



Turkey and the EU Budget Prospects and Issues

**Kemal Derviř, Daniel Gros, Faik Öztrak and Yusuf Iřık
in cooperation with Fırat Bayar**

Abstract

Calculating the cost of Turkish membership for the incumbent members is highly speculative. Not only Turkey, but also the EU are evolving and changing constantly. In addition, one cannot know with certainty what the rules concerning the budget will be by the time of accession. Hence one can only calculate the hypothetical cost under certain assumptions. This paper calculates first what Turkey would receive under the Common Agricultural Policy and the Structural Funds, if it were already a full member today. A second calculation shows what Turkey would receive by 2015 (a likely accession date) if current rules do not change. The main result is that the cost would in either case be rather small in relation to the EU economy (0.2% of EU GDP). EU transfers would have a significant impact in Turkey (amounting to around 4% of its GDP), but would still remain manageable for the EU budget.

Kemal Derviř is former Minister for Economic Affairs, Member of Parliament and Member of the Coordination Board, EDP. Daniel Gros is Director at CEPS. Faik Öztrak is former Undersecretary of the Turkish Treasury and Visiting Professor at Middle East Technical University. Yusuf Iřık is Advisor to Kemal Derviř, and former Head of the Strategic Research Department of the State Planning Organisation. Fırat Bayar is former Associate of the Turkish Treasury and Ph.D candidate at Middle East Technical University.

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EU-Turkey Working Paper No. 6/August 2004

**Kemal Derviş, Daniel Gros, Faik Öztrak and Yusuf Işık
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1. Introduction

The factors that will determine the speed of convergence of Turkish incomes to EU averages are discussed in Working Paper No. 8 of this same series. We present here a brief discussion of the impact Turkish membership would have on the EU budget. How much would Turkish membership cost the then incumbent members? This is a question that is at the same time straightforward and impossible to answer. It is impossible in the sense that the EU is evolving constantly so that it is difficult to predict with any precision what the financial consequences of accession of Turkey, in, say, 2014, would be. However, it is straightforward to calculate how much Turkey would cost the EU budget if it were to enter under present rules.

One may be tempted to argue that the transfers from the EU budget to Turkey will simply be whatever member countries agree that these transfers should be, because they do indeed under the current treaties all have to agree. On the other hand, it would not be possible to negotiate membership with any Turkish government if Turkey is not able to get a ‘fair’ deal, where ‘fairness’ will entail some comparison to other countries that will have joined relatively recently. The three countries on which Turkish negotiators are likely to focus are Romania, Bulgaria and Croatia, assuming that the first two will have joined in 2007, and Croatia some time thereafter. Turkey will be able to accept transition rules of the type accepted by the 2004 accession countries as well as those already accepted by Romania and Bulgaria. And Turkey may even be ready to accept a lengthening of these transition rules reflecting recognition of her size. Turkey will not accept a deal, however, which would set it apart from other member states in a qualitative and lasting fashion. Nor is it actually likely that the EU would propose anything significantly less than fair to Turkey as the experience of Romania and Bulgaria suggests. The principle of equal treatment of member states is deeply ingrained in the EU’s framework – even when it comes to financial matters.

A key factor limiting the degree of freedom of the EU budget is the fact that the financial envelopes are determined in a multi-annual framework called the ‘financial perspective’. The current framework, which was decided among the EU-15 in 2000, and thus long before the current enlargement, runs until 2006. The next framework, which will be negotiated à 25, will run until 2012. By that time Turkey is not likely to have already become a member country so that it will have only a limited influence for the following financial framework, which would run until 2018. Assuming accession by 2015, this would imply that the financial envelope for the first three years of Turkey’s membership would have been decided by the EU-28 (the current EU-25 plus B, R and HR). In this respect, the situation of Turkey might thus resemble that of Bulgaria and Romania, which are likely to join by 2007, so that their first years of membership will also be covered by a financial framework in whose negotiations they were not present.

In terms of negotiations, Turkey would thus be fully part of the EU’s financial framework only during the 2018-2024 round. Given that for all present and former member states it took between 5 and 10 years before they were integrated into all support programmes, it is thus likely that Turkey will benefit fully from the EU’s budgetary support schemes some time after 2020.

What will determine Turkey’s share in the EU budget of the 2020s, are the rules that will *by then* be in effect for everyone else and the level of development reached by the EU and Turkey itself. One cannot

know with certainty what these rules will be and any long-term projections are therefore highly speculative.

In reality, however, the discussion about the financial burden Turkey would represent for the EU budget usually focuses on the current rules. The experience with the current enlargement process suggests that over time the discussion will shift from how much it costs to who will bear the (minor) burden. But this point is still some way into the future. Current circumstances have another impact, however, in that it is usually assumed that the burden would have to be borne by the current EU-15 because it is usually assumed that most of the new member countries will remain net beneficiaries for quite some time to come. By the early 2020s this might no longer be the case, but again it is impossible to forecast with any precision which of the new member countries would no longer qualify for financial support (under current rules) by that date.

The ‘maximum’ that Turkey would receive *after* a transition period under current rules is a ‘starting point’ many analysts have chosen.¹ There are two variants to this approach.

- a) How much would Turkey receive if it were a fully established member today?
- b) How much is Turkey likely to receive under current rules by a likely accession date, e.g. 2015?

The overall calculations are actually quite simple in both cases since the budget of the EU is dominated by two items: Structural Funds (destined for regions with a GDP per capita at PPP below 75% of the EU average) and the Common Agricultural Policy (CAP). The gross receipts of any member country are to a large extent determined by these two items.

2. Turkey in the EU today

If Turkey were a member country today, it could count on Structural Funds allocations, which would be capped at 4% of its GDP as decided at the Berlin European Council. Given that Turkey’s GDP has averaged around €200 billion in recent years, this implies immediately that its allocation would be around €8 billion annually.

It has also been calculated that extending the current CAP to Turkey (with per hectare payments based on current yields) would cost around €9 billion. This implies that the total receipts of a hypothetical Turkish EU member today might be slightly less than €20 billion (Turkey would also receive funding under other programmes). Turkey would then also have to contribute as all other member states to the EU budget. With a current contribution rate of around 1% of GNP (the ceiling for the EU budget is 1.25% of GDP, but the EU spends just slightly above 1% of GDP at present), this would mean around €2 billion annually, leading to a net financial benefit of around €16 billion annually. Apart from the fact that this approach is based on today’s conditions, the sum mentioned also represents an upper bound.

3. Turkey in 2015 in an enlarged EU

In calculating the sums Turkey would receive in 2015, it does not make sense to use current euros since both the EU and the Turkish economy are likely to grow over the next decade.

Once again, the starting point for the Structural Funds is that the absorption limit has been set at 4% of the recipient’s GDP. This implies that one can immediately calculate the ceiling of what Turkey could receive under current rules for the Structural Funds, once one has an idea of the size of the Turkish GDP.

Under the growth scenario presented in section 2 above, Turkey will grow much more quickly than the EU over the next decade and Turkish GDP could reach about 4% of that of the EU-28 GDP (at present it amounts to only around 2%) by the middle of the next decade. This implies immediately that the

¹ See Hughes (2004) as well as Quaisser & Repegather (2004).

cost of extending current Structural Funds to Turkey would cost at most 0.16% of EU-28 GDP ($=0.04*0.04$).

The calculations for agriculture are potentially more complicated since one would have to guess the output structure of agriculture in Turkey in about a decade and then calculate to what extent this would change if Turkey participates in the CAP. This would actually be an exceedingly complex operation as one would have to take into account the entire input/output matrix. For example, some commodities (maize) are used as an input in the production of others (meat). However, this is not necessary as an indirect approach can yield a better result.

The starting point is that Turkish farmers are likely to obtain *at most* 20% of their value added from the EU's CAP, for the simple reason that this is what farmers in the EU-15 obtain today: the CAP costs at present amount to 0.5% of GDP and the value added produced by agriculture is about 2.5% of the EU-15 GDP.

Agriculture produces at present around 12% of GDP in Turkey, but taking into account that its share has been declining continuously over the last decade, a reasonable assumption might be that in about a decade agriculture will account for about 10% of Turkish GDP at the maximum. On this basis one can easily calculate the potential maximum cost of extending the present rate of support of the CAP to Turkey. Assuming, as before, that the Turkish economy accounts for 4% of EU GDP (and that agriculture contributes 10% to this), the cost of providing an 'equivalent rate of support' for Turkish agriculture would be 0.08% of EU-15 GDP ($=0.2*0.04=0.2*0.04*0.1$). To repeat, this is again an upper bound. Other estimates arrive at much lower numbers; see for example Quaisser and Reppegather (2004) who argue that the cost of extending the CAP to Turkey should only be around 0.045% of the EU's GDP.

The number calculated above is again an upper limit, as the CAP is likely to change over time, *inter alia*, because of the commitments made by the EU in the context of the WTO to abolish exports subsidies, and the general limitations the WTO imposes on various types of domestic agricultural subsidies in general. Moreover, it has already been agreed within the EU that the cost of the CAP should rise by less than 80% of the increase in nominal GDP. This implies that the cost of the CAP as a percentage of EU GDP has to fall over the next decade.² Depending on the overall growth rate of the EU, the cost of the CAP is thus likely to be less than 0.4% of the GDP of the enlarged EU once Turkey joins. Since any single country, even if it is the largest one, is not likely to get more than one-fourth of this sum, it is clear that the cost of extending tomorrow's CAP to Turkey cannot be more than 0.05 to 0.1% of the EU's GDP.

The gross cost (Structural Funds plus CAP) together might thus amount to 0.26% of EU-28 GDP ($=0.096+0.16$). Against the gross receipts, one would have to set the contribution that Turkey would have to make to the EU budget. At present, and this is unlikely to change any time soon, all member states contribute at the same rate, or rather % of GNP, to the EU budget. The contribution rate is equal to the share of the EU budget in overall GDP. Assuming that the EU budget will continue to be limited to around 1-1.2% of GDP, this implies that Turkey will have to contribute about 1.2% of its own GDP to the EU budget. Under the assumptions made so far (Turkish GDP at about 4% of that of the EU-15), this would then amount to around 0.048% of EU-15.

The *ceiling* for the net cost should thus be around 0.20% of EU GDP (equivalent to about €20 billion given today's EU GDP of around €10.000 billion) under both illustrative calculations.

² For example, with a growth rate of nominal GDP of 5% p.a., this rule would imply that the budget available for the CAP would have to fall by around 1% (not 1 percentage point) every year).

Table 1. Maximum budgetary cost, full membership

| | Turkey in today's EU (in billions of current euros) | Turkey 2015 in enlarged EU (as a % of EU GDP) |
|-------------------------------|--|--|
| Structural Funds | 8 | 0.16 |
| CAP receipts | 9 | 0.08 |
| Total receipts | 16 | 0.25 |
| Contributions to EU budget | 2 | 0.05 |
| (Max) Net receipts for Turkey | 16 (0.16% of EU GDP) | 0.20 |

Source: Own calculations based on current EU budgetary rules and regulations.

4. Transitional arrangements

The numbers calculated above represent the maximum that would be achieved only after a considerable transition period, as in the case of the new member countries from Central and Eastern Europe, assuming *current rules*. The immediate post-membership transfers would be much lower, as in the case of all new member countries. As argued above, the experience of Romania and Bulgaria might be particularly instructive in this respect given that these two countries have a similar GDP per capita and it could thus be said that they set the benchmark for Turkey. Neither Romania, nor Bulgaria will participate in the current negotiations for the next financial framework, but the EU has already proposed a certain allocation for them (and the two countries have not objected), amounting to a total of around €15 billion at current prices. Since the combined population of these two countries is about 30 million, Turkey should receive about 2.3 times as much if it were to be treated equally on a per capita basis. This would then amount to about €35 billion over three years. All this suggests that for the first years of membership, transfers in the range €9-12 billion per annum might be realistic.

The new member states from Central and Eastern Europe benefited also from modest amounts of pre-accession aid, originally under a programme, PHARE, whose primary justification was to support the transition to a market economy, not preparation for accession. The PHARE funds (mostly for technical assistance for democracy building, etc.) were later augmented by two additional programmes: SAPARD (support to structural change in agriculture) and ISPA (infrastructure). Over the last years (2000-03) the total support going to, for example Bulgaria has been around €300 million per annum, with about half coming from PHARE, one-third under ISPA and the remainder under SAPARD. The original justification for PHARE funding does not apply in the case of Turkey; but it is clear that a substantial amount of funding for democracy-building will appear needed viewed from the EU side.

Since the equality of treatment is so much engrained in the EU approach, it is thus likely that as negotiations proceed a similar amount of financial support for the preparation for accession will become available for Turkey as well. Scaling the funds available for Bulgaria – either on a per capita or on a % of GDP basis – yields a similar result in that the total available for Turkey might be just a bit below €3 billion per annum (not immediately, but after 4-5 years). This would correspond to approximately 1-1.2% of GDP for Turkey (0.03% of the EU's GDP or 2-2.5% of its budget).

5. Concluding remarks

Are figures in the range of 0.15% to at most 0.20% of EU GDP large or small numbers? Compared to national government expenditure, which is usually around 40-50% of GDP, they are negligible. However, a figure of, say, 0.17% of EU GDP would not be negligible compared to the EU-budget ceiling of 1.25% of GDP. The current discussion whether the EU budget should be limited to 1 or 1.25% of GDP shows that sometimes even small sums can have a considerable political impact. It must be stressed, however, that all the numbers referred to here are highly tentative. The rules themselves are likely to become more restrictive for both Structural Funds and agriculture as the current discussions on reform of the CAP and Structural Funds show.

Nevertheless, the projections made here appear realistic in terms of what is economically and politically likely to be feasible. Net transfers in the €9-12 billion range in the first post-membership years and of about €15 to €20 billion in the 2020s would constitute an important amount for Turkey, a significant but manageable amount for the EU budget and be negligible compared to the sum of national budgets or the overall EU economy.

The budgetary side of membership negotiations is usually left to the very end because this is the only area with a zero sum game. What Turkey gains, others must pay. In the end, however, the numbers tell only part of the story. The nature of the financial package will depend to a large measure on how the EU has developed in the meantime. For a self-confident enlarged EU that has successfully absorbed more than a dozen member countries during the first decade of the 21st century, the challenge of integrating Turkey into its rules of financial support to its weaker member states will be manageable, particularly if some of the recent member countries have in the meantime graduated from the need for large-scale financial support. Sustained rapid growth in Turkey would be another key factor as it would dispel the fear that Turkey would be a drain on the EU budget for a long time to come and reflect the rise of Turkey's contribution capacity.

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