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Economic Implications of Turkish EU Membership: The Advantages of Tying One's Hands

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1. Introduction

This paper can be considered as a stock-taking exercise that brings together the existing findings on the potential costs and benefits of EU membership for both Turkey and the EU. Given that the EU-Turkey customs union has been in place since 1996, it will focus mainly on post-customs-union issues that would affect both parties. As far as Turkey is concerned, we focus on the economic impacts of EU membership that are likely to result from compliance with the so-called EU conditionality. Because EU conditionality requires compliance with the *acquis communautaires* and the Copenhagen criteria, EU membership is likely to have significant effects on the Turkish economy mainly through 3 channels: (i) further market integration in the context of the Single Market; (ii) change in the macro-economic policy framework; and (iii) change in the economic governance structures. On the other hand, Turkish membership will affect the EU mainly through 2 channels: budgetary contributions and migration.

For Turkey, the costs of EU membership would arise from structural adjustment and the adoption of EU policies/standards that may or may not be optimal. The benefits, on the other hand, may arise from the adoption of a rule-based economic policy framework, further market integration, and net receipts from the EU budget. We examine evidence from Turkey, Spain, Portugal, Greece and Ireland to ascertain the effect of membership on Turkey. We also examine the budgetary and migration effects of Turkish membership on the EU. Overall, we suggest that the impact of membership is likely to be positive for both parties, but the risks and returns are

associated. In other words, Turkey stands to gain more than the EU but it is also the party that will be faced with higher adjustment costs.

We first discuss the costs of EU membership for Turkey in section 2. We identify three types of cost: (i) the cost of reduced choice for constituents; (ii) the cost of reduced policy autonomy for policy makers; and (iii) regulatory costs. We argue that these costs can be substantial but we also argue that they must be set against the cost of policy failures under the alternative to EU membership. The examination of the 1990s from this perspective suggests that policy autonomy and/or a wide choice set does not necessarily lead to the choice of optimal policies. Therefore, the costs of EU membership must be discounted with the cost of sub-optimal policies that may be associated with the non-membership option.

Then, we move to the benefits of EU membership in section 3. We argue that EU membership is likely to produce better outcomes in terms of economic growth and income distribution. We verify this argument by evidence indicating that Ireland, Portugal and Spain have achieved better economic outcomes after they had joined the EU. The Greek case will be discussed as an exception where performance after EU membership was lower than the historical trend. In this section we also demonstrate that EU membership will have at least a neutral and probably a positive effect on income distribution.

In section 4, we examine the impacts of Turkish accession on the EU. We demonstrate that the cost of Turkish accession will be mainly of a budgetary nature. The cost due to migration is likely to be very small, but it will be borne by low wage-earners. Finally, in section 5 we highlight the main findings and draw attention to the need for further research.

2. The Relative Costs of Discretion and EU Membership

The costs of EU membership can be examined under three headings. First, there are costs that emanate from reduced choice for constituents, which EU membership may entail for two reasons. On the one hand, membership requires adoption of common

policies and standards that are very difficult to change. A candidate country must adopt the *acquis communautaires* and it can hope to change it only if it can secure a qualified majority in the Council of Ministers and sufficient support in the European Parliament. On the other hand, EU membership may lead to convergence of national policies towards the lowest common denominator as a result of competition in the single market. True, there are EU rules that set minimum standards in some policy areas such as environment, employment protection, health and safety at work, etc. However, these standards themselves also reduce the choice set because one size does not necessarily fit all. Because of these adverse effects on the choice set, EU membership may lead to deterioration in social welfare.

A second category of membership costs may arise from reduced policy autonomy for policy makers. Reduced policy autonomy is a result of tying one's hands with EU rules, policies and institutions that may be incongruent either with the preferences of the policy makers themselves or with the structural requirements of the national economy. To the extent that this is the case, EU membership reduces social welfare as policies that may be optimal for the candidate country has to be given up in favour of sub-optimal policies required by EU membership.

Finally, EU membership may also be conducive to a higher level of regulatory burden in the new member country. EU rules concerning environmental protection, health & safety at work, social protection, product safety, competition, etc. may require compliance with higher and therefore more costly standards. Such requirements add to the regulatory and social costs of production and may lead to an increase in unemployment. On the one hand, the higher cost of production induces firms to shed labour with a view to reduce average costs. On the other hand, regulatory burden may accelerate the failure of relatively less competitive enterprises and thereby lead to further increase in unemployment. Unless EU membership generates employment opportunities that would match the increase in unemployment, social welfare in the new member state will deteriorate as unemployment constitute a deadweight loss.

Both economists and political scientists are aware of these potential costs in the context of regional integration in general and European integration in particular. For example, students of European integration and Europeanization hypothesize that the

cost of adopting EU rules and institutions would increase as the ‘goodness of fit’ between the domestic and EU political structures decreases. (Risse, Cowles and Caporaso, 2000). Another factor that is likely to increase the membership costs is the strength of ‘institutional veto points’ that, according to Haverland (2000), are able to block policy decisions favouring EU membership. (See also Bulmer and Radaelli, 2005).

However, analysis based on ‘goodness of fit’ or ‘institutional veto points’ have difficulty in explaining the high level of policy reform that candidate countries have undertaken during the Mediterranean and Central/Eastern European enlargements. In other words, why did countries with a low degree of ‘goodness of fit’ prove willing to undertake high levels of convergence reforms as a precondition for EU membership? The failure to explain this willingness stems from the fact that the Europeanization literature tends to ignore the costs of inefficient rules and institutions that exist before accession. In other words, there is an implicit assumption that the range of policies and the quality of the institutions that exist before EU membership are optimal for the country at large or at least for the majority of the constituents. However, this is an unrealistic assumption because it ignores the possibility that policy choices made before EU membership may be sub-optimal and that EU membership may be the only avenue for escaping the sub-optimal predicament. To the extent that this is the case, accession costs must be discounted to reflect the cost of maintaining the *status quo* as an alternative to EU membership.

Throughout the 1980s and 1990s, the Turkish economic policy framework was driven by a symbiotic relationship between discretionary policies and rent-seeking behaviour. As a result, Turkey’s macroeconomic performance has deteriorated and the prospect of EU membership has become increasingly problematic. (Ugur, 2004). One indicator has been the decline in average growth rates and the increase in the volatility of economic growth. As can be seen from Table 1, the average growth rates have declined from 4.76% in the 1970s to 3.93% in the 1990s; whereas the coefficient of variation has increased from 51% to 137% over the same period.

**Table 1: Declining Growth Rates and Increasing Volatility in Turkey:
Decade Averages**

Decade	1. Average growth (%)	2. Standard deviation	3. Coefficient of variation (2 / 1) x 100
1970-79	4.76	2.43	51%
1980-89	4.04	2.70	67%
1990-99	3.93	5.37	137%

(Calculated from GDP data at 1987 prices)

The negative impact of volatility on GDP growth may be more significant than the falling growth rates reflected in Table 1. According to a recent work by Hnatkovska and Loayza (2005), a one-standard-deviation increase in volatility lowers average per-capita income growth by 2.2 percentage points. The authors also found that the negative association is stronger in countries with weak institutional quality and procyclical fiscal policies. This finding is supported by cross-country studies reviewed by the IMF, which demonstrate that macroeconomic instability (measured as the standard deviation of GDP growth rates) is inversely related to institutional quality. According to IMF (2003: 104-108), the volatility of GDP growth would fall by approximately 25% should a country's institutional quality improve by one standard deviation.

The evidence summarised above suggests that 'choice' and 'policy autonomy' outside the EU had come at a high cost for Turkish citizens: The cost consisted of poor institutional quality, fiscal indiscipline, higher volatility/uncertainty, and falling growth rates throughout the 1990s. (On institutional quality, see Ugur, 2004. On fiscal indiscipline, see World Bank, 2001 and Sayistay 2000). In other words, the availability of 'choice' and 'policy autonomy' does not guarantee that optimal policies are chosen and implemented. On the contrary, policy autonomy under a defective institutional setup can in fact lead to a combination of discretion and rent-seeking behaviour, which generates recurrent crises, lower growth rates and worsened income distribution.

A rough estimate of the cost of discretion and rent seeking in Turkey can be derived from the evidence indicated above. Suppose that Turkey had been able to join the EU in 1990 and that membership had led to a one-standard deviation (approximately 16%)

improvement in Turkey's institutional quality. Then, according to IMF (2003), the standard deviation of Turkish GDP growth in the 1990s would have been reduced by 25%. In terms of standard deviation, this is equivalent to $25/16 = 1.56$ standard deviations. Recall that Hnatkovska and Loayza (2005) report that a one-standard deviation fall in volatility is conducive to 2.2 percentage point increase in the GDP growth rate. Then the GDP growth in Turkey would have increased by $(1.56) \times (2.2) = 3.43$ percentage points over and above the actual growth rates recorded in the 1990s. Finally, given that population growth in Turkey was 1.83% per year over the 1990s, the per-capita income growth would have been $3.43 - 1.83 = 1.60\%$ higher than what was the case. Then, over 10 years, the average person in Turkey would have been better off by 17.2%. [Note that the compound extra growth over ten years is given by $(1 + 0.016)^{10} = 17.2\%$].

Therefore, it was not surprising to observe that, towards the end of the 1990s, large sections of Turkish society have begun to question the desirability and sustainability of the discretionary policy regime. This tendency has reached a zenith with the onset of the 2001 financial crisis, which led to a fall of 7.5% in Turkish GDP. The Turkish government had to sign a stand-by agreement with the IMF, which provided for a credit of US\$ 15 billion in return for structural reforms and fiscal tightening. As Onis (2005a) has indicated, the strictness of the IMF conditionality after 2001 has not led to massive waves of protests against the IMF. Instead, there was a tendency to blame the domestic political system for long-standing economic problems that culminated in the 2001 crisis. In other words, the Turkish public acted rationally and rejected a system of discretion and rent-seeking that had been generating lower growth rates and higher volatility. Interestingly, just at the same time, public support for EU membership reached its highest level of 74% in November 2001 when the negative impact of the crisis was at its highest (Carkoglu, 2004: 23).

These high levels of support were recorded against a background of strong evidence that EU membership would imply significant loss of policy autonomy and that the EU conditionality had to be spelled out in detail in a National Programme for the Adoption of the *Acquis* (NPAA). In addition, the support for EU membership was displayed despite the fact that veto points such as the military and the nationalist-statist elite were trying to mobilise nationalist support for their anti-EU stance on

sensitive issues in EU-Turkey relations – namely the role of the military, the Kurdish problem and the Cyprus problem. This evident public support for rule-based policy-making (including economic policy) has been essential in shaping the electoral success of the Justice and Development Party (AKP) in the election of November 2002.

The analysis above suggests that the cost of EU membership cannot be assessed without taking into account the cost of the *status quo* - i.e., the cost of remaining outside the EU. While outside the EU, the Turkish economy experienced falling growth rates, increased macroeconomic instability, and high levels of inflation that averaged at about 60% per year. As a result, the income gap between Turkey and the EU average has widened, income inequality within Turkey has increased, and Turkish politics has become more unstable, leading to government tenure of 1 year on average in the 1990s. These are significant costs that must be compared with the cost of reduced choice and reduced policy autonomy of EU membership. Such comparison cannot be undertaken on the basis of hard evidence because the cost of reduced choice and reduced policy autonomy cannot be quantified.

Nevertheless, a qualitative assessment is possible. A qualitative assessment suggests that structural differences between the Turkey and the EU would increase the cost of required policy reform. However, it is also true that a credible prospect for EU membership itself reduce the costs of policy reform. When EU membership emerges as a government policy, the economic and political actors likely to be affected will adjust their future expectations accordingly. If the prospect is credible, economic and political actors in favour of EU membership will increase their support to the incumbent government. On the other hand, actors opposed to EU membership will realise that their campaigns against EU membership are now less likely to induce the government to change its mind. Faced with this reduced chance of success, actors opposed to EU membership will begin to take measures that will reduce their adjustment costs rather than maintain a fight that they are less likely to win. As a result of stronger support from pro-membership actors and weaker resistance from anti-membership actors, the government will be able to carry out policy reforms at lower costs.

Such an outcome would depend crucially on two factors: (i) the extent to which the government perceives EU membership as an indispensable policy goal; and (ii) the extent to which the EU is committed to take the reforming country in. In the past, the Greek, Portuguese and Spanish governments as well as the governments of Central and Eastern European countries (CEECs) have perceived EU membership as an anchor that would make the democratisation and transition reforms irreversible. In turn, the EU was committed to integrate these countries as a means of reducing the security risks that may have arisen from political instability and divergent foreign policy orientations in its periphery. Therefore, in the context of previous enlargements, prospective EU membership proved to be a *credible commitment mechanism*. As a result, the economic policy frameworks and institutions in these countries have been subject to significant and sustained change. (For detailed studies of Europeanization in Greece, Portugal and Spain, see Featherstone and Kazamias, 2001; for Europeanization in CEECs, see Schimmelfenning and Sedelmeier, 2005). Therefore, the adjustment cost of EU membership for Turkey can be expected to fall as the credibility of Turkey's membership prospect increases.

3. Economic Benefits of EU Membership: Lessons from Earlier Enlargements

In sections 2 above, we analysed the reasons as to why the costs associated with EU membership may not be as high as usually assumed. In this section, we examine some evidence suggesting that tying one's hands under the *acquis communautaires* may produce economic benefits.

The traditional literature on the impact of regional integration focused on the trade-creation and trade-diversion effects, using comparative static methods of calculation. The pioneering study by Viner (1950) concluded that regional integration would lead to an increase in welfare if the trade-creating effect dominates the trade-diversion effect. Empirical studies on the European Union found out that the welfare effect of the EU-wide customs union would be small – usually less than 1% of the benchmark GDP. (for a review of the early empirical findings, see Balassa, 1975). Studies of the EU-Turkey customs union obtained similar results: the welfare gain from the customs union would be between 0.5 – 1.5 % of the benchmark GDP, depending on the accompanying tax reforms and other structural reforms. (Harrison et al, 1996).

These findings suggest that the gains from regional integration are likely to be small and conditional on a number of reforms. Therefore, they raise the question as to why countries choose to join regional blocs and why regional blocs have proliferated in the 1990s. To explain this conundrum, a new generation of research on regional integration suggests that there may be additional effects of regional integration that are not captured in the traditional approach. One of these effects – the dynamic effect of integration over time - has been noted by earlier studies but it was considered as too uncertain to be taken seriously. R. Baldwin attempted to capture this effect by examining the effect of static gains on investment and future growth. In that widely-discussed paper, Baldwin (1992) demonstrates that the static gains from integration will act like a positive shock to the capital stock – leading to higher growth rates in the future. Although this was an innovative method of trying to capture the dynamic effect, it overlooks other likely effects of the single market on economic growth.

Fernandez (1997) attempts to identify what he describes as non-traditional gains from regional integration. Among those, two are particularly relevant to Turkey's integration in the EU: *signalling* and *policy credibility*. In this context, signalling is essentially a method of overcoming the negative impact of the imperfect information that investors (foreign and domestic) may have about the domestic economy. By entering a regional bloc, the government signals to investors that the economy is resolute enough to cope with competitive pressure in a customs union (or a single market in EU case). Policy credibility, on the other hand, refers to government attempts to overcome the time-inconsistency problem by importing the trade policy (and other economic policies in the EU case) of the regional bloc. Fernandez suggests that both signalling and policy credibility may have positive effects on the rates of investment and growth.

We think that this perspective may be quite relevant for explaining why relatively less developed countries (e.g., Ireland in the 1970s; Greece, Portugal, and Spain in the 1980s; CEECs in the 1990s; and Turkey in the current round) may be interested in joining a regional bloc established by more developed countries. Fernandez's analysis would suggest that these countries, after joining the EU, will outperform their historical trends in terms of economic growth. This will be due to higher levels of

foreign investment (the signalling effect), higher levels of efficiency (policy credibility effect), and less risk of policy failures (policy credibility effect). As can be seen, these expected benefits of regional integration overlap with the benefits of Europeanization referred to earlier. In other words, by transforming the policy framework and the quality of the information about that framework, Europeanization can lead to economic benefits. We test this argument by reviewing some evidence on the growth performance of Greece, Ireland, Portugal and Spain before and after their accession to the EU.

**Table 2: Per-Capita Income Growth:
10 Years Before and After EU Membership (%)
(EU-15 in brackets)**

	Membership Date	Decade before Membership	Decade after Membership
Ireland	1973	3.7 (3.9)	2.4 (1.6)
Portugal	1986	2.0 (2.0)	3.6 (1.9)
Spain	1986	0.8 (2.0)	2.7 (1.9)
Greece	1981	3.6 (2.5)	0.7 (2.3)

(Source: ABN-AMRO, 2004: 13)

Table 2 shows that Portugal and Spain have outperformed not only their historical trends, but also the EU-15 trend. Compared to the pre-accession decade, Portugal's per-capita income grew 1.6% and that of Spain grew 1.9% faster each year. This means that, over 10 years, the Portuguese and Spanish per-capita income was 17.2% and 20.71% higher than what would have been if the countries had remained outside the EU. After membership, the per-capita income of these countries grew faster than the EU-15 too. As a result, the income gap between Portugal and EU-15 narrowed by 18.3% and that between Spain and EU-15 by 8.3%. In the case of Ireland, there was a small slow down in the per-capita income growth rate after accession, but because the Irish per-capita income still grew faster than the EU, the per-capita income gap narrowed by 8.3% too. When we look at Greek performance, we see deterioration not only relative to the historical trend but also relative to the EU. As a result, the average Greek person suffered deterioration both in historical terms and in terms of the income gap with the EU-15.

It is interesting to observe that there was a similar trend with respect to employment performance too (Table 3). Ireland, Portugal and Spain appear to have reversed the negative employment growth recorded before EU membership into modest positive growth after membership. In addition, employment creation in these countries was higher than EU-15. It is important to indicate here that the gain in employment creation has occurred despite the negative impact of the structural adjustment that these countries had to undergo after membership. In contrast, the Greek performance in terms of employment creation mirrored the performance of per-capita income: Greece suffered from deterioration not only in historical terms but also relative to EU-15.

**Table 3: Employment Growth:
10 Years Before and After EU Membership (%)
(EU-15 in brackets)**

	Membership Date	Decade before Membership	Decade after Membership
Ireland	1973	-0.1 (0.3)	0.5 (0.0)
Portugal	1986	-0.1 (0.1)	0.7 (0.5)
Spain	1986	-1.5 (0.1)	1.6 (0.5)
Greece	1981	0.7 (0.4)	0.3 (0.8)

(Source: ABN-AMRO, 2004: 14)

For Turkey, the ABN-AMRO report estimates an annual GDP growth of 4.9% from 2004-2013, and 5% from 2014-2024 (after Turkey is expected to join the EU). These growth rates are higher than the historical trend reflected in Table 1 (which were on a falling trend from 4.76% in 1970s to 3.93% in 1990s) and much higher than the estimated 2% growth rate for EU GDP. Obviously, the usual caveats apply to these figures. First, the estimated growth rate might not be achieved due to unforeseen developments in the world economy or because some of the underlying assumptions might not hold. Secondly, the Greek case suggests that EU membership may not necessarily yield the expected benefits. Finally, the EU may fail to digest the enlargement towards the CEECs and/or Turkey – imposing a negative effect on Turkey’s growth potential. Nevertheless, one can still derive an unqualified

conclusion from the existing evidence: EU membership delivers relatively better outcomes when the external environment and EU policy are controlled for.

That the Greek case was an exception, however, raises the question as to whether all new members are likely to benefit from the signalling and credibility effects of EU membership. This question can be answered only partially. The existing literature suggests that the extent of transformation in Greece has remained highly limited and unstable between 1981 (the accession date) and mid-1990s. This was partly due to the fact that EU conditionality at the time was much less strict and political considerations (anchoring the new democracy) have led the EU Council to take a lenient approach towards Greece's pre-accession convergence. However, the main reason has been the persistence of clientelism and the discretionary economic policy framework associated with it. (See, Ioakimidis, 2001; Patsouratis, 1993; and Sotiropoulos, 1995). Under these conditions, consecutive Greek governments remained caught in what Allison and Nikolaidis (1997) describe as the Greek paradox of inflated promises and poor performance. The implication for Turkey is obvious: the expected benefits of EU membership will materialize only if reforms are implemented in practice and that they constitute a starting point for continued transformation.

Although the evidence examined above tends to indicate a positive effect of EU membership on growth, there have always been concerns about negative effects on income distribution. These concerns are based on the observation that the EU is essentially a project in market integration. Given that market integration may be more favourable for better-endowed economic agents, EU membership may lead to a worsening of income distribution. We can test the relevance of this argument by examining the income distribution trends in the group of countries examined above.

Table 4: Indicators of Income Inequality: Gini Index^a

	Early 1980s	Mid-1980s	Early 1990s	Mid-1990s	Year 2003
Greece	36.6	36.1	32.6	34.5	35.0
Ireland	36.6	38.8	36.8	30.9	31.0
	1973 = 37.2				
Portugal	35.7 ^b	34.8 ^{b,c}	34.7 ^d	36.8 ^d	38.0 ^d
Spain	35.6	25.9	34.5	35.2	30.3
Turkey	48.5	44.0	n.a.	45.7	45.0

Notes:

a: Figures for years nearest to the beginning, middle and end of decade, except 2000. Simple averages, when more than one Gini indices are given for a year.

b: Continental Portugal only.

c: From TUSIAD (2000: 119)

d: Including overseas territories.

(Source: UNU/WIDER Database)

One conclusion that can be drawn from Table 4 is that income inequality has fallen substantially in Ireland and Spain after these countries joined the European Union. The other conclusion is that the decline in income inequality has been negligible in Greece whereas income inequality in Portugal has increased after EU membership. These trends do not allow us to claim that EU accession has led to a decrease in income inequality across all members. Nevertheless, the evidence suggests that income inequality in all EU members lower than income inequality in Turkey at the end of the comparison period. In 2003, income inequality in Turkey was approximately 28.5% higher than the income inequality in Greece, 45% higher than income inequality in Ireland, and 50% higher than income inequality in Spain. Income inequality in Turkey was even higher by 18% than Portugal, including overseas territories.

In addition, there is strong evidence suggesting that taxation and transfer policies in Turkey have had a minimal effect in reducing the pre-tax, pre-transfer levels of income inequality. Whereas distribution policies in core EU member states tended to reduce income inequality by 32-52 percent in mid-1990s; in Turkey the effect was limited to 5.7% only. This finding is based on comparison over long periods of 10-20

years, and not a single-shot comparison over a particular year. (TUSIAD, 2000: 118-126).

Against this background, we would argue that EU membership is likely to reduce income inequality in Turkey for a number of reasons. First, under EU competition policy rules, the government's ability to provide subsidies to exporters and firms in strategic sectors will be curtailed or overturned. Therefore, there will be scope for redistribution towards low-income groups. Secondly, EU membership will involve redistribution through structural funds and the common agricultural policy (CAP) funds – both of which may benefit low-income groups. Third, EU membership will either improve social protection or ensure better implementation of the existing Turkish legislation in this area. Finally, Europeanization will have a demonstration effect, enabling lower-income groups to strengthen their demands for a fair share of the income. Therefore, it is not surprising to observe that 71% of the Turkish respondents to a recent *Eurobarometer* survey considered EU membership to be a 'good thing' in 2004 (Eurobarometer, 2004: 4).

4. Impact of Turkish Membership on the EU

The economic impact of Turkish accession on the EU is likely to be small for three reasons. First, EU imports from Turkey account only for about 3% of total EU imports. Secondly, about 70 percent of Turkish agricultural exports already enter the EU without tariffs or quantitative restrictions. Therefore, Turkish membership will not imply a significant shock to the EU economy through the trade channel. Third, Turkish accession does not affect the existing economic policy framework in the EU. Nevertheless, Turkish accession will have some distributional effects on the EU through two channels: the EU budget and migration from Turkey. In this section, we will elaborate on these distributional effects and the factors that may reduce their significance.

It is quite difficult to estimate the net budgetary implications of for a number of reasons. First, the amount of net budgetary transfers will depend on the future shape of the CAP, the rules governing the distribution of structural support, and the rules governing the member states' contributions to the EU budget. Secondly, the amount

of agricultural and structural support to be received by Turkey will depend on the change in the structure of the Turkish economy. EU transfers will decline as regional disparity and the share of the Turkish agriculture in total output decline. Finally, the amount of Turkey's contributions to the EU budget will not be known until the EU's financial perspective for the post-2014 period is in place.

Given these sources of uncertainty, it may be better to begin with the simplest scenario in which we assume Turkey joins the EU in 2015 and the rules of the game remain the same. Under this scenario, Turkey would contribute to the EU a budget an amount equal to 1.2 per cent of its GDP, which is assumed to be 4 per cent of EU GDP in 2015. Under this assumption, Turkey's budgetary contribution would be equal to $0.012 \times 0.04 = 0.048$ per cent of EU GDP in 2015. Dervis et al (2004) estimate that Turkey's receipts from the EU budget in this scenario would amount to 0.25 per cent of EU GDP in the same year. Therefore, net budgetary transfers to Turkey would be about 0.20 per cent of EU GDP [$0.25 - 0.048 = 0.202$]. Given that EU GDP in 2003 was Euro 9,716 billion and assuming that EU GDP would increase by 2 per cent per year until 2015, then the net budgetary transfers can be calculated as follows: $0.002 \times [9716(1+0.02)^{12}] = 24.6$ billion Euros.

It must be indicated that this is an upper limit because it is based on the assumption that the rules governing CAP and structural fund support would remain the same. However, there are indications that structural fund support will be capped at less than one per cent of the recipient country's GDP in order to take account of the recipient country's absorption capacity. For 2005, the new member states' absorption capacity is estimated to be 0.69 per cent of their GDP. Taken this as a benchmark, the State Planning Organisation of Turkey estimates that Turkey's net budgetary receipts would be about Euro 5.9 billion. If the cap is set at one per cent of Turkey's GDP, the corresponding amount is estimated to be Euro 7.8 billion. If the time horizon is extended to 2020, net transfers would increase to Euro Euro 10 billion (SPO, 2004: 33-34).

Another way of estimating the budgetary implications of Turkish accession is to use the financial packages that the EU has agreed in the last enlargement. Following such an approach, Hughes (2004) estimates that the *gross* budgetary transfers to Turkey in

2015 can be expected to be Euro 10.5 billion. According to SPO (2004), Turkey's budgetary contributions in the same year would be Euro 4.9 billion. Therefore, *net* budgetary transfers to Turkey would be $10.5 - 4.9 = 5.6$ billion Euros – which is very close to the SPO estimate of Euro 5.9 billion.

The estimates presented above suggest that net budgetary transfers to Turkey could range between 5.6 – 24.6 billion Euros per year. This sum is a significant amount, but relative to EU GDP it represents a very small percentage, which is between 0.05 – 0.2 per cent. In addition, the net budget transfers to Turkey are more or less equal to the total budgetary transfers to the 10 new members. Therefore, there is no *a priori* economic reason to suggest that the budgetary cost of Turkish accession is not manageable. There is however a political issue here as the budgetary cost of integrating one country (Turkey) is equal to the budgetary cost of integrating ten countries from Central and Eastern Europe.

However, there may be a positive effect on EU fiscal balances as a result of Turkish migration. In a comprehensive survey, Krieger (2004) establishes that potential migrants from Turkey are better educated than those from Central and Eastern European members and tend to be drawn from the 15 - 39 year age bracket. Brücker (2002: 27) reports that net tax payments (i.e., the balance between tax payments and social security transfers plus government expenditures) by migrants are positive over the life cycle if immigrants' age is between 11 - 48 years. The net contribution of a representative immigrant over the life cycle is around Euro 50,000. These findings are parallel to those of Storesletten (2003), who finds that the net present value of the contribution of a young working immigrant to Swedish public finances is US\$23,500.

This brings us to another issue with evident political connotations in EU-Turkey relations: the impact of Turkey's accession on migratory flows into the EU. The issue occupies the public debate in two ways: (i) the number of Turkish migrants expected to move to core EU countries after the introduction of free movement; and (ii) the impact of Turkish migrants on wages and employment chances of the incumbent labour force.

One estimate of migration from Turkey to EU-15 is provided by Lejour et al (2004: 35-36), who predict that the migration potential (which does not take account of return migration) by 2025 is 2.7 million. This is similar to the number of migrants estimated to move from Central and Eastern European members to EU-15, which is estimated to be 2.9 million. This is equivalent to 0.7 per cent of the EU-15 population in the reference year. Another study by Erzan et al (2004). Assuming that free movement of labour is granted in 2015, Erzan et al estimate net migration to EU-15 to be 1.07 million by 2030. Interestingly, the free movement estimate is lower than a hypothetical guest worker regime estimate, which is 1.83 million by the same year. When migration data for Turkey and cohesion countries (Spain, Portugal and Greece) is used, the net Turkish migration is estimated to be 0.96 million in the case of free movement scenario and 1.92 million in the case of a guest worker regime similar to that implemented by Germany in the 1960s. The highest estimate provided by Erzan et al is a net migration of 2.13 million by 2030, on the basis of an ordinary least square (OLS) estimation for Turkey only.

Krieger (2004) follows a radically different method for estimating the number of migrants from Turkey and Central and Eastern European countries to EU-15. His estimate is based on face-to-face interviews with 15,000 people across the focus countries. Questions were asked to establish the general intention for migration (the 'soft' indicator of migration to EU-15) and the strong intention for migration (the 'hard' indicator of migration to EU-15). The interview results suggest that the number of people willing to migrate from Turkey to EU-15 ranges between 0.4 million (strong intention) and 3.03 million (general intention). This estimate suggests that the number of people who contemplate to migrate under a free movement scenario may be high, but the number of actual migrants is likely to remain small.

We think that this finding is more reliable than the estimates derived from econometric models because it reflects the rationality implicit in migration decisions. Potential migrants will commit to migrate not only on the basis of push and pull factors such as unemployment in the country of origin, wages and employment chances in the destination country, etc. They will also take into account other risks associated with migration, which can include stigmatization, marginalization, and cultural rupture. In fact, the experience of earlier enlargements lends support to this

reasoning. The number of migrants from Mediterranean members such as Greece and Italy remained lower than what was expected at the time (ILO, 1990). Given past experience and the range of estimates reported above, we would argue that the level of net migration from Turkey to EU-15 can be expected to vary between 1 – 1.5 million by 2030. This is hardly an unmanageable flood as it would constitute about one-third of one per cent of EU-15 population and about half of one percent of EU-15 labour force.

Also, there is an extensive range of studies suggesting that the impact of migration on wages and employment chances is usually less significant than what is implied by the policy debate. In fact, some findings suggest that any adverse effect from migration is very likely to be small whereas some others suggest that migration would have a positive effect on the labour market. For example, Smolny (1991) reports that migration into West Germany had positive employment and output effects, and alleviated pressure on wages and inflation. Similarly, Starubhaar and Weber (1994) found that this is the case for Switzerland. Finally, ten empirical studies cited by Brücker (2002: 20) reflect similar results. Nine out of the ten studies show that ‘... a 1% increase in the labour force through migration yields a change in native wages in a range ... between -0.3% and +0.3%.’ These empirical studies also report that individual unemployment risks increase in a range between zero and 0.2%.

A report by the European Integration Consortium (2000) provides similar insights into the likely consequences of free movement within an enlarged European Union. Focusing on Austria and Germany, the Consortium states the following: ‘Against the background of empirical knowledge on the labour impact of migration, the projected flows and stocks of migrants will affect neither wages nor employment in the host countries strongly. ... One should recall that an increase of the foreigner share in one branch by one percentage point reduced wages by 0.25 per cent in Austria and 0.65 per cent in Germany. The risk of unemployment is increased by 0.8 per cent in Austria and 0.2 per cent in Germany.’

These findings enable us to conclude that the negative effect, if any, of Turkish immigration on wages and employment will be very small – much less than 1%. Let us bear in mind that the highest estimates of Turkish migration suggests that the

Turkish migrant stock will constitute only 0.7 per cent of EU-15 population, which is equivalent to 1.1 per cent of the labour force. If we take a less pessimistic view and estimate the number of Turkish migrants at 1.5 million, this will be equivalent to 0.35 per cent of EU-15 population and 0.6 of EU-15 labour force. Taking the worst estimates provided by the European Integration Consortium (2000), the impact of Turkish migration would be 0.3 per cent fall in wages and 0.4 per cent increase in the unemployment risk. These are very small impacts that can hardly be distinguished from zero.

Nevertheless, we must also bear in mind that these risks can be higher for individual host-country workers with very low human capital endowment. We should also bear in mind the fact that the earning capacity of this minority is already low. Therefore, the challenge for EU policy-makers is to find ways for compensating the small number of low-skill workers who are likely to be affected by Turkish migration without falling hostage to demands for suspending free movement of labour indefinitely.

4. Conclusions

The analysis above enables to conclude that tying one's hands through EU membership may be a superior choice compared to the combination of discretion and rent-seeking behaviour that has determined Turkey's poor economic performance in the 1990s. Discretion generates economic instability and delivers lower growth in the long run. It also perpetuates or exacerbates existing inequalities as the clientelistic groups it rewards are generally those who are already better-off in terms of physical or human capital endowment. These costs of discretion and rent seeking have been evident in Turkey before EU membership.

Another conclusion that can be derived is that Turkey will be able to secure benefits from EU membership, provided that the signalling and policy credibility effects of integration are not undermined by political instability and a return to populist economic policies after accession. The potential benefits of EU membership will include both higher rates of per-capita income growth and possible decline in income inequality. The per-capita income growth can be 1.5 – 2.0 percent higher than the

rates of growth that would be achieved under a no-EU-membership scenario. On the other hand, income inequality can be reduced by 5-10 percentage points on the Gini index.

The third conclusion that can be derived from the analysis above is that the benefits and costs of EU membership are correlated. The party that is expected to derive high levels of benefit is also the party that is expected to bear high adjustments costs (or vice versa). The evidence examined above suggests that Turkey is likely to derive significant benefits but it is also likely to bear high adjustment costs resulting from structural change in the economy and from the adoption of new institutions. The EU, on the other hand, is likely to derive smaller economic benefits in return for lower risks. The main benefits for the EU will arise from higher returns on capital invested in Turkey and the positive effect of young and educated migrants on EU GDP and national budgets. The risks faced by the EU are limited to budgetary transfers and very small adverse effects on wages and employment chances of workers with low human capital endowment. A simple cost-benefit analysis based on these dynamics suggests that Turkey's EU membership is likely to be a positive-sum game for both parties.

The final conclusion is a call for caution and further research. Although the estimates reported above incorporate all available information, they should in no way be taken as certain results because they rely on certain assumptions. In addition, some of the estimates are extrapolations, which should be considered as less certain than the model predictions on which they are based. Although these shortcomings do not necessarily invalidate the direction of the estimated effects, they may well reduce the reliability of the reported magnitudes. Therefore, we conclude this chapter by indicating that there is an evident need for further research on sectoral, fiscal as well as macro-level impacts of Turkey's EU membership.

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