Turkey and the EU: Issues and Challenges

The question as to whether, and when, the European Union should open accession negotiations with Turkey has given rise to a heated debate not just among the political and academic communities, but also among the European public at large. Whereas some expect major economic and geopolitical benefits from Turkish EU membership, others fear that it would change the nature of the European project and destroy its original rationale.The following contributions throw some light on the issues involved.

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Turkey and the EU: On the Costs and Benefits of Integrating a Small but Dynamic Economy

At its December 2004 meeting, the European Council might decide to start negotiations with Turkey culminating in full membership without delay in 2005. This would undoubtedly be a historic step, the fulfilment of the Turkish republican dream and, above all, a signal that Europeans want to abolish religious barriers to modernity, freedom and the consolidation of peace. Some even call it the new world of the 21st century on the basis of common values. But currently there is also some water which blurs the wine. For instance, there is the danger that a rational discussion of the economic progress of Turkey during the negotiation period will be superimposed by quarrels about the new Constitution and the redefinition of the Growth and Stability Pact and other aspects concerning the euro area, not to speak of unanimity with respect to common foreign, security and defence policies as well as the inclusion of the Balkan region in the EU. However, the area from which most prejudices and misperceptions stem is economics. To check for this, one has to look in detail at the economic issues likely to emerge during the process of negotiations, assuming that they will start soon. A recent important and excellent publication by the Brussels Centre for European Policy Studies entitled "The European Transformation of Modern Turkey" analyses the challenges and opportunities arising in the fields of foreign policy, security policy, justice and home affairs, domestic governance, macroeconomic policy and income convergence, energy, banking and agriculture. The main results related to economic challenges, which are in my view representative of other studies in the field, can be summarised as follows.[1]

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General Economic Considerations

If Turkey's economic performance pattern is examined more deeply, an extremely heterogeneous picture emerges. Some areas like, for example, trade integration reveal that Turkey even leads the new member countries in some economic fields. However, with respect to other important issues such as formal education of the population, Turkey still suffers from severe backlogs which must be eliminated urgently within the next years. Hence, Turkey should be classified as a typical transition country which is just moving away from a highly distorted boom-and-bust economy to a stable market economy. It seems fair to say that Turkey today is rather open to international trade and foreign investment and offers the potential for rapid and sustainable growth. However, it remains to be seen whether Turkey's reform path adopted since 2001

[1] This contribution heavily relies on K. Derviş, M. Emerson, D. Gros and S. Ülgen: The European Transformation of Modern Turkey, Centre for European Policy Studies (CEPS), Brussels, Economics and Foreign Policy Forum, Istanbul 2004. Further sources are A. Belke and N. Terzibas: Die Integrationsbemühungen der Türkei aus ökonomischer Sicht, Diskussionsbeiträge aus dem Institut für Volkswirtschaftslehre der Universität Hohenheim 230/2003, Stuttgart; H. S. Esfahani: Fatal Attraction: Turkey's Troubled Relationship with the European Union, in: The Quarterly Review of Economics and Finance, Vol. 43, Issue 5, 2003, pp. 807-826; and H. Flam: Turkey and the EU – Politics and Economics of Accession, CESifo Working Paper No. 893, 2003.

is really sustainable and whether the reforms will be fully implemented. In this respect, there is significant uncertainty left and the Turkish economy still strongly depends on international financial markets. Any policy action assessed as inconsistent by the markets inherently bears the danger of leading to strong depreciation of the lira and an increase in interest rates which could immediately endanger macroeconomic stability.

Despite all these imponderabilities, some clear statements can and should be made in the context of the discussion about the potential start of negotiations with Turkey on EU membership. On the one hand, the accession of Turkey would resemble earlier EU enlargement rounds since the realisations of the relative GDP per capita and of the weight of agriculture in employment are similar for Turkey and for the less advanced Central and Eastern European EU members and candidates. As measured by its current economic importance and by its future economic weight in terms of current population, Turkey is about twice the size of the prospective 2007 EU entrants Bulgaria and Romania. Since both indicators serve as proxies for the gross receipts accruing to Turkey within the framework of the Structural Funds and the Common Agricultural Policy (CAP), the budgetary cost of Turkey entering the EU might thus, as a rule-of-thumb, amount to relatively modest values (independent of, for example, phasing-in issues). On the other hand, there are some aspects which legitimise considering the Turkish case as quite distinct from previous enlargements.

Advanced but Asymmetric Trade Integration

The first key property of the Turkish economy is advanced trade integration. Through its asymmetric 1995 customs union agreement with the EU economy, which is 20 times larger, Turkey already participates in the EU internal market for goods (but not for labour-intensive services) and will adopt significant parts of the *acquis* independent of the state of accession decisions. Thus, the country has arrived at a higher degree of EU integration than the CEECs at a comparable stage before their accession, although trade with the EU is somewhat less important for Turkey than for some of the larger new member countries. As indicated by the increasing share of overall exports to GDP and the constant share of the EU in overall Turkish trade, the customs union with the EU did not lead to trade diversion but mainly to trade creation.

Human Capital Endowment Capable of Development

Second, Turkey is endowed with a rather low degree of human capital. In this respect, Turkey's scores in variables like total expenditure on education as a percentage of GDP and the percentage of the adult population with upper secondary education (e.g. by age groups) deserve a closer look. In terms of investment in, and output of, education, Turkey's performance is certainly much worse than in the EU. However, according to the same criteria, the CEECs perform at about the EU average. These deficits appear even larger in view of the exceptionally high share of the Turkish school age population and its great importance for Turkey's future growth prospects. Of course, such a lack of quality might have important negative consequences for Turkey's future growth path.

Demographics Giving Leeway for More Growth

Third, Turkey is characterised by demographic dynamism. Turkey's labour force will continue to experience grow rates of more than one per cent p.a. for at least one more generation. In contrast, the labour force currently tends to be shrinking in many CEECs. This huge discrepancy gives Turkey potentially much more dynamism and leeway for growth – not to forget a better founded right to a say in different EU institutions. Moreover, Turkey's working age population is currently increasing 1.5 percentage points faster than the total population. This implies ample room for redistribution, pension payments etc. before Turkey experiences the same demographic transition to lower demographic dynamics as was experienced by the EU countries several decades earlier.

Modern and Underdeveloped Sectors Coexist

Fourth, Turkey is a textbook example of a so-called dual economy. On average, Turkey's GDP per capita is comparable to that of Bulgaria and Romania. But an inspection of sectoral and regional data reveals that the Turkish economy is divided into a tiny, but exceptionally well-performing, progressive sector outside of agriculture (mainly industry and some services) in some western regions, which is more productive than even in some of the new member countries, and a large, poor rural sector covering approximately half of the labour force. In the emerging markets literature this is typically called a dual economy.

Domestic Banking System on the Road to Recovery?

Fifth, the domestic banking system is significantly changing now and its development towards a supporting pillar for future growth is crucial. As is well-known, foreign banks dominate the banking system in most CEECs by now and, thus, tend to import financial stability. In contrast, the structure of the Turkish banking system has been more complex for some time with some very profitable private banks. However, macroeconomic instability and significant political influence on bank management and on the lending culture of public banks during the 1990s until recently contributed to the malfunctioning of this sector. The fifth, and up to now last, major macroeconomic instability crisis in Turkey since the late 1950s happened in 2001. In retrospect, it can best be characterised not as a balance-of-payments crisis like the preceding four crisis episodes but as the consequence of a persistently high real interest burden on an increasing public debt combined with a premature financial sector liberalisation. Doubts about the health of the Turkish banking system together with debt-event fears finally induced attacks on the Turkish lira. However, this deep banking crisis and its highly visible damaging effects on the economy paved the way for unprecedented comprehensive legal and institutional reforms. If stabilisation is continued, regulation is effective and banks are supervised according to EU norms, the banking system might give considerable support to the further development of the modern part of the Turkish economy. But it is essential for sound growth that financing investment, trade and additional employment is the driving force of bank balance-sheet growth. The significant progress of the Turkish banking system in terms of productivity and efficiency over the last three years, as measured by the ratio of non-interest costs to total assets and the ratio of operating costs to income, gives some cause for optimism. Only in the area of sophisticated capital market products and the full use of global capital markets is there ample room for improvement in the Turkish banking sector.

The Role of Capital Flight

Sixth, external debt and capital flight has been a key feature of Turkish financial performance for decades now. Turkey's foreign debt burden is higher than that of most other new EU entrants or EU candidate countries. According to IMF figures, it amounts to around €80 to 100 billion. Most of it, around 70 per cent, is government debt. Since cumulated current account deficits since 1963 have been only slightly above €40 billion, one-half of Turkey's external debt appears to be the result of a significant capital flight, i.e. residents who no longer trust their government. This pattern has even continued recently in spite of exceptionally high real interest rates. It again stands in sharp contrast to countries like Romania and Poland which have not experienced significant capital flight in spite of continuing current account deficits. However, this constellation offers a great opportunity: if some of this flight capital could be repatriated it would soon become clear that government debt is overstated. This in turn would give Turkey ample room for future capital imports and, thus, for high growth.

Dominance of the Agricultural Sector

Seventh, the agricultural sector is still a big player in the Turkish economy. Turkey is strongly similar to other CEECs (above all Poland and Romania) in that a large part of the workforce is officially employed in agriculture. One third of the Turkish labour force is employed in this sector but it accounts only for about 12% of GDP. As in other EU countries, this indicates the low labour productivity performance of this sector and – to a certain extent – also some potential labour-shedding and emigration. However, a marked difference to other candidate countries consists of the fact that Turkey runs a significant trade surplus vis-à-vis the EU in agricultural goods. The main reason is that Turkey – due to its favourable climate – is one of the few countries which specialise in products for which the EU does not significantly hamper imports (i.e. fruits, vegetables and nuts). In addition, in contrast to the CEEC case, some Turkish agricultural products have been protected even more heavily than by the EU. In the case of Turkish EU membership the protection of this sector would be abolished and would, for instance, mean increasing farm sizes. Hence, human capital problems in this sector will become even more virulent in the future. The dualistic structure of the Turkish economy becomes obvious again, this time in the area of agriculture. A large amount of Turkish exports to the EU come from a minor, progressive sub-sector. At the same time, the remaining sub-sectors employ the vast majority of the labour force but are not competitive.

The Migration Issue: Often Overstated and Misunderstood

Eighth, emigration from Turkey will not be a menace to the incumbent EU countries. Any assessment of this (surprisingly) hotly debated topic should start from an assumption with respect to the degree of liberalisation of labour flows between old and new EU members. There is no reason to assume that Turkey will be treated any better or worse than the recent new member states. The incumbent EU-15 member states introduced a transition period lasting up to seven years (2 plus 3 plus 2) after accession with limited freedom of movement of labour from the 10 new member states in order to prevent the CEECs from exerting "wage dumping" strategies. Under these circumstances, EU entry by Turkey in 2015 would imply that Turkey's labour force will be fully mobile no earlier than 17 years from now. However, at that time a new scenario will prevail. First, due to population ageing, not only the EU-15 but also the new member countries will be plagued by labour shortages instead of unemployment. Second, due to income convergence, emigration will not appear as worthwhile as before to Turkish workers. Seen on the whole, the current public debate on how large Turkish emigration flows will actually be, seems to be exaggerated and misplaced.

The Outstanding Importance of Institutions and Governance

Ninth, enhancing the quality of Turkish institutions will be crucial for exploiting Turkey's growth potential. The main idea behind the transfer of the *acquis communautaire* to the new EU member states is that the full gains of EU membership can only be reaped if the quality of government institutions in the member states is broadly the same. However, improving the quality of governance will also lead to a growth dividend, as confirmed by a large strand of empirical literature on domestic institutions as a determinant of growth. According to the World Bank's well-known indicators of quality of governance (significant control of corruption, effective government, political stability, regulatory quality, rule of law and voice and accountability), Turkey still has a long way to go. This is valid not only vis-à-vis the EU-15 countries, but also in comparison with the newer member countries. However, if the quality of governance in Turkey is low exactly because the level of development of the country is low this is not a drawback for Turkey. Institutions in poorer countries are generally weaker and become stronger in the wake of growth and development of the country. However, Turkey's realisation of the "rule of law" indicator is even below the level which would correspond with its low present GDP per capita. If the change in the World Bank's composite quality of government indicator from 1996 to 2002 is considered, it even becomes clear that Turkey is one of the few among the current EU member and candidate countries experiencing a deteriorating composite index of the quality of governance. However, before making a final judgment on the quality of Turkey's institutions it should always be taken into account that the registered improvements in the case of the Central and Eastern European accession countries were mainly achieved in the wake of the accession negotiations. From this point of view, starting membership negotiations with Turkey could represent a great chance for improving the quality of governance there.

Economic Outlook

Negotiations with Turkey will not turn out to be easy and full membership will be achieved no earlier than in ten years, not least because European governance is currently quickly changing, and Turkey's sheer size corresponds to that of the 10 EU entrant countries. However, Turkey's potential for strong growth and, hence, rapid convergence gives cause for optimism. In the past, Turkey could best be described as a boom-and-bust economy, the macroeconomic volatility of which has, especially in the 1990s, led to an option value of waiting with important employment and investment decisions and has thus reduced growth prospects. In the future, if macroeconomic volatility is removed, Turkey could converge quickly by investment in physical capital, investment in human capital and population growth.

With respect to demographics, the favourable evolution of population composition with an increasing proportion of working age is a clear advantage for Turkey. In addition, the underemployment of labour, above all in the rural areas and among women, can be transformed on a large scale into higher productivity activities in industry and services. This factor may account for an additional increase in Turkish GDP per capita close to one per cent per annum and, hence, is a typical example of the enormous benefits of integrating two regions with significantly different factor endowments. Finally, there is also a potential for acceleration of total factor productivity by means of an increase in technology transfers, i.e. by higher FDI. Taking all three growth-enhancing factors together, the consensus view appears to be that Turkey has the potential to grow between three and six percentage points per annum faster than the EU-15 and between one and three percentage points per annum faster than the new EU member states.

Seen on the whole, the economic outlook for Turkey is rather promising and the start of accession negotiations might be self-enforcing. On the one hand, Turkey is still a very poor country. On the other hand, its economy is significantly more dynamic than that of the present EU members. Full convergence in terms of income per capita will not be reached in the foreseeable future. But this should be no reason to be concerned about the EU accession of Turkey because the recent history of the EU and also the EMU has clearly demonstrated that "small is beautiful". So far, rich "core" member countries with very low growth rates, such as Italy, and Germany with its permanent failure to stick to the stability and growth pact, have caused significantly more problems than poorer but more rapidly growing and more dynamic "peripheral" states such as the CEECs.

Several turning points indicate that Turkey is likely now be on the edge of a more prosperous period during which the huge income per capita differential vis-à-vis the EU will be reduced to a significantly lower level. This, in turn, will render Turkey's accession to the EU politically less disputed. The country launched structural reforms in 2001, is now experiencing inflation rates at lower levels than for decades and envisages an accession negotiation process which might represent a credible anchor for politics (including policies geared towards the adoption of the euro) and prevent populist politicians from withdrawing and watering down the reforms. However, the main challenge is the extraordinary heterogeneity of the Turkish economy.

Conclusions

Seen on the whole, one of the biggest economic challenges for Turkey is to make its recent macroeconomic stabilisation sustainable. Of utmost importance in this respect is a significant catch-up in quality of institutions and governance to the EU level. Although starting with a small GDP, Turkey could significantly contribute to high growth rates of the EU as a whole (as already aimed at by the Lisbon agenda). The analysis of Turkey's human resources has identified a large gap in human capital formation and its central role for backlogs in convergence between Turkey and the EU. Hence, one important policy conclusion would be to link up pre-accession financial support with the accumulation of human capital instead of the usual support for standard infrastructure projects. Another example would be in the area of trade integration. For instance, enhancing the currently existing customs union with Turkey in the direction of free trade in services would generate benefits to Turkey and to the EU which should not be underestimated. Finally, one could imagine the implementation of joint and specific transition policies in the areas of energy, agriculture and education.

If Turkey is able to stick strictly to its reform-oriented path of modernisation, nothing can prevent us from expecting enormous benefits from the integration of two regions with significantly different factor endowments – a straightforward economic insight not often well understood by politicians or the public.

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Turkey and the Borders of Europe

A couple of weeks ago, the British magazine *The Economist* declared on its cover "Why Europe must say yes to Turkey" and argued that the time is ripe for admitting Turkey into the European Union after a long history of application and delay, starting in 1963 with Turkey's first application. Shortly thereafter the outgoing Commission recommended in its report that negotiations be opened with Turkey. It is likely that the same position will be adopted at the European summit in December so that negotiations can officially begin. This, as all parties rightly stress, is an open-ended process. Whether Turkey will eventually be admitted depends on how these negotiations advance and whether Turkey can credibly demonstrate that it fulfils the Copenhagen criteria concerning a stable democracy, the rule of law, minority rights, a market based and competitive economy, and the ability to implement the *acquis communautaire*. All this is necessary for membership and Turkey has not yet credibly proven that it fulfils these conditions entirely.

The enthusiasm in the present member states for Turkey's possible membership is less than overwhelming. In France, President Chirac felt pressured to ensure his fellow citizens that a referendum would be held before Turkey was admitted. Being a supporter of Turkey's membership he did this only after massive protests. The same can be observed in Germany, where the government favours Turkish membership, but the major opposition parties and most of the population oppose it. Similarly, in Austria and the Netherlands it seems that opposition is stronger than support. And even within the present Commission some have voiced grave concerns. Dutch commissioner Bolkestein opined that 1683 (when the Turkish invasion in Europe was stopped at Vienna) would have been in vain if Turkey were admitted to the EU, Austrian commissioner Fischler saw a country more oriental than European, and for former French president and chairman of the European Convention Giscard d'Estaing Turkey's entry would bring no less than "the end of Europe".

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Resistance to Turkish Membership

One reason for resistance is that Turkey is much poorer than the rest of the Union and this invariably means that lots of money will be flowing in its direction. Net payers have the impression that Brussels is already taking too much money and that more poor members will increase this even further. The second argument is that an Islamic country cannot become a member of a Christian Union. The third argument is the fear that Turkish citizens will flood into western Europe. Germany and the Netherlands, where 2.5 million and 250,000 respectively of the 3 million Turks living in the EU reside, are especially afraid of immigration.

Although many of these fears seem understandable, they are not entirely convincing on a closer look. It is true that Turkey already has a population of more than 70 million inhabitants, and in contrast to the biggest country now, Germany, its population is increasing at a considerable speed. By 2020 Turkey would be the largest country with about 15 per cent of the total EU population. But even a country with more than 70 million cannot dominate Europe and, and due to the concept of double majority, would have a voting power of only 14 per cent. Thus, the fear that Turkey would dominate Europe is not well-founded.

Nevertheless, Turkey's membership would have an effect on the Union. Less in the fact that Turkey is such a big country, but in the sense that it is poor. Currently, per capita income is only around 30 per cent of the EU-25 average, including the poorer new members. (Notice, however, that Bulgaria and Rumania are even poorer in terms of purchasing power.) However, overall voting power is already shifting in the direction of poorer countries and will continue to do so with every further addition to the Union. There are simply not many rich countries left that could apply for membership of the EU. The two rich countries remaining outside, Norway and Switzerland, do not seem keen to become members in the near future. In fact, the possibility might even become ever less attractive the larger the Union is. But if the majority of countries in the EU is, some day, much poorer than the current members are, the fear is that even more money will be channelled through Brussels to these countries.

With the current rules in place, regions that are poorer than the average are entitled to receive Structural and Cohesion Funds. Under the Objective 1 classification, a region with per capita income of less than 75 per cent of the EU average is entitled to Structural Funds. (Cohesion Funds payments are presently restricted to Greece, Ireland, Portugal and Spain.) Turkey would thus easily qualify for this support. Moreover, one third of the Turkish population is employed in the agricultural sector, the GDP share of which is more than 10 per cent (and hence four to five times larger than in other EU countries). Turkey is thus still dominated by this sector and would be a considerable burden on the Common Agricultural Policy (CAP) when new members are fully "phased in" and have claims on EU funds to the same extent as old members. The present wave of enlargement is characterised by a gradual increase in the entitlements of the new members. If this were also the case with Turkey, a full entitlement under current rules would imply approximately €14 billion in terms of CAP and Structural Funds for Turkey, making the country the largest net receiver of EU funds.

Yet this is unlikely to happen in any case. The EU will have to revise its fiscal policies before further enlargements. Curtailing the CAP is long overdue, and more pressure on the system would only speed up the necessary process of reform. Recent years have already brought some changes to the CAP system (moving from production based payments to direct support for farmers) and it is clear that more drastic changes will follow. In fact, the more pressure there is on the present system, the sooner reforms will have to come. In that sense, bringing the spending crisis forward could have beneficial implications for the long-term fiscal sustainability of the EU. The system is already on the verge of collapse because nobody is really willing any longer to support the present CAP and regional programmes. Even the French government will have to concede that the CAP can no longer survive in its present form. Much the same applies to the Structural and Cohesion Funds. Here as well, Spain and other countries need to accept that significant changes have to come.

Implicitly, however, the decision for a necessary reform has been taken with the decision to integrate ten new members into the EU and to begin negotiations with further applicants. Consenting to an enlargement of the smaller Union was only possible if it was acknowledged at the same time that reforms were needed. It should have been clear to everyone that redistribution cannot continue on the same scale in a larger Union. The compromise which was made, that new members would be "phased in", was only a way to buy more time for finding a consensus on how to reform the system. That these decisions will have to be taken with new members being entitled to vote will not make it easier, but nonetheless it is necessary. Turkey's membership in the EU will therefore not be the catalyst for fundamental changes, and non-membership of Turkey does not mean that reforms can be avoided or will be less far-reaching.

The other main fear is that Turks will take advantage of their eventual personal right of free movement and migrate to other parts of the European Union. While there would certainly be some restrictions on movement initially (currently migration from new members is restricted for seven years), these would eventually fall. Current projections expect that the Turkish immigrant population in Germany could reach 3.5 million by 2030, based on standard considerations such as income differences and existing networks in the country of immigration. It has to be taken into account, however, that any reduction in income differentials in the next two decades implies less incentive to move. But even if immigration is large, this apparent burden might actually be much more benign for the present member countries than their populations believe.

"Old" and "new" Europe alike suffer from considerable demographic problems and especially Germany, the probable main destination of Turks, needs a lot more immigration to support its social security systems. By 2020, the median age in Germany is expected to reach 47 years (in the EU it will be 45), while in Turkey will be 32. Consequently, Europe will have to rely on immigration to finance these demographic changes and to maintain the present level of production and welfare. To benefit from immigration would of course require that well qualified and economically active persons immigrate. At present, most of the net migration from Turkey to Germany is in the form of family reunions. A change in the nature of migration would therefore be the precondition for Germany and other countries to benefit in terms of migration.

Finally, a reason for caution might be that the recent macroeconomic history of Turkey has been characterised by a high volatility of growth rates and inflation. But in this respect it is comparable to some new members of the Union and to certain other applicants. Some observers even argue that the volatility in the country is less than in Greece, Portugal or Spain.[1] This seems to be conquerable, especially since membership is in any case at least 10 years off. And since the EU and Turkey have had a customs union since 1995, it is not likely that full membership will have implications for trade. The country exports most of its products to the EU but, not surprisingly, is not a major trading partner of the EU. Likewise, the country attracts only very little foreign direct investment, much less than even Bulgaria or Rumania. In terms of economic influence as well, the membership of Turkey will not have large repercussions on the EU economy. Instead, Turkey itself would be much more affected by membership.

Speeding Up Necessary Changes

It thus seems that Turkey's membership will at most contribute to speeding up necessary changes in the setup and the character of the European Union. Enlargement of the EU needs to bring changes to the fiscal system and any further addition of an agriculturally structured country that is poor will have the same effect. Enlargement of the EU will also imply that more migration to the "old" Europe can be expected. This is also not specific to Turkey. Moreover, both these consequences of enlargement need not necessarily be bad for the Union.

So the critics are probably right to expect some impact from enlargement by Turkey. What they are apparently unaware of, or at least are unwilling to admit openly, is that the decision about the change in the character of the EU has been taken already and that Turkey's membership or non-membership has no bearing on this fundamental decision. The decision to enlarge the EU by ten new members earlier this year and the promise to let Rumania and Bulgaria become members was only the first step. The EU has committed itself to take on board all the countries in the Balkans that fulfil the Copenhagen criteria. The next members will probably include Croatia, and maybe Albania. Even Ukraine has expressed its interest in membership and is preparing for it. These countries are also poor, have a large agriculture sector and, currently, problems fulfilling the Copenhagen criteria. But "Brussels" and national capitals have accepted that these countries will apply for membership, even if negotiations will prompt the same discussion about the character of Europe and evoke the same negative sentiments as Turkey does in some quarters.

The decision of enlargement having been taken in principle, it does not even leave religion as a reason to reject membership. Not only Turkey is an Islamic country but Bulgaria and Albania are mostly Muslim as well. And despite some Catholic countries' wishes, the European Constitution does not claim that Europe is characterised by any one particular religion. Today, more than 12 million Muslims live within the European Union's borders. What signal would it send to them if a country were rejected on the grounds of having the same religion as these citizens? The discussion about membership thus cannot be based on this argument and it is rather unlikely that any government in the

[1] Cf. Deutsche Bank: EU-Monitor 18, 2004; and Harry Flam: Turkey and the EU: Politics and Economics of Accession, CESifo Working Paper 893, 2003.

Union would be willing to base its opposition on this argument.

All in all, Turkey's membership is therefore likely to be largely inconsequential for the development of the EU. It does, however, indicate how the Union is changing its character and how it will continue to evolve. The resistance to Turkey's membership may be as much an expression of the resistance to these changes. The EU with more than 30 members will be much less a political union than is currently the case. It is inconceivable that a larger union will have a common currency, a common social security policy, common labour laws, and it may not even have a common external policy. It will probably be not much more than an extended customs union for all those 30 countries, certainly with mobility of capital but possibly even without free movement of people. It could be expected that smaller groups of members will go ahead in certain areas with more harmonisation and common policies, at the same time restricting drastically the amount of redistribution among the larger group of countries. Even the Union of 15 members was less and less able to formulate a common policy and was frequently forced to implement the least common denominator. Policy was too harmonised for some, while others wanted to push harmonisation ahead. This fundamental conflict can only be solved by allowing some to go ahead and others to abstain (much as the UK and Denmark do already with respect to the Social Protocol or monetary union).

It is hard to see why Turkey could not fit into such a European Union. It will fit as well as other countries that are currently preparing themselves for membership and towards which the EU and its member states express less reservation. Turkey should not be rejected on the grounds of any of the arguments that are currently put forward. But neither should membership come automatically. The EU should insist that all the criteria are well and credibly fulfilled, and it should make clear what kind of membership it is offering to current applicants. It should be frank about that fact that the EU in 15 years will not be like the EU of before May 2004. Maybe opposition to enlargement is based on people's dislike of the direction in which the EU is moving. If that is the case, they should say so. But they should not make Turkey a scapegoat for developments that are beyond its control.

Wolfgang Quaisser* and Steve Wood**

Turkey's EU Accession: Political, Economic and Security Considerations

The endorsement or refusal of EU membership for Turkey is a strategic decision.[1] Both Turkey and the EU are at a critical juncture. The conditionally positive view of the Commission in its latest progress report[2] and the apparently supportive position of most member states do not conceal the reality that Europe is deeply divided. This applies to several governments, much of the Brussels civil service apparatus, and, above all, the EU's national publics. Differing opinions circulate within most political parties. This ambivalence reflects great uncertainty about the future of Europe, the EU's tasks, and its ability to manage the challenges it faces. Concurrently Turkey has made great efforts to meet the preconditions demanded of it and appears determined to join the EU.

The EU in a Critical Phase of Development

The planned commencement of accession negotiations with Turkey occurs at a critical time in the EU's development. The enlargement to include ten new members means a continuation of the necessary economic and political deepening becomes an even more difficult task. In the area of economic integration, the internal market and currency union demonstrate considerable progress. Both projects must, however, be consolidated and completed. The Lisbon process, through which Europe aspires to become the most innovative economy in the world, has not achieved

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[1] This article is based on Wolfgang Quaisser, Steve Wood: EU Member Turkey? Preconditions, Consequences and Integration Alternatives, Munich 2004, Forost, which can be downloaded at http://www.forost.de or http://www.oei-muenchen.de. The authors wish to thank Forost for its support.

[2] European Commission: Regular Report on Turkey's Accession, Brussels 2004.

the expected results. Europe is insufficiently prepared to deal with the problems of enlargement and reform. The constitutional treaty is an important step towards strengthening the EU's capacity to act, but is not enough to cope with the internal and external tasks of a Union with at least 28 and perhaps 30 members. If the treaty fails and further economic and political reforms are neglected, the threat of persisting integration crisis, and even a disintegration of the EU with incalculable consequences for Europe's political stability, will emerge. EU membership for Turkey would then not be possible.

Turkey's Fulfilling of the Political and Economic Criteria

There are doubts whether Turkey has fulfilled the political criteria: In its report the Commission noted the considerable progress made by Turkey in the areas of democracy and human rights. Nonetheless, there were considerable deficits in the practical implementation. Accusations of systematic torture, not confirmed by Brussels but corroborated by other independent sources, have caused deep concern in Europe. However, the Commission concluded that Turkey fulfils the political criteria and that negotiations can begin. Based on the report itself it could easily be interpreted that the criteria are not sufficiently implemented in daily life. Rather, the momentum of reform and the hope for its continuation has influenced a positive assessment. Foreign and security policy considerations are decisive. At present it is more likely than not that the European Council will approve a commencement of negotiations, with some reservations and an emphasis on the durability of democratic reforms. The negotiation process would then not be expedited but protracted. A conditional procedure could come into effect, with interruptions if violations of human and democratic rights are observed. Designated *acquis communautaire* chapters, certain benchmarks or specific areas of the Copenhagen Criteria must also be practically implemented before negotiations continue in connected areas. This could cause tensions with Turkey if the impression is of a deliberate delaying strategy.

Turkey is carrying out credible economic reforms that also have far-reaching political implications: It is to Turkey's advantage that, in contrast to the new EU members from CEE, it does not have to change its complete economic system. Rather, the basic structures of a market economy are secured. However, the functionality of the market is disturbed by high state influence and recurring internal and external disequilibria (high debt and inflation). Periodic crises and lapses in growth (recently 1999 and 2001) with extensive economic and social costs resulted. Since 2001 successful stabilisation measures have been pursued. For the first time these have seriously tackled the structural causes of fiscal deficits (banking system, state enterprises, public sector, social system, agricultural subsidies) and thereby laid the foundations for sustainable growth. The reforms have far-reaching socio-political consequences as they affect the traditional political system of populism and/or clientelism.

Accession suitability in the economic area will be measured by Turkey's capacity for sustainable above average growth: The initial results of the Turkish economic reforms are positive. After the deep crisis of 2001 the economy has returned to a growth path (2003: almost 6%; prognosis 2004 and 2005: 5%), inflation has reduced (prognosis 2004: 12%; prognosis 2005: 8%), the currency has stabilised and debt indicators have improved. It cannot yet be established whether this is the beginning of a sustainable higher medium and long-term growth path. It can, however, be affirmed that the reform road is long. While Turkey has made great progress in reforming the banking system, privatisation and reform of the public sector and the social system remain in the introductory phase. Adaptation pressure is high and during the accession process Turkey will have to struggle with substantial economic and social problems (regional disparities, poverty, education deficits, internal migration, infrastructure deficiencies). Of particular concern are the, in comparison with countries of a similar level of development, unfavourable education indicators, along with high youth unemployment.

Fulfilment of the economic criteria will require many years: Regarding the economic criteria, Turkey is in many areas only slightly worse than Bulgaria and Romania. If the reform process is consistently pursued, within ten years there will be no serious barriers to a EU entry. This presumes that no further macro-economic crises obliterate the recovery process. We do not share over-optimistic growth forecasts because of the great uncertainty on major policy related growth factors. We assume a growth difference of 3 percentage points in per capita GDP in PPS (Purchasing Power Standards) between Turkey and the EU-15, which is higher than that of the ten New Member Countries (NMCs). Even with such a positive economic development an enormous gap between Turkey and the current EU will remain. A special problem for Turkey is its huge regional disparities. The eastern part of the country can be compared with a "developing country." These economic considerations will have substantial effects on the content of negotiations (demands for transition periods), the timing (delaying tactics) and the modalities (special rules for integration in community policies).

Relevant indicators suggest it would be easier for the EU to integrate Mexico than Turkey; Bulgaria and Romania are a false benchmark of preparedness to join the EU: Turkey is comparable in population size with the ten New Member Countries (NMCs) combined but produces roughly half of their GDP. In many respects Turkey is not so different to Bulgaria and Romania, especially in its major economic regions. However, lower education standards are reflected in the rating of the Human Development Index (HDI) wherein, at position 88, Turkey is similar to Turkmenistan and Paraguay. Concurrently the World Economic Forum (WEF) rated Turkey similar to Bulgaria and Romania and in some areas better. This evaluation does not say anything about the tremendous challenges EU membership poses for all these countries. An international comparison might illustrate the uniqueness of this venture: in most relevant indicators (including income differentials) Mexico is doing much better than Turkey. Yet nobody is seriously considering a full integration (especially labour markets) of Mexico with the United States. The similar rating of Bulgaria and Romania compared to Turkey does not imply that Ankara will be ready to join the Union soon. Many *acquis*-related institutional and policy changes are needed which are not reflected in the HDI and the World Competitiveness Index (WCI). The question here is whether Bulgaria and Romania actually represent a sensible benchmark for EU-membership. If they are considered to be a benchmark then we are observing an erosion of EU standards caused by the enlargements. This might negatively affect the proper functioning of the internal market and other aspects of European integration. Additionally, the EU is not properly prepared to deal with the economic and social implications of integrating lower-middle-income countries.

Benefits and Costs of EU Accession for Turkey

Is EU membership a rational decision for Turkey? From the perspective of an acceding country it is politically rational to seek to influence decisions of the "club" by which those acceding will in any case be affected. This is an important motivation for EU membership, which can also pay off economically. Despite its comparatively low economic power, Turkey will become one of the more influential and militarily significant EU countries. Internally, various political streams (AKP, opposition parties, economic elites, Kurds) use the EU as an "external anchor" to enforce their own, often very different political goals. In this sense political rationality endorses and explains deployment of the EU-steered modernisation process in order to extend one's own power position. It cannot be excluded, however, that radical or nationalist factions will regard the EU accession process as too restrictive. In such a situation Turkey's political priorities may change again and a looser connection to the EU would apply. Along with rational motivations for membership, emotional considerations are also playing a role.

Turkey would benefit economically but extensive structural change may cause serious problems: For Turkey, economically rational grounds for accession are the possible growth and welfare effects, along with financial transfers, that would result from EU membership. As trade barriers are in large part already removed by means of the Customs Union, the economic effects will be limited (not more than 5% of GDP over a long run). These could be more robust (perhaps around 10%) if dynamic effects, in particular investment from external sources, occur. A EU perspective, however defined, would encourage the increased political stability that would promote this kind of development. The reform capacity and solidity of Turkish economic policy will nonetheless be decisive. Even with growth rates (5%) well over that of the EU, Turkey will need about four decades to reach 75% of EU-15 income levels. Turkey will certainly profit from EU transfer payments, which, according to current rules, will count for 3% to 4% of GDP.

Implementation of the acquis will be a major problem for Turkey and entail costs that are intensified by the demands of structural adjustment: Costs arise through structural change (such as higher unemployment, especially in rural areas) and the acceptance of norms and standards. These will burden Turkish small enterprises oriented to production for the local market. Then come social and environmental standards, conceived for highly developed countries, which could adversely affect the internationally competitive position of transition countries. On the other hand there are in the medium and long-term also positive social outcomes. Long transition periods are envisaged before the full introduction of EU environmental standards in areas that do not directly concern the internal market. Difficult adaptation is also certain for competition policy. Entry to the CAP will mean advantages for Turkish consumers but disadvantages for farmers. Transfer payments from Brussels can mollify this but the costs of structural change will be only partly compensated by EU structural and regional policies. They will become fully available only after the initial and most difficult adjustment phase of ten to fifteen years.

Higher levels of pre-accession financial assistance will be necessary.

Costs and Benefits of Turkish Accession for the EU

The Commission's Impact Study is too general to be a solid basis to evaluate the effects on the Union: The Impact Study or "Issues Paper"[3] released concurrent to the Regular Report assessed Turkey's accession to the EU as incomparable, though in geo-strategic and security policy terms as advantageous. It is envisaged that Turkey could take on a stabilising function for the entire region, even if the formulation of a Common Foreign and Security Policy (CFSP) may concurrently run into difficulties. Problems related to the control of the EU's possible new and dangerous external borders are also highlighted (organised crime, smuggling and terrorism). The economic effects on the EU are rather insignificant and some adjustment pressure is expected. The economic effects for Turkey are evaluated as positive. In contrast to previous announcements, including from the Enlargement Commissioner, the Commission also undertook an estimation of budgetary effects (two scenarios of net costs in 2025: €16.5 billion and €27.6 billion). In regard to institutional effects the document is very general (new voting weights in the Parliament and the Council). Effects on the Commission are, in light of forthcoming reductions in its numbers, not to be expected. It is noted that "If well managed, Turkey's accession to the EU would offer important opportunities for both."[4] Measured against this, the remark that the process is uncertain in terms of outcomes and will last many years (10 to 15), along with proposals for restrictive negotiation procedures, indicate that in the Commission itself doubts and "mixed feelings" existed.

The growth impulse for the EU as a result of Turkey's membership will be marginal: From the Union's viewpoint, the entry of a country is rational if it raises internal and external security and/or increases overall economic benefit. Considering the relatively small size of Turkey's economy and the limited trade volume, membership for Turkey will have only marginal effects on growth in the current EU. This does not mean that trade and investment cannot rapidly expand to bilateral advantage as a Turkish growth process occurs. Such a development is also possible in the context of current integration levels combined with a solid national economic policy. An EU accession perspective further supports this. However, for the continuation of Turkish economic reforms the IMF is currently the more important and appropriate competent partner. This might change as the IMF has a clear exit strategy.

The migration potential and the financial costs will be high: Potential economic effects only have real purchase when unified rules are implemented in the same manner for all participants of a defined economic group. In the case of Turkey this will require time and considerable effort. Large economic disparities can also lead to adaptation costs in EU core countries. The income gap would remain an important motivation for itinerancy and a high – if also difficult to quantify – migration potential is to be reckoned with (up to 4 million). Long-term transition periods before full free movement of persons (together with a permanent safeguard clause) is introduced would then be unavoidable. The costs of an accession to the EU by Turkey will be high: with full political integration, around €21 billion per annum (in 2014). By comparison the Commission estimates €27.6 billion (in 2025). Welfare loss for old and new member countries is to be expected if transfers to Turkey are redirected from elsewhere or tax increases are imposed. It is unlikely that EU member states would be willing to pay such large sums. Alternatives could be found by formulating special conditions for Turkey, which could stimulate political tensions with Ankara. Extensive reforms of agricultural and structural policies would be the other option. However, they are very difficult to implement in a EU with 27 or more members.

Political-strategic arguments dominate: There are frequent assertions that accession negotiations will have resulting positive effects on European security, on the Turkish reform process, and on the Islamic world (as a counter model to fundamentalist Islam). A perspective of EU membership certainly supports the internal reform process. It would however be a bold thesis that argued that the success or failure of the latter is dependent on the former. Such an argument would be further weakened by the actual continuation of reforms independently of the EU decision, because, as Turkish sources increasingly emphasise, they are in Turkey's interest. Its questionable status in the Arab Middle East, and tense relations with many of its neighbours, means that any notion of Turkey's functioning as some kind of model for other Muslim countries to emulate is presently hard to support (intellectually if not politically). Beyond this, a European perspective for Turkey could be developed without a necessary full EU membership.

Membership for Turkey will have far-reaching consequences for the EU: The entry of the CEECs has

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

[4] Ibid. p. 3.

already changed the EU from a union of mainly rich industrial countries to a heterogeneous club with a large number of transition countries. Economic (in particular competition policy) and monetary policies are therefore faced with stern challenges to maintain internal coherence and a sharp focus on goals. This affects the enforcement of internal market regulations and coordination tasks. While the industrial core countries are compelled to internationally secure and extend their competitiveness in advanced technologies (see Lisbon Agenda), the cohesion countries must first induce a successful real convergence process. Additionally, the question is raised as to whether in such a heterogeneous economic space it is sensible that all adhere to a communal monetary policy. Movement towards monetary union should proceed cautiously and joining the Euro should remain optional.

The issue of cultural difference should not in principle exclude an accession, though it should be dependent upon the agreement of the European citizenry: EU membership for Turkey has a political-cultural dimension that is of wide-ranging importance for both parties. It cannot be determined *a priori* whether, against the background of a largely Muslim society and a state whose secular character is guaranteed by the military, European values can be anchored and sustained in Turkey. If they can be, then this would certainly have an important exemplar function. If this does not happen then a culturally motivated backlash would cause enormous problems for the EU. It would require the application of comprehensive sanction mechanisms in order to enforce basic values. For the EU, as a union of citizens, the membership of Turkey is also a matter of identity. European citizens should answer the question of whether the cultural and/or geographic borders of Europe have been transcended. An entry for Turkey would be justified if they gave a clear vote in favour. They would then also be prepared to render the necessary solidarity within the community framework.

The EU's Negotiation Concept and Alternative Integration Concepts

The negotiation process will be (intentionally) protracted and Ankara may be faced with a membership second-class: The uncertainties of a future accession process influenced the Commission's proposal for a conditional negotiation procedure with Turkey. The actual implementation of individual *acquis* areas will be a prerequisite for the continuation of negotiations in other linked areas. For the EU, such a strategy is a form of self-protection. Thereby the process will be drawn out over ten to fifteen years. This strategy is not without risks as it could cause frustration and lead to political conflict with Turkey. On the other hand, the time gained would give Turkey and the EU room for manoeuvre in order to enforce and complete necessary reforms. High migration potential means that full free access for persons will in any case be excluded for many years. Moreover, the EU would seek to avoid fully extending its expenditure programme to Turkey. Ankara is threatened with a membership second-class.

Europe's functioning as a "stability anchor" for Turkey does not necessitate its full EU membership; this could also be organised by means of a "Privileged Partnership" or an "Extended Associate Membership": Turkey receives strong backing from international organisations (IMF, World Bank, OECD), which already act as "external anchors" balancing the internal reform process. However, it is questionable whether the EU could credibly sustain an "external anchor" function over 15 or perhaps more years, the time-span envisaged for Turkey's accession. Integration alternatives are, in light of obligations entered into and foreign policy considerations, presently not likely to be officially offered or accepted. Nonetheless factors internal to the EU (refusal of a Turkish entry by a member state government or electorate, or incapacity for reform), or through uncertainties on the Turkish side (possible retrogression in the reform process), could motivate reappraisals. It is therefore sensible to consider more precisely formulated ideas for alternatives. The Extended Associate Membership (EAM) concept goes beyond that of a Privileged Partnership. The EAM presents a durable and clearly defined perspective for Turkey and other EU aspirants, which, in addition to economic integration (European Economic Area - EEA), envisages forms of political integration (participation in European Council meetings) and a more substantive financial benefit through customised inclusion in various EU programmes.[5]

If the negotiations are commenced, they may well culminate with a "Privileged Partnership": Should a negotiation process begin it will be faced with many uncertainties. If the constitutional treaty fails this will in practice signal a preliminary end for Turkey's perspective of full membership. The same would be likely if reforms in Turkey stagnate. The Commission has indicated that were this to eventuate negotiations could immediately be suspended. They may be precluded in the course of the ratification process or through a referendum in one or more member states. The Commission appears aware of these potential outcomes and emphasises that "regardless of the outcome of

[5] See Wolfgang Quaisser, Steve Wood, op. cit.

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.

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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.