The Financial Consequences of Turkey's Potential Accession into the European Union

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Abstract

Turkey, with a population of nearly 74 million and a strategic location opening up to Europe, Middle East, North Africa, and East Asian markets, has been one of the fastest growing markets in the world in the present day. Having recorded a GDP growth with a level of 11% in the first half of 2011, Turkey was regarded to have the fastest growing industry in Europe. Turkey’s accession talks have been around since 1950s and have been official when Turkey became an associate member of the EU in 1963. Although Turkey has made a remarkable progress in the last decade, EU still hesitates to accept Turkey’s full time membership. In this essay, I have attempted to analyze the possible financial consequences of Turkey’s accession into the EU.

In order to complete a successful study, I have divided the project into four sections. In the first section, *Summary*, I have collected facts from the authorized European Union websites and empirical studies towards which my assessment will be given in the coming parts of the project. In the *Evaluation* section I started reviewing the facts and the approaches of the member states towards the Turkish accession based on these facts, such as positions and perspectives of the relevant countries within the EU market and their previous experiences with EU enlargements mainly emphasized on the 2007 EU expansion. The next section *Analysis* concentrates on the future based developments and information presented in the Evaluation and Summary sections. Therefore, in this section, I have attempted to illustrate the foreseen benefits and fears of both sides on Turkey’s accession. Finally, in the *Conclusion* section I present an answer to the question “whether Turkey should join the EU or the economic benefits and costs should be neglected” from Turkey’s perspective.

Since Turkey has been regarded as one of the fastest growing economies in G20 by OECD and IMF, Turkish accession into the EU and its financial implications may alter the political, economic and strategic balances of the world in many ways; therefore it can be claimed that including Turkey as a member state will not only be a hard decision made by the EU on political terms but also it will be a decision that will have crucial implications for the world economy.

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Chapter 1: Summary - Set Up

A Brief History of the EU Enlargements from an Economical Perspective

The European Union, which is an economic and political union consisting of 27 independent member states, has been in an expansion process in terms of its borders and power since the first day. Being comprised of only six founding states in the 1950s, now having twenty-seven member countries, the union went through many processes, treaties and implementations. Yet, I will only focus on the ones that are related to the expansion. Starting with the establishment of the European Coal and Steel Community (ECSC) and (EEC) in 1958, the union has grown in size in the following years, with the accession of new countries. After signing Euratom Treaty in 1957, the Single European Act in 1987, the Maastricht Treaty instituted the European Union under its current tag in 1993. Finally, the Treaty of Lisbon was the last adjustment which maintained the constitutional basis of the Union.

European Coal and Steel Community (ECSC) came into force in 1951, which formed the basis of the European Union right after the Second World War with an aim of strengthening the steel and the coal sectors and controlling these sectors with an authority therein. Belgium, Germany, France, Holland, Luxemburg, and Italy, also called as the “inner six”, were the six countries that brought the European Coal and Steel Community into existence on April 18, 1951. The main purpose of the treaty was to contribute support to the common market for coal and steel, to create an economic expansion, to increase employment, and to raise the standard of living. This unification process therefore, had to guarantee a systematic supply to the common market by making sure that there was an equal access to the sources of production, via setting up the lowest possible prices and improving the working conditions in the coal and steel industry.

Only six years after ECSC, the EEC treaty was signed in Rome in 1957. What made the establishment of EEC unique was that it laid the foundations of the supranational Europe. Although the first attempt for a unified European group was not successful, as the European Defense Community came to a halt in 1954, meetings and conferences did not end. The establishment of EEC supported the construction of a common market, common policies, and customs union. As stated in the articles of this treaty, the main goal was to institute a common market and determine the obstacles the union could face during this process.

The expansion provided a vital opportunity to the countries that were preparing themselves for the 21st century. By offering prosperity and stability to the new members' economies, the union seemed as a promise for a well-integrated continent living in peace. Therefore, it can be claimed that the European Union has achieved a successful expansion history. The Paris Treaty (1951) establishing the European Coal and Steel Community and The Rome Treaty (1957) establishing the European Economic Community (ECC) were signed among the Inner Six European countries; Belgium, Germany, France, Holland, Luxemburg, and Italy. Subsequently, the European Union went through a series of expansion processes in terms of both physical and economical means:

- (1951) ECSC Treaty

    - (1957) EEC Treaty
- (1957) Belgium, France, Germany, Italy, Luxemburg and Holland (Inner Six)
    - (1957) Euratom Treaty
- (1973) Denmark, Ireland and England
- (1981) Greece
    - (1987) The Single European Act
- (1986) Portugal, Spain
    - (1992) Maastricht Criteria
- (1995) Austria, Finland and Sweden
- (2004) Estonia, Lithuania, Latvia, Czech Republic, Poland, Cyprus , Slovakia, Slovenia and Hungary
- (2007) Bulgaria and Romania

The Maastricht Criteria

The **Treaty of Maastricht** (formally, the **Treaty on European Union**, (**TEU**)) was signed on 7 February 1992 by the members of the European Community in Maastricht, Holland. The European Commission stated the mandatory Economic and Financial conditions to form a common monetary unit.

These necessary Economic and Financial conditions can be classified under the titles of -the introduction of an independent law that allows the gradual independence of central banks and – the macroeconomic criteria:

- The inflation rates of the lowest performing countries should be no more than 1.5 percentage points higher than the average of the three member states having the lowest inflations.
- The ratio of the planned or the actual gross debt of the member countries to their gross domestic products should not exceed 3 percent.
- The ratio of the planned or actual debt stocks to gross domestic products should not exceed 60 percent.
- Every member state was allowed only to exceed the average of the best three member states' long-term interest rates only by 2 points in terms of price consistency.
- The national currency of the member states, were to remain at "normal" fluctuation margin allowed by the European exchange rate mechanism (As for now, it is 15%, however most of the countries remain in 2.25 margin).

By signing the Treaty of Maastricht, the political desires of the Community came into prominence, and the community surpassed its initial economic objective, which was the creation of a common market.

As seen from the criteria, the main intentions of the Treaty of Maastricht were as follows:

1) To reinforce the independence of the institutions,
2) To strengthen the effectiveness of the institutions,
3) To establish economic and monetary unions,
4) To expand the Community's social dimension,
5) To launch a widespread foreign and security policy

These policies intended to lift the barriers for the movement of people, goods, services, and capital, to preserve common policies on agriculture, trade, and regional development, and to ensure stability in justice and home affairs.

Motives behind the Union

The combination of various factors contributed to the formation of the European Union. With a quick glance at the European history, we see that Europe hosted many kinds of violence that included dictatorships, two world wars, rebellions, occupations, and invasions. Leaving behind the ashes, deaths, and the ruined countries after the Second World War, there was a deep longing for the establishment of an environment that would allow countries to improve and prosper as a unit. In short, due to a heavy reaction against the violence in the continent and the desire for peace, the political climate favored a continental unity that could maintain the harmony in Europe.

The aftermath of The Second World War and the gathering round of the allied powers' soldiers in Berlin streets were not long before the breakout of suspicion between the allied forces. At the time, Winston Churchill, the prime minister of

UK, explained the situation as the increasing distance between eastern and western European countries due to the increased Soviet influence over the Eastern Europe. The situation then turned into “The Cold War”, a war that was against a possible Soviet domination and communism. The Cold War tension ever increased starting from the late 1940s to 1960s with regard to the fear of the possible expansion of Soviets combined with the drawing of the “iron curtain” between the Eastern and Western European countries by the Soviets. Particularly after the tension in Cold War reached a climax with the nuclear threats by both sides, it became vital for the western European countries to build their shield. This common shield, allowed the countries in the western part of Europe to integrate themselves into a unit, later to be called as the European Union.

The political willingness of these countries and their desire for an economic development were also two crucial reasons behind the creation of the European Union. Following the Second World War, political and economic teamwork for restoration of the economies replaced the European economic and political competition that preceded the two world wars. Furthermore, there were concrete steps towards a cooperation and progress as a unit such as International Monetary Fund (IMF), General Agreement on Tariffs and Trade (GATT) and most importantly The Marshall Plan. The Organization for European Economic Corporation (OEEC), which later on turned into Organization for Economic Cooperation and Development (OECD), established in an attempt to finance the post-world war renovation of Europe, came into existence as a feature of the Marshall Plan.

In conclusion, reacting against the overall violence and Soviet dominance, Europe had a desire for peace, and had the willingness both politically and economically to achieve it under a unification process. Consequently, as the motives behind were so mature, the formation of the Union should be brought into existence without any doubt.

Current Financial Situation of the EU

The current worldwide financial crisis seems as a unique one when the period since the Second World War has been taken into account. The Great Depression was not only a point of reference, but also it served as a great lesson with respect to the policy mistakes done by governments and central banks. When compared to the U.S. Government during the Great Depression, European states at the time did not opt for protectionism as much, which was an economic policy that controlled the trade between states through methods like tariffs on imported goods and quotes. It therefore showed the coordination of the European countries in their domestic markets during a crisis.

In the early phases, the crisis appeared as a clear liquidity deficiency within financial institutions as they were having short-term problems. During this stage, the ever-increasing number of people in Europe who could not pay their short-term debts was regarded as a problem for these financial institutions; however, a crisis that would devastate Europe was not foreseen. This view completely changed by the collapse of a main investment bank, Lehman Brothers, in

September 2008. [i]Next thing the Europe knows, confidence in the market disintegrated, investors liquidated their accounts and stock markets collapsed. Subsequently, the EU markets faced the biggest crisis since 1930's. The real GDP of the EU contracted as never before with 4%. Due to the negligible adjustments in the industry and low demand, although there are signs of a recovery, the process is expected to be sluggish.

Chapter 2: Evaluation

A General Overview of the Turkish Economy

Throughout history, countries such as Ottomans, Romans, and Americans achieved to establish property rights, a sense of justice, democratic approach towards people, encouragement for technological innovations, liberal reforms and a quick re-adaptation period to the fast changing worldwide conditions. The nations that achieved these goals faced high macroeconomic growth rates and created sustainable welfare that lasted for decades. As soon as the Ottoman Empire was not able to keep up with these pre-requisites of durable economic growth, it slowly broke down and the world's history faced the fall of one of the biggest empires in the world. The limited capital resources in order to invest in a brighter future slowly melt down due to the weaknesses in the social law. Finally, after being defeated in the First World War, Ottoman Empire passed its tradition of external debt to the newborn Turkish Republic.

Following the disintegration of the Ottoman Empire, the new leadership under Mustafa Kemal Ataturk aimed at rebuilding the Turkish economy starting from 1923. Initially, the new regime was not interested in the economic or financial stability; however, the main concern was hunger and possible destruction of public law and order that could damage human capital in return.

In the early years of the Turkish Republic, although roughly 82% of the population was engaged in agriculture, which formed 67% of the national income, industry could only provide the essential needs for families that were involved.[ii] There were not more than 220 tractors in the country. However, it was not only the domestic problems like the lack of resources that created obstacles for the establishment of economic welfare in Turkey but also the global economic problems like the crash of the markets in the United States in 1929 stimulated this. The Great Depression in the U.S. boosted the external debt. As soon as economies started the process of healing themselves, the social unrest in Europe led to the Second World War. Therefore, domestic and international circumstances prevented the establishment of strong economic conditions and basis in Turkey.

The 1950s may be considered as the first decade in which Turkey had the potential to make a progress financially. However, due to the military coup that took place in the following decade, Turkey could not maintain a financial stability. Under the dominance of the army, enough capital was hoarded to make a smooth transition to financial stability. This time; however, the first and second oil price shocks during the 1970s were the reasons why Turkey borrowed money from outside, mainly from Europe.

Throughout the 1980's, the policies that aimed to have a trade surplus (by exporting more than the import rates) that were designed to lead to a high growth appeared to have disadvantages for the economy. These liberalization-based policies created a major financial crisis in 1983. However, the economy caught up fast and Turkey faced high growth patterns in the following decade as Turgut Ozal took hold of the office and extended the liberalization policy. Economic liberalization gave birth to another problem: dollarization. Leaving behind a traditional regime-directed economy, that was relatively isolated from the exterior markets, former Prime Minister then President, Turgut Ozal, started to open up the horizon for the expansion of the economy in the 1980s. This paved the road for the signing of a customs union with the European Union in 1995. During the 90s Turkey was undergoing high inflation and boom-and-bust cycles that revealed the coming of a severe economic crisis. One of the main international financial establishments, IMF (International Monetary Fund) hosted Turkey many times for the nation's external debt problems. Finally, the curtains were closed with a bottomless financial collapse in 2001 and the Turkish economy closed the decade at its worst.

Improvement of The Turkish Economy in the last Decade

Turkey's economy started to make a strong progress since the 2001 downturn due to solid fiscal and monetary policies and financial modifications supported by the IMF. Currently, the Turkish economy has been in a transition process from a highly agriculture-dependent and intense industry state to a more expanded economy with increasingly embracing large and globalized sectors. The Nation's economy achieved a growth of 6.0% every year from 2002 and 2007, achieving one of the highest growth rates in the world. In this five-year period, inflation has shrunk; interest rates have fallen to normal levels, the volatile currency has become more stable, and Turkey's major problem, the government debt, dropped down to manageable levels (39.5% of the overall GDP in 2008).[iii] However, due to the fast growing economy, the trade deficit increased into 5.6% of the overall GP in 2008. As the markets crashed towards the end of 2008, the growth naturally contracted to 1.1% while the economy diminished by 4.7%.[iv] In 2010, the growth rate improved up to 8.2%, while the government continued to implement reforms, adopt a strict fiscal policy, and secure monetary policies of the Independent Central Bank (TIB) in order to maintain economic growth and stability.

As stated previously, since 1995 Turkey has been a member state of the customs union of the European Union. This association helped to increase the trade between Turkey and other EU member states although Turkey maintains its large trade deficit tradition. Currently, the European Union is Turkey's major trading partner, despite the fact that Turkey is still delaying to fulfill various requirements. The customs union consists of trade in manufactured products including the position of Turkey according to the EU policies concerning technical regulation of products, competition, and Intellectual Property Law.[v]

Pertaining to product groupings, Turkey continues to import technologic equipment (automotive products, machinery...) chemicals, iron, and steel regularly from the EU as well as agricultural products including cereal. Key exports of Turkey to the EU market include textiles and cloth, machinery, transport equipment.[vi]

At record setting levels of growth, Turkish economy is regarded to ignore the financial crisis in Europe fallout although some impacts are felt by Turkey. Despite a slowdown warning of European experts in the close future, Turkish Deputy Prime Minister, Ali Babacan, claimed that Turkish economy was able to dodge the recent impacts of the Eurozone crisis. However since EU is the biggest partner of Turkey, and the two sides are linked closely through Customs Union, Turkey felt some of the effects as Eurozone tilted towards recession. As Sarp Kalkan, a financial analyst at TEPAV stated "Turkish exports to the EU stood at 56% before the crisis in 2008, but currently they are approximately 47%." Although the overall impact was not quite big, due to a small decrease in Turkish exports to the EU and a rapid increase in Turkish exports to Middle East and North Africa.

Finally, with Turkish economic growth outpacing that of China's in the first half of 2011, Turkish leaders strongly believe that Turkish economy will move from 17th biggest economy in the world to top ten by 2023.

Possible Costs of EU memberships to Turkey

For candidate countries, the main purpose of EU membership should be based on rational political and economic objectives. A logical approach of a candidate country would be to expect greater economic stability and economic convergence with the industrialized countries. From an economical perspective, it is totally rational to assume that the road to growth will be supported by EU with monetary and financial transfers as a result of full time membership. However, there will be some costs as well. Every group has its own rules and guidelines that the new-comers have to follow. This process will therefore be dependent upon the availability of resources and investment conditions. So what are the main costs that Turkey fears of?

Besides accepting economic conditions in Copenhagen, implementing the whole legal body of acquis communautaire, will not be easy and will have some costs particularly for the applicants that are relatively at lower economic levels, which is the case for the new EU members or candidates. The never-ending list of integration measures noted in the report by the Commission will take many years until Turkey adequately adopts the acquis. The EU will be governing the implementation process of legal corpus and accordingly, Turkey will have short term economic problems in the areas of agricultural policy, regional policy and environmental and social standards.

Turkey, investing nearly 1.5 billion US $ in Central and Eastern European countries, is one of the biggest sources of foreign direct investment in the Balkan region. If the EU accepts Turkey as a member, Turkish businesses require restructuring and most of the public economic enterprises (SEE's) would need to be privatized and liberalized. This is a major fear faced by the political party running the government because the privatization can eventually cause political and social tension. This decision would not only be highly criticized by other political parties but also by the public. In addition, during the privatization process, the government may run into economic problems such as the allocation of money or the amount needed to meet the price of the enterprise.

Another point that Turkey has been in fear of, after accessing into the European Union, is the potential changes that will take place in its agricultural sector. Agriculture is still an essential sector of the Turkish economy. According to the European Commission's Agriculture and Rural development titled article, in 2010 it represented 10.1% of the total GDP and 24.7% of Turkish employment. Also noted by Moustakis, "the most efficient working sector in the country and has a compatible high standard in the agricultural world market..."[vii] Thus, one of the biggest fears of Turkey is the import of inefficiency from EU through the CAP (Common Agricultural Policy), once Turkey is a full time member.

Fears of the EU from Turkish Accession

This section will try to analyze the main economic concerns and doubts of the European Union about the possible Turkish membership within the EU. Turkey's large size, poor macro situation, low contribution to Union's internal market, costly budget implications after membership and migration from Turkey are the main fears whereas, low foreign investment to the country and its accession to the internal market are thought to have minimal effects on the EU economy as a result of a possible Turkish accession into the EU.

Size

Many consider Turkey as a weak economy when compared to its large population. Turkey is a big; however a poor country, as well. Based on these two facts, opponents to Turkish membership believe that Turkey will cost too much financially and will have too much power with respect to its population. Although size alone will not be the sole ground to make a decision for its future, yet it will be a significant and relevant actor in managing Turkish membership.

According to the critics, Turkish accession would not only have a small positive impact on the much larger EU market, but relatively weaker Turkish economy would also require financial assistance. Furthermore, at the political level, a weak economy with around a population of seventy million would play the second biggest role in designing economic policies: how fair would it be in the eyes of many Europeans?

Table 1 points out UN predictions for Turkey, the EU member states with population over 5 million, and total EU population from 2030 to 2050. Today, Turkey has a population of approximately 72 million.

Table One: Total Population: Various EU member states and candidates, and total EU 25, EU 27 and EU 28; UN estimates 2003-2050

(thousands)	2003	2015	2025	2050
Austria	8116	8058	7979	7376
Belgium	10318	10470	10516	10221
Bulgaria	7897	7167	6609	5255
Czech Republic	10236	10076	9806	8553
Denmark	5364	5447	5469	5273
Finland	5207	5284	5289	4941
France	60144	62841	64165	64230
Germany	82476	82497	81959	79145
Greece	10976	10944	10707	9814
Hungary	9877	9324	8865	7589
Italy	57423	55507	52939	44875
Netherlands	16149	16791	17123	16954
Poland	38587	38173	37337	33004
Portugal	10062	10030	9834	9027
Romania	22334	21649	20806	18063
Slovakia	5402	5441	5397	4948
Spain	41060	41167	40369	37336
Sweden	8876	8983	9055	8700
UK	59251	61275	63287	66166
Turkey	**71325**	**82150**	**88995**	**97759**
Total EU 25	**454187**	**456876**	**454422**	**431241**
Total EU27	**484418**	**485692**	**481837**	**454559**
Total EU28 (incl Turkey)	**555743**	**567842**	**570832**	**552318**
Turkey as % of EU 28	**12.8%**	**14.4%**	**15.5%**	**17.7%**

Source: UN World Population Division: *World Population Prospects: the 2002 Revision*

Until the possible membership date of 2015, Turkey will reach an estimated population of 82 million, likely to surpass Germany due to its decreasing population. In 2025, ten years later, Turkey will be the largest state in the Union with its population of 87 million. Meanwhile, Turkey is not regarded as a European country by most of the Europeans. The difference between the largest members of the Union by population such as Germany, France, Italy and the UK is that these countries also have the strongest economies. Unlike the case of Turkey, political and economic dominance go together.

Finally, Turkey has obvious regional variation illustrating the rural/urban division with its deprived regions in eastern Anatolia. Income disparity is as much as one fifth per head when compared to Turkey's richest parts, which is Marmara region. Dealing with the widespread poverty and regional inequality is Turkey's one of the largest economic challenge.

Macro Situation

Although Turkey has a relatively smaller sized economy that would hardly damage the internal European market and the Euro, serious financial crises it faced in its recent past like the one in 2001 are great examples of financial instability. Table three shows the key economic variables of Turkey right after the 2001 financial collapse. Such volatility has been a concern especially when it comes to accepting a state that exhibits weak economic patterns. Although adopting the common currency, Euro, by a country is possible in some years after the membership, it is certainly not the EU's interest to admit a country that has financial recessions in its modern history. As stated in Copenhagen criteria, candidate countries are expected to keep up with ever tightening internal market regulations and have functioning economies. Economies which are vulnerable to regular financial crises do not meet these criteria.

Table Three: Turkey – Macroeconomic Picture

	2002
Real GDP growth %	7.8
Unemployment (%)	10.68
Inflation (annual avg %)	45.0
Inflation (year end %)	29.5
Budget balance (% GDP)	-14.16
Public debt (% of GDP)	88.90
Exports (% of GDP)	29.7
Current account balance (/GDP)	-0.98
Foreign direct investment Inflows (%GDP)	0.3

Sources: European Commission DG Enlargement website; Economist Intelligence Unit; World Bank Group

Although European's fear from such adverse effects, it is quite noteworthy that Turkey has rebounded from the 2001 crisis in an impressive manner. Since 2010, Turkey has the highest real GDP growth rate by 9.0% and 7.5% respectively[viii]. European analysts consider this growth as healthy within Turkey's potential, within an evaluation of the ongoing monetary reforms at macro and micro level.

Another macroeconomic fear Europeans have in their minds in relation to Turkey's accession talks is the inflation. Inflation dropped significantly from 45% in 2002 as seen in table 3, to 8.7% in 2010[ix]. Turkey is one of the few emerging economies that had high inflation levels once and managed to stay away from hyperinflation. Although Turkish economy witnessed single digit inflation for the first time in thirty years, economic observers believe that it is critical for Turkey to preserve the situation and make it sustainable.

Turkey's consistency is questioned when it comes to external debt. With almost 89% of its GDP in 2002, external debt (public and private debt owed to nonresidents repayable in foreign currency, goods, or services) is still an unsolved problem on the Turkish side. Turkey's foreign debt burden is greater than any other EU entrants or EU candidate states. Because much of the debts is short-run government debt (about 70% being cumulated current account deficits since 1963 accounting for 40 billion US$) and is expressed in foreign currency, Turkey is having a very volatile market, and the Turkish economy is vulnerable to market sentiment and exchange rate fluctuations[x]. External debt and flight of Turkish capital to legal looking financial institutions has been a key feature of its poor financial performance in its modern history.

In the meantime, Turkey was criticized highly by the European member states because of the issues with the IMF. According to most of the EU states, the motives that have driven the Turkish reforms are the IMF loans and conditionality since the 2001 crisis. Although IMF pushed for monetary cutback and structural reforms along with alterations in the banking sector seen particularly crucial to diminish risks for additional problems, Turkey did not adopt a successor IMF program in 2005 and has declined to work with the IMF[xi]. Just before Turkey started to face high levels of real GDP growth, European observers believed that both state and non-state banks needed fundamental reforms. Still today, Turkey is being criticized for different problems that it is said to have in its banking system and this makes the accession process harder.

Immigration

Aside from direct financial implications, another feared outcome from a possible Turkish accession has been the immigration case. As Jurgen Gerhards and Silke Hans interpret the data from Eurobarometer, most EU citizens are confident that accession would result in an increased immigration from Turkey to more industrialized EU countries. Furthermore, 76.3% of 22,480 EU citizens agreed with the idea that “Turkey's accession could risk favoring immigration to more developed countries in the EU.” It is regarded as a realistic fear since Turkish citizens would have the right to freely travel within the EU following a flexible transition period of up to seven years.

According to the EU member states Turkish immigration could have adverse effects on some specific parts of the labor market due to increased competition. Although not every single EU state would be affected to the same extent, specific countries attract immigration particularly the ones that are more economically advanced like EU-15. As observed with the 2004 enlargement, by which 10 new states joined, migration became a sensitive political and economic issue, in public opinion who are strictly against it. Eventually, the EU decided to allow a flexible transition period maximum for seven years.

A second point that the legal immigration could affect the EU labor markets is the countries with already high unemployment rates would be worse off since most of these immigrants would be looking for jobs along with the citizens of the country itself. Although countries that have low unemployment rates may welcome the immigration in order to resolve labor shortage problems, since unemployment is a lot bigger problem than lack of labor, immigration is therefore believed to have negative economic implications in aggregate.

Budgetary Implications of Turkish Accession

Turkey has made a legitimate progress since the last decade with its GDP per capita (GDP on a purchasing power parity basis divided by population) 6,200 US$ in 1999 up to 12,300 US$ in 2010.[xii] Additionally, its economy grew an average of 6.0% per year between 2002 and 2007. During this period, inflation along with interest rates dropped while the currency stabilized and the government debt decreased to manageable levels (39.5% of GDP in 2008 from

73.1% in 2002[xiii]). However, according to the EU, when considering every economic indicator, despite all the recent significant economic developments, Turkey would be one of the least economically developed country among the Member states, including the groups of countries that joined the EU in 2004 and 2007 waves. Structural convergence aimed through the catching up of the economies is one of the main goals of the EU. Therefore, to balance out these economic differences, Turkish accession would be supplemented by transfer payments from the EU citizens' budgets. This is obviously regarded as a negative economic implication that arises from the Turkish accession to the European Union. Citizens complain from being unemployed already, and therefore do not agree on "paying" by accepting Turkey as a member.

Remembering the negotiations with the 10 new EU member states, not only current policy rules, but also traditional politics and intense disputes control the budget discussions between the "givers" and "takers" in the EU. Table 4 from (Hughes 2004) shows the budget deals done for new member states. The EU Council assessed each country's structural fund requirements and CAP eligibility (Common Agricultural Policy) to determine the right amount of payment needed for each country. In addition, EU Council limited the structural payments for ten states that joined in 2004 to 4% of GDP. Estimates show that funds to Turkey vary between 5.6 to 24.6 billion Euros per year, which is nearly equal to those of the ten member states in 2004.[xiv] Therefore, the acceptance of Turkey is feared since it is estimated to have the costs of ten EU countries.

Although a significant amount of budget transfer is necessary, it is quite difficult to estimate the net budgetary implications following the Turkish integration, due to uncertainty of the future of the two economies. However, a rational way the financial analysts estimate the budgetary implications of Turkish membership is to utilize the financial packages the EU provided in the 2004 enlargement. Assuming a Turkish membership in 2015, Hughes (2004) expects a 10.5 billion euro worth of gross budgetary transfer from EU to Turkey in 2015. Following such estimation, according to SPO (2004) Turkey would transfer 4.9 billion euro in 2015. As a result, net budgetary transfer from EU to Turkey equals to 5.6 billion euros (10.5-4.9=5.6), out of EU citizens' pockets.[xv]

Table 4: The EU Financial Perspective for the EU 25

	2004	2005	2006	Total
Agriculture	44.657	45.677	45.807	136.14
Structural & Cohesion funds	35.665	36.502	37.940	110.10
Total EU25	**102.985**	**105.128**	**106.741**	**314.85**
of which 10 new member states:				
Agriculture	1.897	3.748	4.147	9.79
Structural & Cohesion funds	6.609	6.907	8.770	22.28
Total EU 10	**11.199**	**13.813**	**15.840**	**40.85**
EU10/EU25 %	10.8 %	13.1 %	14.8%	12.97%

Employment

In addition to macroeconomic affects, Turkish accession may have negative implications at the individual level as well. According to Gabel and Palmer (1995), market liberalization regarding European integration is likely to have negative effects for low skilled workers. For instance, workers with low skilled human capital that have a precarious position in the labor market are on the spot. Also confirmed by Hooghe and Marks (2005), EU enlargements bring along negative economic consequences for low-skilled people by making them easily replaceable with the immigrant workers. This also includes unemployed people who are threatened by immigrant workers who have lower expectations and lesser demands from their employers, and relatively lower costs of working. Although increased immigration does not necessarily risk high skilled workers job positions by lowering the prices, low skilled workers of the EU 15 will be highly affected due to mass amount of either unemployed or unsatisfied Turkish people who are willing to migrate in order to find jobs or improve their working conditions.

European Integration Consortium (2000) reports similar findings regarding the EU fears of free movement in an enlarged European Union. Concentrating on Austria and Germany, the EIC believes that based on the empirical knowledge of migration impact on labor, the increase of foreigners will affect the wages and employment in the host countries. In addition, previously an increase share of foreigners in a country by only one percent reduced the wages by 0.25% in Austria and 0.65% in Germany while the risk of a person being unemployed increased by 0.8% in Austria and 0.2% in Germany.[xvi]

The Customs Union Agreement, Trade and the Internal Market

Turkey and the EU benefit from a deep trade relationship since Turkey and EU were linked by a Customs Union agreement in 31 December 1995. As mentioned before in this project, Customs Union agreement does not cover fundamental economic areas like agriculture. Therefore the EU has been in an attempt to do a cost-benefit analysis of a possible Turkish accession. The EU financial analysts believe that economic benefits the EU could collect from bilateral trade from Turkey is small-not worth it. In more detail, Turkish exports to the EU account only for about 3.3% of the total EU imports (equivalent to €47 billion), while EU exported 4.3% of total EU (€53 billion) in 2007[xvii]. In addition, approximately 70% of Turkish agricultural exports already go into the internal market of the EU without tariffs or any other restrictions. Hence, taking the Customs Union to the next level by accepting Turkey as a member is not regarded by the EU as a boost to the EU economy through the trade channel.

Customs Union agreement that was ratified between the EU and Turkey in 1995 was expected to bring trade and economic benefits to both sides. In addition, many observers believed that through this agreement Europeans would be able to predict their likely future benefits after a possible Turkish membership, when Turkey could access the internal market fully (free movement of people, agriculture, and services are excluded in the Customs Union). Unfortunately, the European side has been disappointed at the operation of the Customs Union by the Turkish side. Although trade barriers were removed, bureaucratic barriers and other non-tariff barriers have remained as obstacles for a closer future partnership. Until 2005, Customs Union did not lead to any apparent FDI changes as well. Starting from 2005 and lasting in 2008 FDI flows to Turkey has dramatically increased from (2.8 billion US $ in 2004 to 10 billion US $ in 2005); however, once again the consistency of this rise is doubted by many Europeans[xviii].

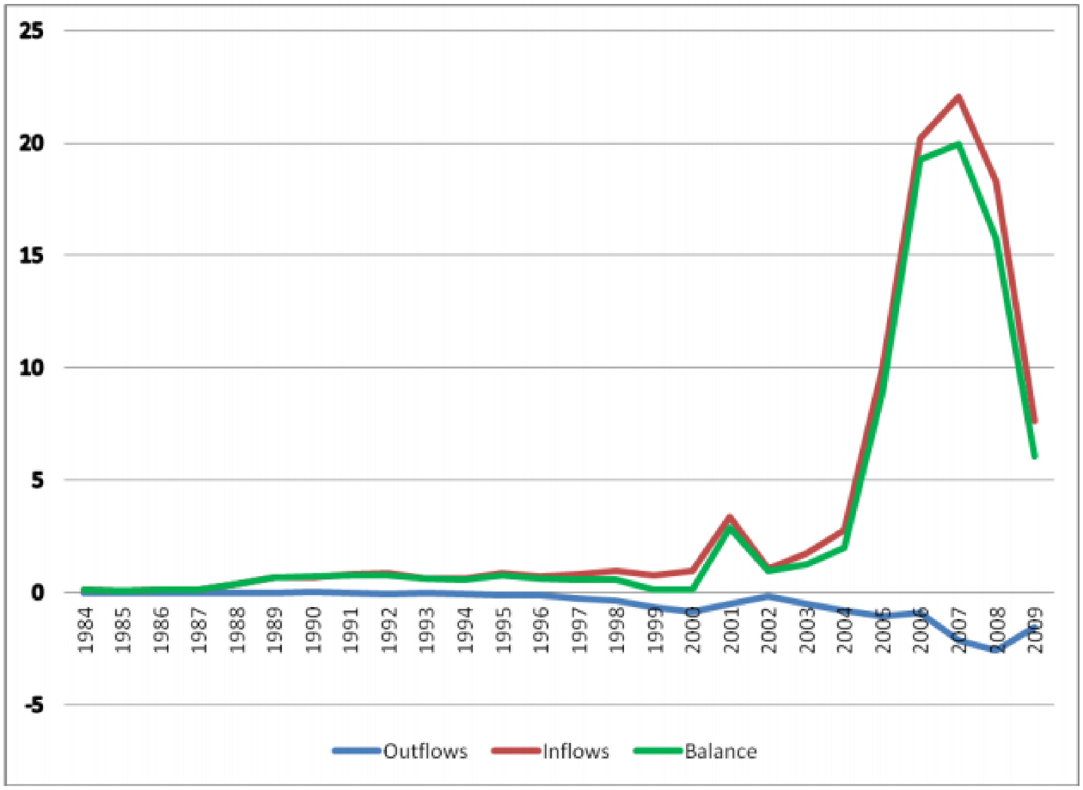
Economic implications of Turkish accession into the EU have also been estimated by the Netherlands Bureau or Economic Policy Analysis[xix].According to the Bureau, initially there would be an approximate 34% increase in bilateral trade. Then, they estimate the effects of an imaginary Turkish accession in 2010 in 2025 by using a complete simulation excluding the FDI affects, technology spillovers and EU budget transfers. Results illustrate that accession to the internal market would generate a 0.8% GDP growth for Turkey, 1.4% rise in consumption and an 8.1% increase in exports. Turkey benefits most from the textile and clothing. On the other hand, the implications on the European side are much smaller when compared to a relatively smaller size of the Turkish economy. According to the estimations by the Netherlands Bureau for Economic Policy Analysis, the EU 15 faces an increase of 0.1% in consumption and 0.2% in exports along with a 5.07 billion US$. As predicted further, as a result of the Turkish accession, the ten member states that joined the union in 2004 are expected to face a growth in consumption by 0.2% and export volume by 0.3%. In total, according to the NBEPA simulations, Turkish influence on the EU GDP is too small to register for one decimal place.

Turkish accession to the internal market concerns the European Union at the policy enforcement level as well. The memberships of central and eastern European countries have already transformed the EU from mainly industrial core rich countries to a more diverse group which consists of many transitioning countries. Therefore, economic and monetary policies severely change in order to maintain internal coherence[xx]. This affects the implementation of internal market regulations and coordination of countries in achieving specific goals. When industrial countries race to increase the level of domination in the market with their advanced technologies, transitioning countries must first go through a successful convergence process. Therefore the concern is whether a more heterogeneous economic group with the accession of Turkey would decrease the competition which may harm the EU in return.

The Problem of Foreign Direct Investment

While Turkey began to launch trade policies and started observing its exports more carefully (since it has a trade surplus), foreign direct investments appeared to be very low. Before 2000, only less than a billion dollars' worth foreign direct investment flew to Turkey. However, since 2000, FDI climbed increasingly and mounted in 2007 with 22 billions of dollars then fell down during the recent global crisis.[xxi]

Figure 1: Foreign Direct Investments (FDI) inflows to Turkey in billion current US-$, 2000-2009



Data Source: Central Bank of the Republic of Turkey, Electronic Data Delivery System (EDDS) available at: http://evds.tcmb.gov.tr/yeni/cbt-uk.html.

As seen from the Figure, the entire amount of the FDI Turkey received from 1980up to 2003 was mainly as debt payments or portfolio investments. However, from 2003 to 2006 a total of 25.5 US$ foreign investment has flown in Turkey. This unpredicted pattern existed until 2008, when the economic crisis hit the world. Since 2003, most of the foreign investments to Turkey were from Europe. This indicates a remarkable change of perception by the European investors towards Turkey. The fact that foreign direct investment increased tremendously without the EU membership is a disincentive for the EU countries to accept Turkey as a member anymore. In other words, the issue is Turkish membership is not expected to change this increasing foreign capital inflow significantly and predicted to have minimal positive implications for the EU investors and the EU economy in general.

Table 2. Citizens' Attitudes towards Different Propositions with Regard to Turkey (%)

	Support	***N***
1. Turkey's accession would help rejuvenate an ageing European population	36.7%	20,486
2. Turkey's accession to the EU would strengthen security in this region	40.6%	21,996
3. Turkey partly belongs to Europe by its history	50.3%	22,497
4. Turkey partly belongs to Europe by its geography	64.7%	23,129
5. The cultural differences between Turkey and the EU Member States are too significant to allow it to join the EU	68.9%	22,744
6. Turkey's accession could risk favoring immigration to more developed countries in the EU	76.3%	22,480
7. To join the EU, Turkey will have to significantly improve the state of its economy	89.5%	22,574
8. In order to join the EU, Turkey will have to systematically respect human rights	93.6%	23,609

Source: Authors' own calculations based on Eurobarometer data.[xxii]

Note: Percentage of those who said ‘tend to agree’ or ‘totally agree’ as opposed to those who ‘tend to disagree’ or ‘totally disagree’. ‘Don't know’ responses were excluded from the analysis.

Chapter 3: Analysis

Positions of Relevant Actors

Germany

Germany was among the main proponents of Turkish accession under the SPD party led by Gerhard Schroder and demonstrated a new approach to EU-Turkey negotiations. However, as the CDU joined the SPD for a coalition government following the 2005 elections, position of Germany changed noticeably. The CDU has always been one of the biggest adversaries of full time Turkish membership for all political, social and economic reasons, while the Chancellor, Angela Merkel supported the unique “privileged partnership” with majority of her party supporting this idea. In contrast, SPD is still a strong advocate of Turkish accession but is criticized by senior figures such as the former Chancellor Helmut Schmidt. Due to the given uncertainty resulting from the coalition of both parties, there is no single strict policy towards Turkish membership and all the options remain possible. Among the German population, 12% of the public support the Turkish accession whereas 66% are against it.

France

During the presidency of Jacques Chirac, the French policy towards Turkish accession was somewhat vague. Chirac was in favor of Turkish accession leading up to the accession talks; however, faced a large opposition from the right parties. Throughout his electoral campaign, the current French president, Nicholas

Sarkozy, clearly stated his bitter opposition to Turkey's accession into the EU several times. French public fear and guardianship against a large Turkish immigration of workers is the backbone of this strong opposition. Furthermore, Sarkozy offered establishing a Mediterranean Union that would include Turkey but details were not defined later.

United Kingdom

Tony Blair, the former prime minister of the UK was one of the main supporters of Turkish membership. Taking the charge after Mr. Blair, Gordon Brown stated in numerous occasions that he was supportive of Turkish accession. Since the British policy is aligned with that of U.S., it sees this expansion as widening the range of EU rather than isolating Turkey from the West. Up to now, the rightist parties such as the conservative party are united for pro Turkey enlargement, due to UK's long-established transatlantic alignment. Blair emphasized the significance of Turkish membership by visiting Turkey and being the first British Prime Minister to visit Turkey in nearly two decades. Brown also got together with Turkish Prime Minister Erdogan in late 2007, and convinced the media on the British confidence in Turkey by signing a UK-Turkish strategic alliance Agreement.

Greece

Greece which was one of the main adversaries of Turkish accession changed its position considerably in recent decade. After the continuous pressure from the EU and the US and since the 1999 earthquake that struck both countries terribly, Greece stepped away from being an ardent adversary to a more somewhat logical observer. Since then, Greece tolerated numerous frustrations regarding Cyprus and Aegean F-16 battles; however, sustained its position on Turkish accession. It can be claimed that Greek government believes the bilateral problems would be solved easier under the roof of the EU. Kostas Karamanlis summarized the Athens' approach on Turkish membership "full compliance, full accession." However, it should be noted that Greek public stance is intensely opposed to EU enlargement by Turkey; a recent public poll revealed that 25% supported while 45% were against it.

Cases of Romania and Bulgaria

In this section I will primarily mention how the Central and Eastern European Countries (mainly focusing on Bulgaria and Romania) are hitting the ground running as they catch up with their European peers. Then I will focus on Bulgaria and Romania and discuss some negative implications of their integration within the EU.

Latest EU members, Romania and Bulgaria immediately showed an attempt to close the economic gap with the European Union members. Despite the obstacles on their way, such as their domestic problems within the states and the global financial crisis, healthy investment growth and economic progression make the transition a less painful one for these two countries. Being the largest economy in the world since the fourth enlargement, European Union accepted Romania and Bulgaria who became official members on January 1, 2007. With the fifth and latest enlargement, Romania and Bulgaria contributed some 30 million people to the EU, increasing the population to almost 500 million people.

Romanian and Bulgarian prime ministers have indicated that they are interested in accomplishing the remaining tasks identified by the EU Commission. According to the monitoring findings, two countries were demanded to intensify their battle against corruption and improve their judicial reform procedure.

Although Romanian and Bulgarian economies vary in terms of their size, industrialization levels, and monetary performance, they do have some similar macroeconomic features. They both faced a major immigration from their countries in the early 90s due to economic problems after the collapse of the Soviet Union. Nowadays, unemployment problem still exists and they both lack high-skilled labor in several sectors.

Table Maastricht Convergence Criteria – Present status and future changes

	Access to EMU	Inflation rate		Budget balance general government		Gross debt general government		Long-term interest rate	Degree of integration in EMU
		2007	2008	2007	2008	2007	2008	2008	
		In %		In % of GDP		In % of GDP		In %	
Reference values		2.8	4.3	–3.0	–3.0	60.0	60.0	6.3	
Belgium	1999	1.8	4.7	–0.3	–0.5	83.9	86.5	4.5	€
Bulgaria		7.6	12.4	0.1	3.3	18.2	13.8	5.3	CB
Czech Rep.		3.0	6.6	–1.0	–1.2	28.9	26.6	4.6	
Denmark		1.7	3.8	4.5	3.1	26.2	21.1	4.4	ERM II. Opt-out
Germany	1999	2.3	3.0	–0.2	0.0	65.1	64.3	4.1	€
Estonia		6.7	10.6	2.7	–1.4	3.5	4.2	7.9	ERM II. CB
Ireland	1999	2.9	3.3	0.2	–5.5	24.8	31.6	4.5	€
Greece	2001	3.0	4.4	–3.5	–2.5	98.4	93.4	4.8	€
Spain	1999	2.8	4.2	2.2	–1.6	36.2	37.5	4.5	€
France	1999	1.6	3.3	–2.7	–3.0	63.9	65.4	4.3	€
Italy	1999	2.0	3.6	–1.6	–2.5	104.1	104.1	4.7	€
Cyprus	2008	2.2	4.5	3.5	1.0	59.5	48.2	4.5	ERM II. €
Latvia		10.1	15.7	0.1	–2.3	9.5	12.3	6.1	ERM II.
Lithuania		5.8	11.9	–1.2	–2.7	17.0	17.5	5.1	ERM II.
Luxembourg	1999	2.7	4.4	3.2	2.7	7.0	14.1	4.7	€
Hungary		7.9	6.3	–5.0	–3.4	65.8	65.4	8.4	
Malta	2008	0.7	4.4	–1.8	–3.8	62.2	63.1	4.9	ERM II. €
Netherlands	1999	1.6	2.5	0.3	1.2	45.7	48.2	4.3	€
Austria	1999	2.2	3.4	–0.4	–0.6	59.5	57.4	4.4	€
Poland		2.6	4.3	–2.0	–2.3	44.9	43.9	6.1	
Portugal	1999	2.4	2.9	–2.6	–2.2	63.6	64.3	4.6	€
Romania		4.9	7.8	–2.6	–3.4	12.9	13.4	7.7	
Slovenia	2007	3.8	6.2	0.6	–0.2	23.4	21.8	4.6	€
Slovakia	2009	1.9	4.0	–1.9	–2.3	29.4	28.8	4.8	ERM II/€.
Finland	1999	1.6	4.2	5.3	5.1	35.1	31.6	4.3	€
Sweden		1.7	3.0	3.6	2.6	40.4	34.7	4.0	
United Kingdom		2.3	3.7	–2.8	–4.2	44.2	50.1	4.6	Opt-out
EU 27		2.4	3.9	–0.9	–1.6	58.7	59.8	4.5	
Euro area 16		2.1	3.5	–0.6	–1.3	66.1	66.6	4.1	

CB . . . Currency Board. ERM II . . . participation in the Exchange rate mechanism II (national exchange rate can fluctuate vis à vis the Euro within a band of ±15%). € . . . participation in the Economic and Monetary Union (EMU). Opt-out . . . "Opting-out" clause according to the Maastricht Treaty.

Source: Breuss (2007C), p. 946 and updates with AMECO data (Autumn 2008 Economic Forecast by the European Commission).

Another evidence of convergence of Central and Eastern European Countries including Romania and Bulgaria can be found on the Maastricht Convergence

Criteria presented in the article *European Economy* by Fritz Breuss.[xxiii] The changes in these two countries are significant when following their accession to the European Internal Market. In Bulgaria, the Gross debt of general government decreased from 18.2 % to 13.8 % of GDP and the budget balance increased from 0.1 % to 3.3% of GDP. Similar effects can be seen in Romania. Although the decreases in budget balance and increases in inflation rate should have been exaggerated due to the global crisis, accession to the EU market has diminished the negative implications. We have to keep in mind that these two countries have prospered in such a short time and currently have not accessed into the European Monetary Union yet.

The latest EU enlargement broadened the single market of the EU as well as the Schengen area. Bulgaria and Romania have not fully integrated into the internal market of the EU and they have not fulfilled all the pre-requisites of the Single European Market (SEM); however, these two new members benefited evidently after their participation in the SEM.

Furthermore, Romania and Bulgaria extended their trade with their peers. In fact, the two new member states started trading with themselves as well. The new members also benefited as the former EU members have passed on their trade flows to the new member states. According to Breuss (2008)[xxiv], the change in trade between 1993 and 2007 in Bulgaria and Romania is +7.7 and +24.6 in percentage points respectively. Industrialized members of the EU have also benefited significantly from the Bulgarian and Romanian EU accessions. If we take a look at the following table, we can see that the exports to Bulgaria and

Romania have increased tremendously, +7.7% to Bulgaria, and 24.6% to Romania respectively.

Table : Shifts of Trade since Opening-up of Eastern Europe and since EU Enlargement

	EU 27 Export shares	
Reporter	2007 In %	1993/2007 Change in percentage points
Belgium	76.9	–1.6
Denmark	70.0	+2.5
Germany	64.7	+2.6
Greece	64.6	–7.3
Spain	69.6	–2.2
France	64.6	+3.3
Ireland	63.7	–7.9
Italy	60.0	–1.0
Luxembourg	87.6	+2.4
Netherlands	77.9	+0.3
Austria	72.5	–4.2
Portugal	74.4	–6.1
Finland	56.7	–7.4
Sweden	60.5	+1.8
United Kingdom	55.4	+1.7
Czech Rep.	85.2	+3.1
Estonia	69.9	+6.9
Cyprus	59.3	+13.3
Latvia	72.7	+30.7
Lithuania	64.7	–20.3
Hungary	78.7	+16.3
Malta	48.7	–23.7
Poland	78.6	+4.5
Slovenia	69.5	+2.4
Slovakia	86.7	+5.6
Bulgaria	60.7	+7.7
Romania	72.0	+24.6
EU 15	66.5	+1.8
EU 27	67.7	+2.8

Source: Breuss (2007C), p. 942 and updates with IMF, Direction of Trade statistics.

Following the collapse of the Soviet Union the Central Eastern European Countries started trading and receiving foreign direct investment mainly from the industrialized European countries. Especially after the latest EU enlargements, the CEECs appeared to be a great market for Western European companies. Specifically, Austrian businesses and more so German companies whom had a long history within the area exploited this emerging situation. Dutch, Austrian and German investors are the most noticeable source of foreign capital inflow for CEECs. In particular, Bulgaria and Romania attracted the major share of FDI during their integration into the European Single Market as they adopted the policy of privatization.

The global financial state had negative implications on the new member's economies'. The economic crisis limited the growth potential of new members including Bulgaria and Romania. The International Monetary Fund, the OECD along with the European Commission has observed downward financial trends towards the end of 2008.

The following table designed by Fritz Breuss in the article *An Evaluation of the EU's Fifth Enlargement With special focus on Bulgaria and Romania* illustrates the effects of integration on the key indicators of each economy. It is clear to see that both Bulgaria and Romania benefited from the membership.

Table : Direct Integration effects[1)] of EU's 2007 Enlargement in Bulgaria and Romania xxv

Integration effects	Scale	Pre-accession period 2000-2006		EU membership 2007-2020	
		Bulgaria	Romania	Bulgaria	Romania
GDP, real	%	+0.3	+0.2	+0.6	+0.6
GDP, real	*C%*	*+1.8*	*+1.2*	*+9.2*	*+8.9*
GDP, real (incl. migration)	*%*	*+0.3*	*+0.2*	*+0.5*	*+0.6*
Investment quota (% GDP)	%	+1.5	+0.5	+0.7	+0.6
Labour productivity (PR)	%	+0.3	+0.2	+0.4	+0.5
Employment (E)	%	+0.0	+0.0	+0.3	+0.1
Wages, nominal (W)	%	+0.3	+0.1	+0.3	-0.2
Inflation rate (P)	%	+0.0	-0.0	-0.2	-0.6
Unit labour costs (ULC)	%	+0.1	-0.1	-0.2	-0.8
Unemployment rate (U)	%	-0.4	-0.0	-2.8	-0.4
Budget balance (% GDP)	%	+0.1	+0.0	+0.3	+0.1
Public debt (% GDP)	%	-0.1	-0.0	-0.2	+0.1
Interest rate, short-term	%	+0.1	+0.2	+0.2	+2.0
Interest rate, long-term	%	+0.0	+0.1	+0.0	+1.9
Export quota[2)] (% GDP)	%	+1.3	+1.5	+4.6	+3.5
Import quota[2)] (% GDP)	%	+3.2	+2.9	+12.9	+10.1
Real effective exchange rate	%	+0.1	+0.1	+0.4	+1.0
Wage share (LQ) (% GDP)	%	+0.0	+0.0	+0.6	+0.2
GDP p.c. relative to EU15	%	+0.2	+0.2	+3.3	+3.1

[1)] Without migration effects
% = annual average growth rate in % or average annual change in % of GDP; C% = cumulated deviations from the baseline in percentage points.
[2)] Export and import quota refer to total exports and imports of goods and services.
Source: Own simulations with the integration models of Appendix A

The Case of Bulgaria

Bitter reforms along with EU support assisted Bulgaria out from the hopeless tangle in the 1990s. Today, Bulgarian financial growth doubles the average of EU. In 2005, Bulgaria's real GDP grew at 5.5%, in 2006; this was 6.1% whereas the EU-25 growth was 1.7% and 2.8% respectively. Besides investment, consumption growth at 6.4% was regarded as the main reason behind the economic progress.[xxvi] Although Bulgaria started to catch up, it still has a long way ahead in order to converge fully with rest of its peers. Since the accession, the unemployment has also been decreasing steadily. Although unemployment is still higher than the EU average, it decreased from 9.3 % in 2006 July to 5.2% in November 2008. Following the EU accession, Bulgaria's most glowing accomplishment has been the stabilization of its economy. Investor confidence rose rapidly as Bulgaria started to pay attention to the findings of European Union Monitoring Mission. Meanwhile, a fast ageing and decreasing population makes it harder for unemployment to increase in the youth population. Head of the DG ECFIN Unit for economic matters, Peter Grasmann stated that the unemployment is estimated to drop below 7% later in 2013[xxvii]. Additionally, According to EFCN autumn forecast evaluations, Bulgaria's future seems bright as they claimed "Economic growth is expected to accelerate further…as strong investment growth and ongoing enterprise restructuring continue…"[xxviii] However, Bulgaria will also have to face the remaining membership challenges such as adopting the reforms for euro entry and making sure the Structural Funds provided by the EU are used efficiently.

By achieving the desired level of stability, Bulgaria is not close to being an elite level economy. One of the features of fast growing economies is the ever growing trade deficit. Right after the accession, due to the elimination of trade barriers, exports from industrialized countries to Bulgaria increased dramatically. In 2008, imports were 34.88% of GDP while exports were floating around 22.51%. However, unlike Romania, Bulgaria recently started to export more than it imports. Since Bulgarian exports grew at a higher pace than imports the trade deficit of Bulgaria's foreign deficit shrank by 64% in January/August 2011[xxix].

The Case of Romania

Romanian economy faced so many ups and downs in the 1990s, and only since 2000s the economy proved to be more stable. Nowadays, Romania is on the way towards the end of a financial rebound. Since 2007, the EU provided Romania with a Structural fund worth 20 billion Euros along with an agricultural development fund worth 13 billion Euros. These funds were intended to enhance infrastructure, improve living standards, increase the competitiveness of companies, and therefore create more job opportunities to fight with unemployment. Establishment of Customs Union and accession into the EU internal Market opened Romanian businesses up to nearly half billion consumers without barriers on trade, interest on capital, and limits on travel of labor. In addition, due to high level of European market competition, Romanian firms reached another level as a result of European market competition.

However, despite the EU support, during the following years after the accession, Romania could not get the most out of the membership yet. Some negative effects are the trade balance worsening, weak competition of Romanian firms, expensive agricultural products, and growing of budget deficit.

Romania's adoption of the EU Common Customs Tariff and the Generalized System of Preferences has generated anxieties regarding the rise of imports and therefore worsening of the trade balance. In fact, trade deficit grew since 2006 by 46%. On numerical terms, the deficit between Romania and non-EU countries decreased from 34.43% of the total deficit in 2007 to 29.64% following the accession and to 22.78% in 2008. While, the deficit between Romania and the EU countries turned out to be approximately 46% after the accession[xxx]. Although trade deficit with non-EU countries decreased, the trade deficit between Romania and the other EU countries increased more than the decrease on the non-European side.

The immediate effects of Romanian accession and implementation of Internal Market acquis were negative since further investment was required, domestic businesses could not compete with the EU companies, and this in turn caused exports to decrease and trade balance to deteriorate. Imports increased 11.2% more than exports, resulting in a 44.4% bigger trade deficit compared to 2006. [xxxi] Furthermore, the trade deficit kept rising in 2008 as exports increased only by 14.37% and imports increased by 10.48% from 2007 (since imports were bigger than exports by 5.17%)[xxxii].

Implementation of the Common Agricultural Policy resulted with increased agricultural prices as predicted due to huge agricultural product price difference between Romania and EU member states. Therefore, Romania faced 1.5% price increase in January 2007. According to Buletin statistic de preturi ianuarie 2008, agricultural products were 24% more expensive in January 2008 than in January 2007[xxxiii]. Within a short period of time, Romania grew with one of the highest rates in Europe.

Conclusion

Overall, similar to what would happen with Turkey, Bulgaria and Romania benefited much more from the EU membership than core countries in the ratio of 20:1. In the close future, around 2020, Romania and Bulgaria are expected to face 1.5% GDP growth increase annually on average; however this is still not enough to bring Romania and Bulgaria to an elite level of economy. Evaluations reveal that new member states Bulgaria and Romania have already been able to benefit strikingly as a result of their accession to the internal market of the EU, although they have not been fully integrated. In addition, we cannot count out the shadows of the international financial crisis on this rapid growth. The question of when Romania is going to benefit fully from this accession depends on when it is going to get rid of corruption and create a more stable environment that generates economic growth. This is the way how Bulgaria prospered and if Turkey joins, it is the way how Turkey will benefit: by creating a more stable environment for the economy to operate smoothly.

Benefits to the EU

Economic Implications of Homogenization of the Two Economies

How would a potential membership of Turkey affect the European Union? Turkey has maintained inward oriented trade and advancement policies since the World War II. After the Cyprus Peace Operation in 1974, the embargo that the U.S imposed on the Turkish economy raised doubts in many European's minds about the possible future official economic relationship. Starting from the 1980s Turkish economy started to open up with the liberalization of its trade. Liberalization of trade not only strengthened its economic cooperation with the EU but it also guided the way for the Customs Union agreement in 1995.

In spite of the economic collaboration between the European Union and Turkey, some Europeans are unwilling to accept Turkey as a member of the EU for several reasons.

Turkish membership will affect the economy of the European Union in many ways. Migration, agriculture, and integration of trade will be the main advantages of Turkish accession to the European Union. My analysis concerning the economic implications of the possible Turkish accession to the European Union will include three parts:

Macroeconomic Effects as a result of Turkey's accession to the Internal Market

Table 4.3	Macroeconomic effects of Turkey's accession to the internal market in 2025				
	Volume of GDP (%)	Volume of consumption (%)	Equivalent Variation (billion US$)	Export volume (%)	Terms of trade (%)
Turkey	0.8	1.4	4.4	8.1	3.5
Accession-10	0.0	0.2	0.1	0.3	0.2
Bulgaria	− 0.0	0.1	0.3	1.3	0.1
Romania	0.0	0.2	0.0	0.8	0.2
EU-15	0.0	0.0	3.8	0.2	0.1
Germany	0.0	0.0	1.2	0.3	0.1
The Netherlands	− 0.0	0.0	0.2	0.2	0.1

Source: WorldScan simulations.

xxxiv

Turkey's accession into the internal market

Turkish membership in the EU will allow the accession of Turkey into the domestic market. This requires a full adoption of the EU law on the side of Turkey. Accomplishing these goals goes through reforms, which may cause Turkey to suffer from short run costs. In the long-run however, these reforms may well shake the economies of both sides via strong trade relations. Certainly the Turkish accession into the internal market will escalate the trade for various reasons. First of all, administrative barriers on trade will be lifted or at least be diminished to the levels that the EU countries have within each other. This would cause less time delays, less formalities and provide many other opportunities at the frontier. The formation of a single market due to Turkish accession will also eliminate technical barriers on trade as both sides would agree upon technical regulations and other guidelines. Although the EU and Turkey got rid of some minimum technical requirements through customs union, it is clear that accession would help to advance substantially. In addition, risk and uncertainty affiliated with politics and volatility within the economy will be reduced with the accession of Turkey into the EU. In particular, political risk and macroeconomic instability associated risk will likely be in a declining manner. Based on the estimations, mutual trade between Turkey and the EU may increase by nearly 33% as Turkey gets integrated within the EU as a member. According to the researchers, textile and agriculture products will face the most increase.[xxxv]

Potential trade increase following the elimination of non-tariff barriers, revealed a cost of non-accession into the internal market. Furthermore, a scenario created by Lejour (2008) related with a Turkish accession into the internal market illustrates interesting results for both sides. In this scenario, the authors assume that Turkey grows with an average of 5% (although it grows with 9% currently), with a GDP growth faster than that of EU by 2.5%. Then, the authors assume a removal of trade barriers between the EU and Turkey and estimate the effects after twenty years. According to the findings, Turkey is estimated to face an annual welfare increase of 4.4.US$ and GDP increase by 1%. This is a result of integration into the EU market, establishment of a more free trade and specialization. Although the results are positive for EU member states, they are trivial in monetary terms, whereas Turkish gain is significant. The main cause of the difference in benefit is a big portion of Turkish exports flow to EU, while only a small fraction of European exports flow to Turkey. Although EU faces an overall welfare gain, the Central and Eastern European member states that were accepted in 2004 and 2007 experience a slight decrease in textile production due to the existence of a more competitive environment after Turkish accession into the internal market of EU.

Reforms and the Turkish Institutions

EU membership requirements and the process of accession into the EU facilitate Turkish institutions to reform, and this will eventually affect the Turkish economy in various ways. In fact, more efficient institutions and less corruption will definitely inspire confidence in Turkey which would encourage more investment in and further trade with Turkey. Estimations reveal significant results from the improvement of Turkish institutions. For instance, if Turkey becomes as less corrupt as Portugal on the Transparency International Corruption Perceptions Index, overall Turkish trade would more than double. This would generate a GDP growth of 5.6% in Turkish GDP and welfare increase by 28.2 billion US$. These impacts are noticeably bigger than the effects of accession to the internal market. Due to deeper bilateral trade relations, EU countries would benefit further as well, experiencing a total increase of 8.5 billion US$ in private income, with Netherlands benefiting from 7% of it.

Benefits to the European Union

As a result of a possible membership, Turkey may increase the size of the Union's market. A bigger market will spur growth and trade, and create job openings. Advanced trade integration plays a major role in the Turkish economy. Since the ratification of the customs union agreement with the European Union in 1995, Turkey is a key trader in the union's internal market for goods (though not in labor market) and adopts significant reforms regardless of its possible membership. Customs union agreement allowed the travel of goods between two entities without any customs control. In addition, it was one of the steps towards a full Turkish accession into the EU. 1996 and onwards, Turkey and the EU established a free trade area for products that were covered by the European Coal and Steel Community. Therefore, throughout the recent years, Turkey has proved that its integration at the European Union's economy is at a high level. [xxxvi] Furthermore, the customs union agreement between Turkey and European Union led to a creation of a legitimate trade partner, instead of diversion in trade, which can be justified by looking at the ever-increasing Turkish share in the EU market.

The Customs Union already concerns the industrial goods. It suggests that there would not be any additional benefits since this agreement cannot go further even in the case of a full membership. On the other hand, the issue about getting rid of customs duties does not take account of the trade of agricultural products. Agricultural products will be excluded of customs obligations only when Turkey shall be a full-time member. Turkey's accession can generate an increasing welfare in exchange of various agricultural products in the European Union. When the foreign trade of Turkey with the EU is reviewed, Turkey has a trade deficit with the EU in industrial goods, and has a surplus when it comes to the agricultural products. Turkey's higher export compared to its import from the EU considering the existence of custom duties signifies that Turkey may well contribute even more to the European trade under full accession. Therefore, Turkish membership may bring full or at least some self-sufficiency to the EU as the production of agricultural products that lead Turkish export such as seeds, corn, citric fruits eventually wind up in the market.[xxxvii] According to the Common Agricultural Policy of the EU, self-sufficiency is an essential principle. Moreover, in the case of Turkish accession, excess products produced by the EU, especially the ones that Turkey lacks, would make Turkey an excellent market. As stated by several Turkish market analysts, if Turkey becomes a full-time member to the EU, the cream butter production will end since buying it from EU will be cheaper due to EU's vast stock of the product.[xxxviii] Although agricultural products in bilateral trade take up just about 17% in Turkish export and 5% in import, European Union would benefit from Turkish membership on the trade of the agricultural products.

Agriculture is still one of the key properties of the Turkish economy. Similar to the case other central and eastern European countries, like in the case of Poland and Romania, a big bulk of the labor force is engaged in agriculture. Nearly one out of three in the workforce is labored under agriculture however, it accounts only for 12% of the total GDR. Like in other countries, this sector exhibits a low labor productivity performance. Therefore, in the case of Turkish accession, this would lead to emigration due to job openings[xxxix] An important reason what makes Turkey a more realistic candidate compared to other candidate countries is Turkey's trade surplus on the EU agricultural goods. This is because of Turkey's favorable climate, in which it can concentrate in products that the EU countries do not slowdown in buying. Not only the EU hinders these products like fruits, vegetables and nuts from coming in from Turkey, but also protects them even more in contrast to the other central and eastern European countries.

In the case of Turkish accession to the European Union, the shield on this sector would be lifted, and therefore can create advantages for the EU; for instance increasing farm sizes. Since the majority of the exports from Turkey arrive at the EU from a small growing sector, productivity of the people in this sector will be more important in the future. [xl]

Another benefit Europeans would enjoy is the foreign direct investment to Turkey. As pointed out earlier in the section <u>Turkish economy</u>, Turkey has been the target of increasing Foreign Direct Investment since 2001. After a possible Turkish accession, investors from the EU will have an advantage compared to other foreign investors who do not have any privileges. Moreover, Turkish membership in the EU would assure the future maintenance of Turkey's open economy policy.

Immigration

one of the factors that make Turkey's accession unique from the previous enlargements is its population. Aside from the pessimistic views, in one of the EU Commission documents it was noted that a possible mass migration from Turkey following a Turkish accession is considered. Although the EU fears the migration to cause a serious discomfort in the EU labor market, study results also show that "Turkish population dynamics might provide benefits in terms of balancing the ageing population in the EU..."[xli] Furthermore, some EU policy makers and financial analysts feed optimistic views concerning the contribution of Turkish accession to the EU labor market needs. The EU economy is slowly suffering from disappearance of working age population and increasing the elder population. Therefore, Krieger and Maitre (2006) argue that the younger Turkish population may well be the antidote for the problematic EU labor markets, especially if Turkey can take an advantage of the situation in Europe and use its demographic power to educate and train its young population according to the current EU market needs.

Although Europeans fear Turkish migration due to various social, economic and political reasons, it is believed to have positive effects on EU fiscal balances as well. After a comprehensive Krieger's (2004) findings reveal that Turkish migrants have a better education than those from Central and Eastern European members and are likely between the ages 15-39. Brücker (2002) reports that over their life cycle, Turkish migrants' net tax payments (tax payments = social security transfer + government expenditures) exhibit positive numbers especially if they are between 11 and 48 years of age. A Turkish immigrant contributes 50,000 Euros on average over his or her lifecycle as long as it fits the descriptions above. Moreover, another Swedish analyst Storeseltten, finds similar results regarding the net contribution of a Turkish guest worker over his lifetime. According to his research, a young working immigrant contributes a net present value of US$ 23,500 to Swedish government.

Access to Energy

Compared to aging Europe, Turkey is not only rich in terms of human energy but its strategic location also plays a major role concerning the natural energy resources. Europe demands more and more energy every single day, and according to European Energy and Transport Trends, Europe will demand 160%

more natural gas throughout the next thirty years. Currently, Russia plays the major role in providing Europe's natural gas demands. Although Russia supplied 67% of European gas in 2000, this amount will certainly drop down to lower levels, as low as 35% in 2020's. In this regard, Central Asia, and the Middle East will play a more critical role in the necessity for the expansion in energy supply sources. Additionally, Europe will also need to diversify the energy transfer paths for a safer access to its energy needs.

Considering this background, it is the essential for Europe to build a closer relationship with Turkey, in order to diversify the sources that supply the energy and ensure the path of access. Turkey's location plays a critical role, serving as an energy corridor connecting East to West, as well as the North to South, and bridging the Middle Eastern and Caspian energy to Europe. In short, Turkey has already been an energy center and its significance has been growing as new international projects that are critical for the future of the area emerge.

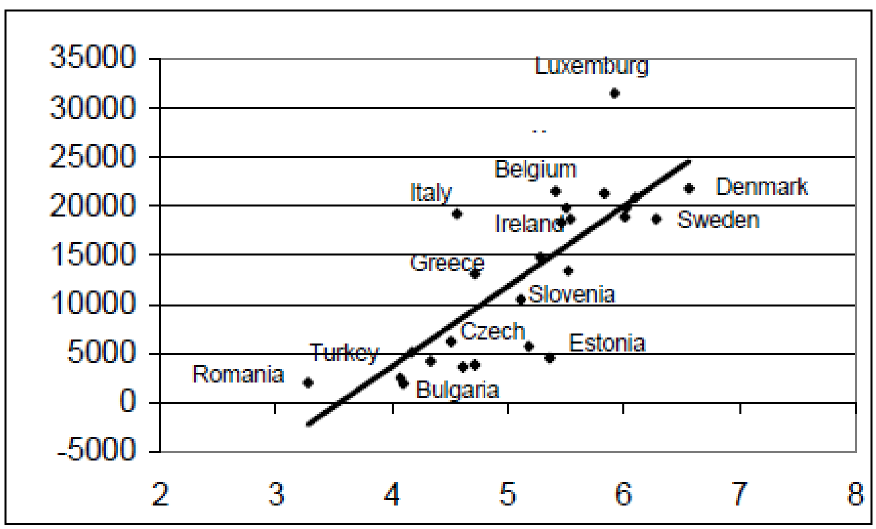
A project that will have geopolitical consequences would be the 1730 kilometer-long recently running Baku-Tbilisi-Ceyhan (BTC) delivering crude oil from Azerbaijan to Ceyhan Port in Turkey, which is capable of transporting 50 million metric tons per year. It is crucial to note that this project that is bringing almost 1 billion barrels per day to Turkey is actually not dependent to OPEC countries and Russia.[xlii]

After the projects like (BTC) and the pending projects such as Nabucco, which will be channeling Caspian natural gas to Europe, it is anticipated that Ceyhan port of Turkey will replace Rotterdam in transporting energy resources to international markets.[xliii] Therefore, as a member state, Turkey would support the security of access to energy as well as the diversification supplies once it becomes a member state.

Chapter 4: Conclusion

In fact, the reason why the EU delays the accession talks and negotiations with Turkey is not due to the economic weakness of Turkey. Convergence of the candidate countries' economies is not a pre-requisite of membership, even if the countries have unemployment or regional income disparity problems like Turkey does. As considerable amount of evidence shows, economic progress is an expected result of honest institutions and sophisticated social capital (as seen from the graph below).

Correlation between GDP per capita and Quality of Public Institutions [xliv]



Source: WEF (2003) and authors' calculation

Further, corrupt institutions and weak social capital of the country will cause integration problems in the EU internal market that is becoming more competitive every single day. As indicated earlier in this project, income differences between countries disappear very slowly, but they do not serve as an obstacle for membership while corrupt institutions constitute major obstacles in terms of successful implementation of the EU economic criteria. Concerning the quality of institutions, the WEF index considers Turkey to be more advanced than Romania and comparable to Bulgaria. However, in the long-term, receiving aids by the EU, Turkish institutions can benefit significantly under EU market competition.

The European social welfare form, excessive regulation with massive monetary transfers to poorer members has been under constant pressure ever since. It does not even encourage the economic progression. However, there is only one case of success in which budget transfers were actually useful: Ireland. Besides taking advantage from the EU redistribution, Ireland also benefited from the attraction of foreign direct investment, implementation from significant tax changes and investing in education and technology.

I personally do not believe that the EU should absorb all the third world countries and try to make them a better one, as it is not realistic and it does not reflect the true goals of the EU. However, Spain at the beginning of the 1970s was not an eligible country to join the EU. But Spain has changed tremendously and permanently and in today's union, it is an indispensable member. If the chance is given, I have no doubt that so will Turkey.

Summary of Capstone Project

European Union is a unique financial and political partnership composed of 27 sovereign states who are working together for the benefit of all their citizens. It was established following the Second World War, initially aimed at stimulating the economic cooperation and tie European countries to one another through trade. Therefore, they are economically dependent on each other due to bilateral trade. Since then, the EU became a huge single market adopting euro as its common currency. As the EU continued to expand, it was necessary for the candidate states to fulfill economic and political criteria in order to become a part of the union.

Currently the EU got over the worst days of the Eurozone crisis in general and has been facing a mild recession with signs of stabilization. Due to decreasing growth momentum and low confidence, the real GDP of the EU is estimated to drop by 0.3% in the Eurozone towards the end of 2012. At the same time, besides Belgium, Greece, Spain, Italy, Cyprus, Hungary, the Netherlands, Portugal, and Slovenia, the growth is expected to be positive. Therefore, economic convergence is still in process; however, is nowhere close to being done. With inflation declining only gradually, the EU is cruising through a crisis slowly, but currently still in it.

The longest and still ongoing enlargement negotiation process of the EU is the one with Turkey and Turkish accession talks have been around since 1950s. Unlike any other EU country, Turkey faced record pace growth levels, surpassing

China's GDP growth in the first quarter of 2011. Decreasing inflation, public debt at manageable levels, relatively lower unemployment levels compared to some EU countries, Turkish economy wants to prove that it is currently a good fit for the EU single market, although there will be some costs for joining the EU. Implementing the whole body of law, will cause both economic and political costs since the laws will be questioned by other parties and the ruling party will be blamed for accepting and implementing some of the laws. In addition, once Turkey is accepted as a member state, Turkish business would need to be privatized and liberalized. This also can cause issues since so many people would be opposed to the idea of privatizing government businesses. Finally, the most efficient sector working in Turkey, agriculture would also be affected negatively by the policies Turkey would need to adopt.

Turkish membership talks still continue and Turkey is still not a member because the EU has major fears regarding the financial effects following a Turkish membership. The EU believes that Turkey is too big of a country and relatively too weak of an economy compared to other members. Additionally, the free travel of Turkish workers within the EU, especially to the industrialized countries is a huge financial concern for the industrialized member states. According to the financial analysts, Turkish accession is also regarded to have too much cost in terms of money transfers that would be made to Turkey after the accession. Besides from the financial implications which are predicted negative, the EU does not expect to collect worthy benefits from the bilateral trade between Turkey and the EU. The EU also believes that EU businesses investing in Turkey will not be privileged just because Turkey is a member of the EU.

Although the public opinion of majority of the EU countries is against the Turkish accession, it is crucial to consider the positions of some relevant actors. Until the presidency of Sarkozy, France was in favor for Turkish accession. Similarly, until CDU, led by Angela Merkel, joined SPD to form a coalition government in Germany, SPD was in favor for Turkish accession. Greece was an ardent opponent of Turkish membership; however, its position changed tremendously in the recent years. Although the Greek public opinion is still slightly against Turkish accession, the recent Greek governments believe that Greece can solve its problems with Turkey though EU enforcement, under EU authority. Unlike the other member states, England, under both previous and current Prime Ministers, has been concerned with the security issues and wanted to expand the EU borders and include Turkey.

In order to predict the possible financial impacts of Turkish accession, I have considered the most recent EU enlargement, the cases of Romania and Bulgaria. These two countries had weaker economies compared to the EU average and were terribly affected by the financial crisis yet showed signs of convergence despite the ongoing economic crisis. The biggest problem of these two countries was corruption in the government which held the institutions from running smoothly. This was also a problem for Turkey and is one of the biggest reasons why Turkish economy could not transform into an elite level of economy. Although these two countries faced a decrease in the GDP growth and employment due to the economic financial crisis, the EU accession decreased the negative implications though increased trade and cooperation. Once these two counties get rid of corrupt governments with the help of the EU, their growth will be sustainable.

Although EU has fears born out of a suffering from negative financial implications from a Turkish accession, EU will be able to collect many benefits once Turkey is a member state. First of all, when Turkey becomes an EU member and its institutions face EU encouraged reforms, it will definitely attract more foreign capital. Besides investment, bilateral trade will also increase since both sides would get rid of technical barriers and tariffs on agricultural products. Turkish accession will expand the market; create job openings and a market for EU products. In particular, excess agricultural products that are sold at a very low price would find a market to be sold at higher places. Immigration is a feared financial consequence of Turkish accession; however, several simulations point out that the EU can benefit from this in a number of ways. Migration of Turkish youth within aging Europe and the monetary contribution effect of those immigrants over their lifetime to the countries they lived in are expected as positive financial implications. Lastly, being an emerging energy port of the world, Turkey would be able to provide safer energy access to the EU than Russia, who cut of the energy supply for political reasons in the past.

Although EU would be able to benefit from Turkish accession in many ways, Turkey does still not have an elite level economy and has to sustain its current growth to become one. The EU should not accept countries that could be damaging its already volatile economy although it did accept countries that were not in the level of the member states. Overall when we look at this possible accession from Turkey's perspective, budget transfers and short-term bilateral trade implications are not going to turn Turkey to an industrialized economy. However, as seen from many literatures, what lies behind sustained economic growth is a government with efficient institutions. EU could encourage Turkey to reform and establish less corrupt and therefore more efficient operating institutions and this could transform Turkey into a better economy.

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