradually and conditionally, and develop alternatives to full membership for strategic partners.

[6] European Commission: Communication from the Commission to the Council and the European Parliament. Recommendation of the European Commission on Turkey's progress towards accession, Brussels 2004.

[7] Fred Bergsten: The Primacy of Economics, in: Foreign Policy, Issue 87, Summer 1992, pp. 3-24.

Sübidey Togan*

# Economic Aspects of the Accession of Turkey to the European Union

The conditional offer to negotiate with Turkey, a large Muslim nation, on EU membership is stirring political debate in Europe, a debate that can be very useful or extraordinarily dangerous depending on how it is managed. The purpose of this note is to contribute to this debate by highlighting the economic aspects of Turkish accession. We start with the analysis of the impact of EU accession on the Turkish economy. We then study the impact of Turkish accession on the economy of the EU, and end with some concluding remarks.

### Impact On the Turkish Economy

With accession to the EU, Turkey will adopt and implement the whole body of EU legislation and standards – the *acquis communautaire*. In the following we consider selected issues related to free movement of goods, adoption of the Common Agricultural Policy (CAP), freedom to provide services, liberalisation of network industries, joining the European Economic and Monetary Union (EMU) and the trade and growth effects of integration.

### Industrial Goods

In the case of industrial goods a customs union was created between Turkey and the EU starting on January 1, 1996. According to the Customs Union Decision (CUD) of 1995 all industrial goods with the exception of "European Coal and Steel Community" (ECSC) products circulate freely between Turkey and the EU as of January 1, 1996 as long as they comply with the EC norms. In the case of ECSC products Turkey signed a "Free Trade Agreement" with the EU in July 1996 as a result of which ECSC products have received duty free treatment between the parties since 1999. Nine years have passed since the formation of the customs union. Currently, no quotas and tariffs are imposed on imports of industrial goods by Turkey and the EU. Turkey is implementing the Community's Common Customs

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Tariff on imports of industrial goods from third countries, and has adopted most of the preferential trade agreements the EU has concluded over time. On the commercial policy side the country is implementing measures similar to those of the Community's commercial policy. Turkey has adopted the EC competition law, established the Competition Board, adopted the EC rules on the protection of intellectual and industrial property rights, and established the Patent Office.

Although customs duties and equivalent charges as well as quantitative restrictions on industrial products were eliminated with the formation of the customs union in 1996 between Turkey and the EU, there are still barriers to trade between the parties. The two remaining issues are contingent protectionism and technical barriers to trade. Article 44 of the Customs Union Decision allows the EU to impose anti-dumping measures as long as Turkey fails to implement effectively the competition rules and the rules on intellectual, industrial and commercial property rights of the customs union. Similar considerations apply for Turkey. During the period since 1996 both parties have been active users of these measures. On the other hand, according to Decision 2/97 of the Association Council Turkey had to incorporate into its internal legal order a large number of instruments that corresponded to various EEC or EC Regulations and Directives on technical legislation before the end of 2000. But the work has not yet been completed. In addition Turkey has to align its national quality infrastructure to the European one. Products manufactured in Turkey must satisfy the same requirements as those prevailing in the EU, and the demonstration of conformity to these requirements must be done according to the same principles as in the EU. Recently, Turkey has taken major steps to align its legislation with the *acquis*. But it still has to establish the operators and operation of standardisation, testing, certification, inspection, accreditation, and metrology according to the same principles and obeying the same rules as in the EU. Although there has been considerable progress in establishing sound conformity assessment and market surveillance structures internally, implementation is still a cause of concern according to the European Commission.[1]

### Agriculture

In Turkey the most important part of agricultural policy has been price support. Since 1999 Turkey has introduced significant reforms in this sector, and under the reform programme output price supports and input subsidies and grants in various forms are being phased out and replaced by direct payments to farmers based on land holding as in the EU.

The impact on agricultural markets and incomes of EU accession by Turkey has been studied recently by Togan et al.[2] According to the authors adoption of the CAP will lead to substantial changes in the agricultural incomes of producers, the welfare levels of consumers and the budget revenues of the government. Since the prices for many major agricultural prices in Turkey will have to be reduced at some point between now and accession, consumers will derive great benefits. The authors estimate that in the medium to long term, EU-like policies will lead to a 1.87 per cent increase in real household incomes in Turkey, amounting to €2.9 billion. Furthermore, lower income households (rural households) will experience a more significant increase in real income. On the other hand the adoption of the CAP will require substantial adjustments on the part of Turkish farmers, and the effect on farmers' incomes will be driven mainly by the amount of CAP-like compensation payments granted to the farmers. Farmers' income will decrease considerably under Agenda 2000 policies without direct payments, and will increase under Agenda 2000 policies with direct payments. It has been estimated that the agricultural value added will increase by €2.145 billion under Agenda 2000 policies with direct payments equal to those applied in the EU, and by €0.341 billion under Agenda 2000 policies with direct payments at a level of 35 per cent of the payments granted in the EU member countries. The budgetary costs will amount to €2.998 billion under Agenda 2000 policies with direct payments equal to those applied in the EU and to €1.2 billion under Agenda 2000 policies with direct payments at a level of 35 per cent of the payments granted in the EU member countries.

### Services and Network Industries

Joining the EU will require that Turkey liberalises its services and network industries and adopts and implements the EU rules and regulations in those industries. Such changes will have considerable effects on the economic welfare of consumers. Attempts to quantify the welfare effects of the liberalisation of services and the network industries have recently been made by Togan.[3] According to the author the change in Turkish consumers' real income due to the adoption of EU

[1] European Commission: 2004 Regular Report on Turkey's Progress towards Accession, COM (2004) 656 final.

[2] S. Togan, A. Bayener, J. Nash: Analysis of the Impact on Agricultural Markets and Incomes of EU Enlargement to Turkey, in: S. Togan and B. Hoekman (eds.): Turkey: Toward EU Accession, copublication of the World Bank and Oxford University Press, Washington DC (forthcoming).

[3] S. Togan: Quantifying the Impact of EU Accession, in: N. Tocci and A. Evin (eds.): Towards Accession Negotiations: Turkey's Domestic and Foreign Policy Challenges Ahead, European University Institute, Robert Schuman Centre for Advanced Studies, Florence 2004.

rules and regulations in the banking sector will increase by about €2.12 billion. The study shows that with the adoption of EU rules and regulations the real income of Turkish consumers will increase by €0.915 billion in the case of adoption of EU rules and regulations in the telecommunications sector, by €0.822 billion in the case of the electricity sector, by €0.128 billion in the case of the natural gas sector, and by €1.57 billion in the case of the transportation services. Thus with the adoption of EU rules and regulations in banking, telecommunications, electricity, natural gas, and transport the real income of Turkish households is expected to increase by about 3.6 per cent to €5.56 billion.

### Membership of EMU

Participation in the Economic and Monetary Union is a must for Turkey since the *acquis* is expected to be taken in full, including EMU participation, and in due time all the requisite "Maastricht criteria" for Euro Area integration. Turkey will not be expected to adopt the euro immediately upon accession. Upon accession Turkey, according to Article 122 of the Treaty establishing the European Community (the "Treaty"), will be treated as a "country with a derogation" until it fulfils the convergence criteria, which involve conditions on price stability, interest-rate convergence, budget deficit, government debt and exchange-rate stability.

Thus, Turkey during the pre-accession period will have to introduce legislative changes and take measures for the thorough implementation of this legislation. The country will then be faced with the problem of attaining sustainable development over time while simultaneously satisfying the Maastricht criteria. The challenge facing Turkey is how to move from the current state of affairs to a state where the Maastricht criteria will be satisfied. As emphasised by Togan and Ersel[4] the country should pursue economic policies designed to satisfy over time the conditions for fiscal sustainability and sustainability of the current account. To avoid the risk of speculative attacks on the Turkish currency Turkey should take measures to establish a sound fiscal framework and achieve a sound banking sector. In addition, in order to attain sustainability in its current account Turkey should try to target its real exchange rate to be around its long-run equilibrium level.

### Trade and Growth Effects

Although the pattern of Turkish-EU trade is not expected to change substantially as a result of full membership, there is considerable potential for an increase in the volume of trade. Following Togan[5] we note that with accession trade between the parties will increase by about 41 per cent. Since integration will remove the distortions in the price system, which in turn will boost allocative efficiency in the economy, the heightened efficiency will make the country a better place in which to invest. Investment will increase and hence foreign direct investment (FDI). Thus the allocative efficiency gains from integration will be boosted by induced capital formation. While investment increases above its normal level the Turkish economy will experience a growth effect. Furthermore, with accession Turkey will be eligible for EU structural funds. The increase in infrastructural investments will contribute to economic growth in Turkey. In addition, Turkey will reap benefits from monetary integration. All this means improved material well-being for Turkish people in the long term. Togan,[6] studying the magnitude of this effect, shows that with accession income per capita in Turkey will increase by about 1.5 per cent.

The above considerations reveal that the welfare gains from integration will be substantial for Turkey. However, the welfare gains that will be derived by Turkey from integration will have a price. The price will be the adjustment costs associated with the attainment of macroeconomic stability, the adoption of the CAP, the removal of technical barriers to trade and the adoption of the *acquis communautaire* in general such as the adoption of the EU's labour market rules and regulations, and the costs associated with complying with the EU environmental directives.

### The Impact on the Economy of the EU

The effects of Turkish accession on the EU are analysed in the following under the headings of trade effects, budgetary effects and migration.

### Trade Effects and Increased Investment Opportunities

Although Turkish trade with the EU are expected to increase with accession to the EU as indicated above by about 41 per cent, this increase will still be small for the EU-25. On the other hand, until lately FDI from the EU to Turkey has remained at a very low level. With the implementation of the *acquis* and the adoption of the institutional framework of the EU, FDI from the EU to Turkey is expected to increase substantially.

### Budgetary Effects

In the EU budget expenditures have two main destinations: the CAP and the Structural Operations aimed

[4] S. Togan, H. Ersel: Macroeconomic Policies for EU Accession, in: S. Togan and B. Hoekman (eds.), op. cit.

[5] S. Togan: Turkey: Toward EU Accession, in: The World Economy, 2004, pp. 1013-1045.

[6] Ibid.

at disadvantaged countries and regions. The CAP has until recently built on price supports. Starting in 1993, the CAP has gradually been shifting away from price to income support. On the other hand, Structural Operations are based on the criteria of relative income level, underdevelopment and the structural problems of particular regions and countries. Regional support is given by the Structural Funds. For example, to be eligible for support under the "Objective 1" classification a region has to have a per capita income of less than 75 per cent of the EU average. Nearly 70 per cent of Structural Operations expenditures fall under this classification. Cohesion Fund expenditure is rather modest, or about two per cent of the total budget, but is important for the recipient countries. Relative to GDP, the largest recipients of Structural Funds are Greece and Portugal, which receive the equivalent of more than two per cent of their GDP, and Spain, which receives more than one per cent.

After accession the funds to be received by Turkey from the EU budget consist of direct income support payments under the CAP, trade-related net subsidies under the CAP, payments from the Structural Funds and payments from the Cohesion Fund. According to Togan et al.[7] direct income support will amount to €2.772 billion with direct payments equal to those applied in the EU and to €970 million under Agenda 2000 policies with direct payments at a level of 35 per cent of payments granted in the EU member countries. While trade-related net subsidies will amount to €23 million, Structural and Cohesion Fund payments will amount to about €8.664 billion. Since after accession Turkey will also contribute to the EU budget in the form of VAT-based and GNP-based contributions amounting to about €1.9 billion, the total annual net transfers that Turkey can expect to receive from the EU after accession will amount to around €9.557 billion, if direct payments under the CAP are equal to those applied in the EU, and to €7.755 billion if direct payments are made at a level of 35 per cent of the payments granted in the present EU member countries.

### Migration

The prospect of large-scale immigration from Turkey is a source of considerable concern among the EU countries, where it is feared that the immigrants will depress wages, boost unemployment and cause social friction and political upheavals. Free migration will surely not be allowed immediately upon full membership, but only after a certain period of transition. The PPP-adjusted income per capita in the EU is more than three times higher than in Turkey. It will probably take decades before Turkey attains an income level comparable to that of the EU-15. The income differential will continue to be a strong incentive for migration from Turkey to the EU.

To make a forecast of migration Togan[8] uses the Boeri and Brücker[9] estimation of the migration equation. The calculations he reports reveal that the Turkish immigrant population starts out at about 2.2 million in 2000 and reaches about 3.5 million in 2030 under the assumption that no restrictions are placed on migration.

### Conclusion

Turkish accession will be beneficial for Turkey. The accession will also affect the welfare of current members of the EU. With Turkish accession current members will derive welfare gains from standard comparative advantage sources and also from the growth effects of integration. Furthermore, the migration of Turkish labour to the EU will affect the welfare level in member countries. The empirical research on the economic effects of immigration indicates fairly small and on the whole positive effects; employment opportunities are not affected much, the wages of low skilled labour are depressed somewhat but those of skilled labour are increased, and the net present value of public transfers is positive. In addition to these effects, the EU will have to incur the net annual budgetary cost of Turkish membership to the EU. Estimates indicate that this cost will be around €7.8-9.6 billion annually unless the rules on the CAP and the Structural Funds are changed by 2014. There will also be political gains for the EU. Turkey is a large and fast expanding market. It is in fact the largest market in the Middle East, Balkans and Caucasus. Turkey, located at the crossroads between Europe, Eurasia and the Middle East, has the potential to act as a major link between these markets. With the harmonisation of commercial legislation, EU companies will be able to use Turkey as a joint investment and export base for the Middle East and Eurasia. Istanbul is emerging as a location for transnational corporations' headquarters for operations in the Caucasus and Central Asia. The EU will derive potential gains from increased trade in the region. Finally, Turkish membership could help to secure stability and security in the Balkans and Caucasus, as indicated by the European Commission.[10] The EU could then increase its energy security and also decrease its defence expenditures.

[7] S. Togan, A. Bayener, J. Nash, op. cit.

[8] S. Togan: Turkey: Toward EU Accession, op. cit.

[9] T. Boeri, H. Brücker: The Impact of Eastern Enlargement on Employment and Labour Markets in the EU Member States: Final Report, Berlin 2000, European Integration Consortium.

[10] European Commission: Issues Arising from Turkey's Membership Perspective, Brussels 2004.