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Ministry of Finance
Strategy Development Unit

Enlargement of the EU in the Context of Turkey's Accession: Budgetary Issues

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To my mother and father...

PREFACE

Begun in 1957 as a core group of six countries, the European Union has now gradually expanded to a group of 27 countries. The process of enlargement has progressed with little difficulty up until the last two expansions. This so-called “eastern enlargement” of the Union however was a far more intricate and highly debatable process. Never before have so many countries joined the Union at the same time and more importantly never before have the economic differences within the group of countries joining this integration been so great. The European Union does not have a great appetite for further enlargements including Turkey at the moment. Besides some academic researchers, many European people think that especially Turkish accession will be so costly for the Union budget. By departing from the cost of earlier enlargements, the aim of this study is to reveal that Turkey’s accession will not be unaffordable for the Union.

Many people and institutions have played a part in the production of this book. First of all, I am grateful to The Turkish Academy of Sciences for their financial support throughout the research. I would like to thank to Professor Jim Rollo for his helpful comments and profound contributions. Many thanks to Turkish Republic Ministry of Finance Strategy Development Unit for helping publication of this book and to Naki Gökçe for designing it carefully. I also would like to thank to Associate Professor Ahmet Kesik for all his contributions and supports. Finally, I have to thank to my family for their patience, motivation and moral support. I also must send my special thanks to my sister and colleague Asuman Oktayer for all her contributions and supports.

CONTENTS

ABBREVIATIONS

CAP	:	Common Agricultural Policy
CEEC	:	Central and Eastern European Countries
CEPS	:	Centre for European Policy Studies
EAGGF	:	European Agricultural Guidance and Guarantee Fund
ECSC	:	European Coal and Steel Community
ECU	:	European Currency Unit
EEC	:	European Economic Community
ERDF	:	European Regional Development Fund
EP	:	European Parliament
ESF	:	European Social Fund
EU	:	European Union
EUR	:	European Monetary Unit
EU-15	:	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, the United Kingdom
EU-25	:	EU-15 + New Member States-10
EU-27	:	EU-25 + Bulgaria and Romania
EU-29	:	EU-27 + Croatia and Turkey
FAO	:	Food and Agriculture Organization of the United Nations
GATT	:	General Agreement on Tariffs and Trade
GDP	:	Gross Domestic Product
GNI	:	Gross National Income
GNP	:	Gross National Product
PPS	:	Purchasing Power Standards
SIS	:	State Institute of Statistics
SPO	:	State Planning Organization

TOR	**:**	Traditional own resources
TURKSTAT	**:**	Turkish Statistical Institute
US	**:**	The United States
VAT	**:**	Value added tax
WTO	**:**	World Trade Organization

Introduction

The Copenhagen summit in December 2002 was one of the most important milestones in the long process of the European Union (EU) enlargement. It was not only a historic event ending the postwar political separation of Europe, but also had far-reaching economic implications.

On 1 January 2007, two new Member States, Bulgaria and Romania was admitted to the European Union. With the accession of these two countries the Union extended to 27 Member States. This expansion followed a wider enlargement on 1 May 2004, which saw the EU increase from 15 to 25 members. Currently, three countries, Croatia, the former Yugoslav Republic of Macedonia and Turkey are formal candidate countries. Negotiations on EU membership with Croatia and Turkey were opened on 3 October 2005. A number of other countries in the region are considered potential candidate countries.

The eastern enlargement changed the structure of the Union in economic and social terms. It shifted the EU from a group of largely rich industrial countries to a heterogeneous club of states with economic disparities. After 2004, the significance of the cohesion countries has grown. If we compare the old EU-15 in 2001 with a EU-29 including Turkey in 2015, it's clear that the number of cohesion countries will increase from three to at least fifteen.

Because Turkey is poor relative to the EU-15, much attention has been given to the budgetary effects of this accession, on the presumption that enlargement will be very costly for the Union. The present net recipients from the EU budget seem to fear that transfer to them will be cut, and the net contributors fear that they will be required to increase their contributions.

The structure of the current system of EU revenue and expenditure is such that the financial resources are transferred from the rich member states to poor countries. But the relation between income per capita and net transfer is far from straight. Some rich countries give proportionately more than others, while some poor countries receive a disproportionate share of the transfers.

For any potential candidate country the budgetary effects result from both application of the Common Agricultural Policy and the Structural and Cohesion Policy. Because of its size and level of economic development, Turkey's accession would undoubtly have an impact on the Union's budget. But how big would this cost be?

This book is composed of three chapters. In the first chapter, the structure of the EU budget is analyzed in the context of enlargement. Because of importance of the common policies, common agricultural policy and the structural funds are detailed. In this context, budgetary costs of the past enlargements of the Union are analyzed.

The second chapter of the book covers the key elements of Turkish economy. In this chapter, share of agriculture in the economy is analyzed in terms of population living in rural areas, agricultural labor force, agricultural production, agricultural policies and the agricultural reforms in Turkey. Since regional income distribution is one of the basic determinants of the budgetary cost, both household and regional income distribution are the field of interest.

Finally in the last chapter, in the light of the first and the second chapters and some empirical studies, the budgetary impact of Turkish accession to the European Union is tried to be find out. In this context, determinants of the budgetary cost of Turkish accession is analyzed.

Chapter 1

BUDGET OF THE EUROPEAN UNION IN THE CONTEXT OF ENLARGEMENT

1.1. Structure of the European Union Budget

The EU budget sets out and authorizes the total amount of revenues and expenditures annually deemed necessary by the European Community and the European Atomic Energy Community (Lorca, 2005). It is a financial instrument of the EU in implementing the fiscal policy from the central or supra-national level of the Union. The policies that were commonly agreed by the member states in the Treaties are performed via the budget. In other words, it is a mechanism which makes it easier for the EU to reach some ambitious objectives.

At the beginning of European integration, the EU budget was quite small and limited to the expenditures covering mostly the Community administration. However, together with the new policies accepted by the member states, it increased both in absolute and relative terms. The implementation of some common policies, especially Common Agricultural Policy and the Structural Policy had led to the Union budget achieving an important magnitude.

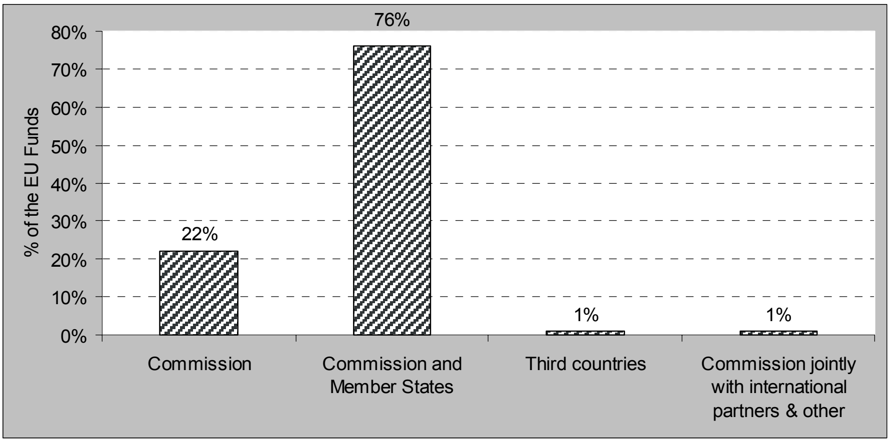
Because of political and constitutional limitations that exist in the Union, in its essential features the EU budget is quite different from the classic budgets of the nation states. In comparison with the classic national budgets, the differences can be observed in several basic characteristics of the EU budget: (1) the revenue and expenditure sides of the Union budget differ from the budgets of national states; (2) the EU budget is relatively small in comparison with the size of the economy it refers to; (3) it is more strictly and strongly regulated, which leads to its being austerely balanced and in connection with this (4) the EU is not allowed to cover its expenditure with debt, meaning that the budget must always be in balance (Simovic, 2005).

The budgetary policy-making in the EU involves several actors. Multi-annual financial perspective (financial framework) and annual budgets are the main actors of the EU budgeting process. Since 1988, the broad outlines of the budget are defined in the multi-annual financial perspective which set limits to the annual budgets. It safeguards the control of the evolution of the budget expenditure, ensures a predictable inflow of resources, facilitates the agreement of the annual budget and aids planning of multi-annual programs and projects. The Perspective defines a general framework and principles for the collection of revenue for the next seven years and allocation of expenditure in different budget items. The multi-annual financial perspective is decided by the heads of the member states in the European Council. This decision requires unanimity. The most important task of the perspective is to define expenditure ceilings for future budgets in broad spending categories but usually these ‘budget packages’ include several lower level spending decisions as well (Mattilla, 2006, Lorca, 2005).

The annual budgetary process operates in the context of the financial framework. This process includes three institutions of the Union; the European Commission, the European Council and the European Parliament. After an internal orientation debate to lay down the main political and budgetary priorities for the next year, the Commission prepares a preliminary draft budget to the Council. Once the Council has approved this draft budget it sends the budget proposal to the European Parliament for further considerations. Within the Council, the main preparatory work is done by the Budget Committee, which consists of the financial attaches in the Permanent Representations of the member states. Decisions in the Committee are made by using qualified majority voting. Parliament has the right to reject the entire budget in which case the procedure must start all over again. If the budget is approved by both the Council and the Parliament, the Commission has the responsibility of implementing the budget (Mattilla, 2006).

In using the EU funds, the principle of *sound financial management* has a vital importance. According to that principle, managing the money must make every effort to obtain the best value for money spent. This requires strict adherence to all the rules and regulations. European Commission has the ultimate responsibility for the implementation of the budget. The Commission implements the budget on its own responsibility, but shares most of the management with the Member States.

Figure 1.1. Management of the EU Budget



Source: (http://ec.europa.eu/budget /index_en.htm)

1.1.1. Expenditure of the Budget

The European Union functions on the basis of jointly accepted objectives, agreed policies, detailed instruments of those policies and financial resources transferred to the EU level which complements national public funds designated to reach those same objectives. The EU budget finances actions and projects in policy domains where all EU countries have agreed to act at the Union level (European Commission, 2007).

One of the most important principles of the EU budgeting is "subsidiarity" which is referred to in the Treaty of Maastricht. According to this principle, the European Union can undertake activities where the Member States decide that specific activities and objectives cannot be sufficiently well implemented and achieved by the Member States separately and the activity of the Union would ensure greater efficiency and better results. There are some policies, which the EU countries decided not to maintain them at the Union level such as defence, national social security and pension. All these policies are financed by national, regional or local governments without any intervention of the Union. Some expenditure such as education and housing exist but in a minimum level (European Commission, 2007).

The structure of the EU budget has been changed at the beginning of the 2007-2013 financial period. For this reason budgetary expenditure will be analyzed for each period separately.

1.1.1.1. Expenditure Structure Before 2007-2013 Financial Framework

The EU budget amounts to about 1 percent of the Gross National Income of all the Member States annually at the moment. It amounts to EUR 129.1 billion in 2008 which corresponds to 0.96 percent of EU-27 GNI[1]. An important amount of the budget is directed to the implementation of European policies, mainly the agricultural policy, which absorbs about 40 percent of the budget and structural policies which absorbs 35 percent.

As the European Union expanded with the accession of new member states, the EU budget has also increased. In nominal terms, the value of the budget has been slightly more than doubled over the last 25 years but in relative terms that growth was stopped in mid-1990s when the EU budget amounted to about 1.18 percent of the GNI of all the Member States. The highest volume of the budget was recorded in the year of entry

[1] The budget forecasts both commitments (legal pledges to provide finance, provided that certain conditions are fulfilled) and payments (cash or bank transfers to the beneficiaries). Appropriations for commitments and payments often differ because multi-annual programs and projects are usually committed in the year they are decided and are paid over the years as the implementation of the program and project progresses.

into force of the Treaty of Maastricht – that is in 1993 and still before the EFTA countries enlargement. After that year, although growing nominally, the size of the EU budget has only decreased in relative terms. When it comes to the top ceiling, the important point of reference was brought along by Agenda 2000 which began a modest but clear drop in the size of the budget to be continued with 2013 in sight. In spite of the new grand projects such as the introduction of the euro as the common currency, the adoption of the Lisbon Strategy or enlargement to countries of Central and Eastern Europe, the European Union has not increased the share of joint expenditures either in the total GNI, or in the accumulated public expenses. The maximum limit agreed in Berlin in 1999 of 1,24 percent of the joint GNI of the Member States is still binding and it was formally upheld at the summit in 2005.

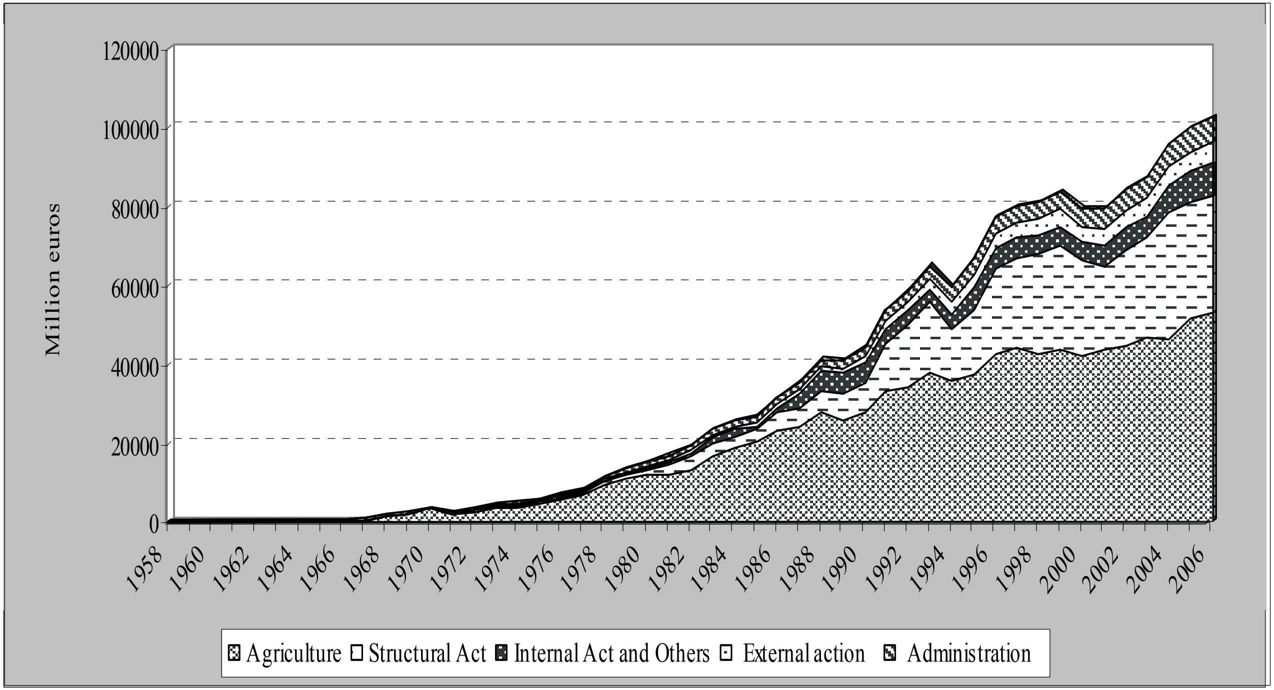
The EU's spending priorities and the level of spending have changed dramatically since its inception in 1958. Until 1965, the EU spending was negligible, the budget was spent mainly on administration. But this figure changed as the cost of the CAP started to rise rapidly in the 1960s and cohesion spending started to rise in the 1980s. CAP spending began in 1965 and soon came to dominate the budget. For almost a decade, farm spending regularly took 80 percent or more of total expenditures; at its peak in 1970, it made up 92 percent of the budget. From the date of the first enlargement, 1973, cohesion spending grew in importance, pushing down agriculture's share. Indeed, the sum of the shares of these two big items has remained remarkably steady from 1973 to 2000s, ranging between 80 and 85 percent of the budget (Baldwin and Wyplosz, 2004: 59-60).

Today, the expenditures related to two main policies, the common agricultural policy and the structural policy, are dominant on the expenditure side of the EU budget. The share of common agricultural policy and structural spending together accounts for 75 percent of all spending in the EU budget. The rest of the expenditure is devoted to external EU activities, internal policies aimed at boosting competitiveness and the implementation of other objectives and administrative costs.

Almost half of EU spending is used to meet the cost of the CAP. Yet, it is only the budget share of the CAP that has declined. In absolute terms, CAP payments have risen over the years (Mattilla, 2006). According to Blankart and Kirchner (2004), because agricultural spending was not limited in the Union, the CAP spending expanded sharply in the early years of integration. France as a strong player contributed heavily to the expansion of the CAP arguing that farmers did not benefit from the Common Market as much as industry and perhaps even lost out. France was a necessary member of the EEC and threatened to leave the Community in 1960s. Germany, on the other hand, was more interested in the development of the common market and expansion of CAP spending in the budget was the price of it.

Figure 1.2. The EU Budget Expenditure (1958-2006)

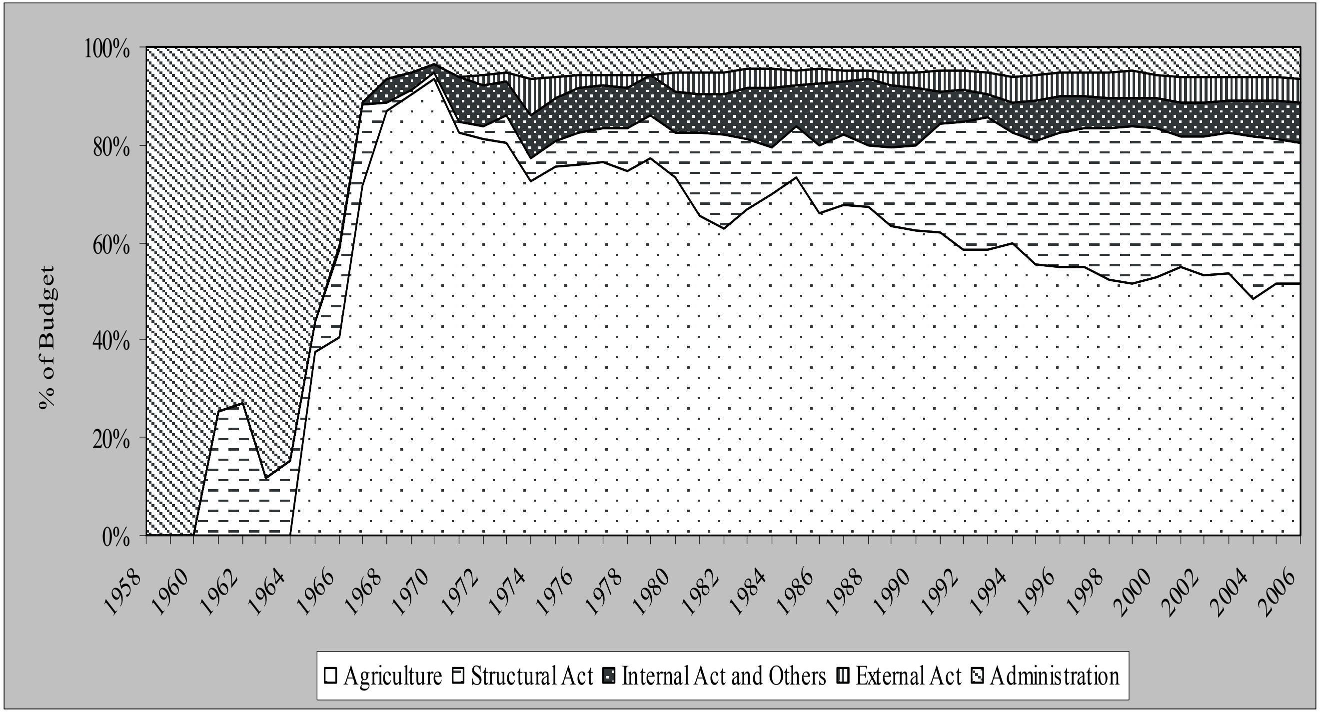
(Million Euros)



Source: 1958-1999 from *The Community Budget: Fact in Figures*, European Commission, 2000; 2000-2006 from the Financial Perspective 2000-2006 (downloadable from http://ec.europa.eu/budget /index_en.htm).

Figure 1.3. The EU Budget Expenditure (1958-2006)

(% of Budget)



Source: 1958-1999 from *The Community Budget: Fact in Figures*, European Commission, 2000; 2000-2006 from the Financial Perspective 2000-2006 (downloadable from http://ec.europa.eu/budget /index_en.htm).

As mentioned before, structural spending is the second biggest and increasingly important part of the EU budget. Figure above shows that there is an important shift in the structure of spending from agriculture to structural operations. The main reason for the decline of the share of the CAP in the budget has been the growth of spending on structural operations. Structural funds are aimed at improving economic and social cohesion in the European Union, i.e. to promote growth in economically disadvantaged member states and their regions. The share of structural expenditures was less than 5 percent of the total budget in 1975. Today, roughly one-third of the budget is spent for structural operations (Mattilla, 2006). Structural spending started to expand in the 1980s. This development coincides with the accession of the poorest member states to the Union (Greece, Spain and Portugal).

Considering the budgetary classification of 2000-2006 Financial Framework, the third largest component of the expenditure side of the EU budget consists of funds allocated to internal policies. This item includes various policies such as research and development, education, culture, trans-European networks, energy and environment. External action spending is mostly directed outside of the Union. This comprises spending on development and humanitarian aid and financing the economic transformation of the European Union's neighbouring states. Pre-accession aid is paid to future member states to prepare their economic, legal and political institutions for joining the Union. Finally, about 5 percent of the expenditure is used to finance European Union administration in Brussels and other locations (Mattilla, 2006).

1.1.1.2. Expenditure Structure After 2007-2013 Financial Framework

As it was mentioned above, one of the main components of the budgeting process in the EU is Multi-annual Financial Framework. So far, there have been three financial frameworks (Lorca, 2005);

-The Delors Package I, covering years 1988-1992, and focused on establishing the Internal Market and consolidating the multi-annual research,

-The Delors Package II, covering years 1993-1999, and focused on giving priority to social and cohesion policies and the introduction of the Euro,

-Agenda 2000, covering years 2000-2006, and focused on the EU enlargement.

The current seven year financial perspective covers the years 2007-2013. It was negotiated among the Member States in December 2005 and its final adoption took place on 17 May 2006 when the Parliament, the Commission and the Council signed the Interinstitutional Agreement.

Traditionally the financial perspective has been broken down into policy headings, with a maximum level of expenditure agreed for each heading. Obviously the more detailed the headings the less flexibility there is, for money cannot be transferred between lines without the agreement of the budgetary authority. The structure of the Financial Perspective 2000-2006 was based on the policies. Headings of the major expenditure categories were as follows: agriculture, structural operations, internal policies, external policies, administration, reserves, pre-accession assistance and compensations (Mayhew, 2004).

Table 1.1. Financial Framework 2007-2013

(EUR million, current prices)(*)

Commitment appropriations(**)	2007	2008	2009	2010	2011	2012	2013	Total
1. Sustainable growth	54.405	57.275	59.700	61.782	63.614	66.604	69.621	**433.001**
1a. Competitiveness for growth and employment	8.918	10.386	11.272	12.388	12.987	14.203	15.433	**85.587**
1b. Cohesion for growth and employment	45.487	46.889	48.428	49.394	50.627	52.401	54.188	**347.414**
2. Preservation and management of natural resources	58.351	58.800	59.252	59.726	60.191	60.663	61.142	**418.125**
3. Citizenship, freedom, security and justice	1.273	1.362	1.523	1.693	1.889	2.105	2.376	**12.221**
3a. Freedom, security and justice	637	747	872	1.025	1.206	1.406	1.661	**7.554**
3b. Citizenship	636	615	651	668	683	699	715	**4.667**
4. The EU as a global player	6.578	7.002	7.440	7.893	8.430	8.997	9.595	**55.935**
5. Administration(***)	7.039	7.380	7.699	8.008	8.334	8.670	9.095	**56.225**
6. Compensations for Bulgaria and Romania	445	207	210					**862**
Total	**128.091**	**131.487**	**135.321**	**138.464**	**142.445**	**147.075**	**151.886**	**974.769**
Commitment appropriations(**), % of GNI(****)	1,06%	1,06%	1,05%	1,03%	1,01%	1,00%	1,00%	**1,03%**
Payment appropriations(**), % of GNI(****)	1,02%	1,04%	0,95%	0,99%	0,95%	0,96%	0,94%	**0,98%**

Source: http://ec.europa.eu/budget /index_en.htm

* All amounts are expressed in current prices. To accommodate inflationary expectations during the 2007-2013 period, the EU countries agreed to adjust the financial framework ceilings (expressed in 2004 prices) by using a 2 % price deflator per year between 2004 and 2013.

** EU budgets forecast both commitments (legal pledges to provide finance) and payments (cash or bank transfers to the beneficiaries). Appropriations for commitments and payments often differ because of the multiannual nature of the EU programs and projects. The total amount is usually committed in the first year but the payment is made in several installments over the years as the implementation of the program and Project progresses.

*** Excluding staff pension contributions.

**** Estimates based on Spring 2007 forecasts of Gross national income (GNI)

As regards the current financial perspective (2007-2013), in its proposal, the Commission tried to undertake a certain change in the structure and objectives of expenditures by means of changing the structure of sections, their names and content. The number of headings in the current financial perspective has been reduced from eight to five with the intention of making the system less rigid and allowing the resources to be used more efficiently. In other words, in 2007-2013 financial perspective, the Commission has selected headings which are wide policy objectives rather than individual policies. Headings of the current financial perspective are as follows (Mayhew, 2004):

-sustainable growth broken down into competitiveness and cohesion,
-preservation and management of natural resources,
-citizenship, freedom, security and justice,
-the EU as a global partner,
-administration.

There has been an agreement on new budget structure, part of which can be attributed to Andre Sapir, who concluded that the EU budget is a “historical relic” that is not helping Europe’s economic growth. Professor Sapir recommended that the EU should reduce the portion of the budget it spends on agricultural support to just 15 percent (Lorca, 2005). But, when we analyze the new budget in term of the main categories and allocation of expenditure, it is impossible not to be impressed that the financial perspective for the years 2007-2013 is to a large extent a continuation of the earlier ones in the shaping of the EU budget (Begg and Heinemann, 2006). Although this new structure does not significantly change the Financial Framework, it does show the political priorities which the Commission sees for the medium-term. It also makes clear that the budget should reflect these policy priorities (Mayhew, 2004).

In view of the European Commission, the objective of this budgetary classification and the allocation of funds to the respective positions was the integration of efforts in the area of the EU single market with objectives concerning durable growth and the mobilization of economic, social and environmental policies as well as giving greater significance to the concept of the European citizenship by means of creating an area of freedom, justice, security and access to the basic goods and public services. At the same time, according to the Commission, the objectives of this budget aim at establishing a coherent role for Europe as a global partner, acting in line with its basic principles and accepting through that process a responsibility in the region, promoting sustainable development and ensuring its contribution to the civil and strategic security.

Table 1.2. The European Union Budget 2008

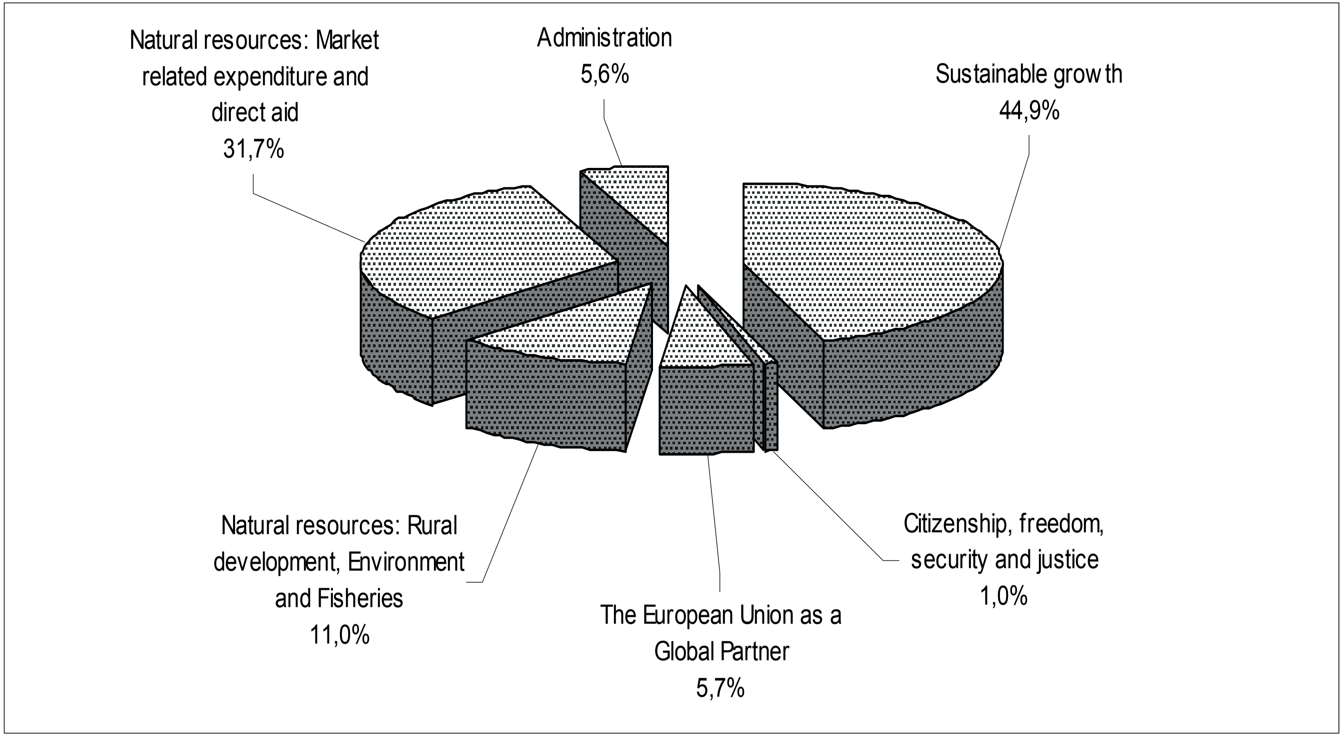
(Billion Euros)

Sustainable growth:	**58**
Competitiveness, including:	*11,1*
-Education and training	1
-Research	6,1
-Competitiveness and innovation	0,4
-Energy and transport networks	1,9
-Social policy agenda	0,2
Cohesion, including:	*46,9*
-Convergence	37
-Regional competitiveness and employment	8,6
-Territorial cooperation	1,2
Natural resources:	**55**
-Environment	0,3
-Agricultural expenditure and direct aids	40,9
-Rural development	12,9
-Fisheries	0,9
Freedom, security, justice (including fundamental rights and justice, security and liberties, migration flows) and Citizenship (including culture, media, public health and consumer protection)	**1,3**
EU as a global player:	**7,3**
-Pre-accession	1,4
-European neighbourhood	1,6
-Development cooperation	2,3
-Humanitarian aid	0,8
-Democracy and human rights	0,1
-Common foreign and security policy	0,3
-Stability instrument	0,2
Administration:	**7,3**
-European Commission	3,4
-Other institutions	2,7
Compensations to new EU countries	**0,2**
TOTAL	**129,1**

Source: European Commission, EU Budget 2008, (http://ec.europa.eu/budget /index_en.htm)

The 2008 budget amounts to EUR 129.1 billion (commitment appropriations), an increase of 2.2 percent compared to 2007. It corresponds to 1.03 percent of the EU-27 Gross National Income. Payment appropriations will amount to EUR 120.3 billion, or an increase of 5.7 percent in nominal terms. It represents a level of only 0.96 percent of EU-27 GNI. In 2008, for the first time ever, the largest share of the EU budget -45 percent of all EU spending- will go on measures to boost economic growth and greater cohesion in the EU-27. Agriculture will continue to receive over 40 percent of EU budget.

Figure 1.4. Allocation of Expenditure in the EU Budget (2008)

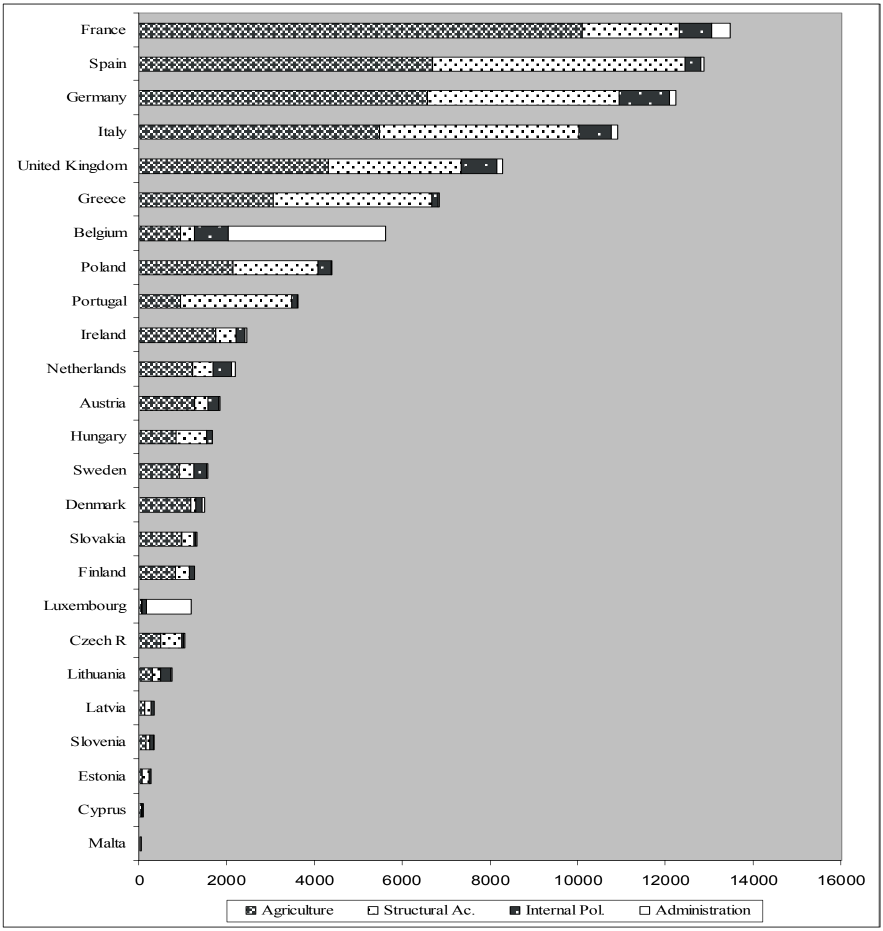


Source: http://ec.europa.eu/budget /index_en.htm

The amount of European Union spending varies significantly across Member States, both in terms of the total amount and its nature. As the Figure 1.5. shows, France is the main recipient with Spain, Germany and Italy. Most of the French receipts come from the CAP, while cohesion spending is the most important source for Portugal.

Figure 1. 5. Expenditure by Member States (2006)

(Million Euros)



Source: http://ec.europa.eu/budget /index_en.htm

1.1.2. Funding of the Budget

While the expenditure side of the EU budget split into many spending categories, the revenue side of the budget is simple. The budget is financed through the “own resources” system. Up to 1970, the budget was financed by annual contributions from the member states. The own resources system was established in 1970. A pair of Treaties in the 1970s and a handful of landmark decisions by the European Council established the system we have today in which there are four main sources of revenue. The own resources system has evolved considerably over the years, especially as a result of the changes introduced by the 1988 and 1994 own resources European Council decision. Over the years, the importance of tariff revenue and agricultural levies has fallen to the point where they are no longer major items (Baldwin and Wyplosz, 2004: 63-64).

Today, the money comes from customs and agricultural levies (traditional own resources), value added tax (VAT) resource levied on national VAT base and the “fourth” resource based on gross national income. The latter has a residual role: its amount is determined ex-post so as to fill the gap between actual spending and the revenues flowing from the traditional and VAT resources. This residual is allocated amongst the member states in proportion to their share in the Union’s GNI, and is paid by each member state out of its national budget.

The traditional own resources are the tariff revenues[2], agricultural duties[3] and sugar levy, collected at the Union’s external borders or as a fee that punishes the excess production of sugar. They are transferred directly to the common resources bar a share that pays for the local administrative collection costs. While the traditional own resources initially played a major role, nowadays their proportion is very limited in total revenues.

The third resource is based on the VAT base of the Member States. The VAT resource is levied on the statistical national harmonised VAT bases of Member States, which is calculated on the basis of national VAT

[2] Tariff revenue stems from the Common External Tariff. Although trade within the EU is tariff-free, tariffs are imposed on imports from non-member nations.

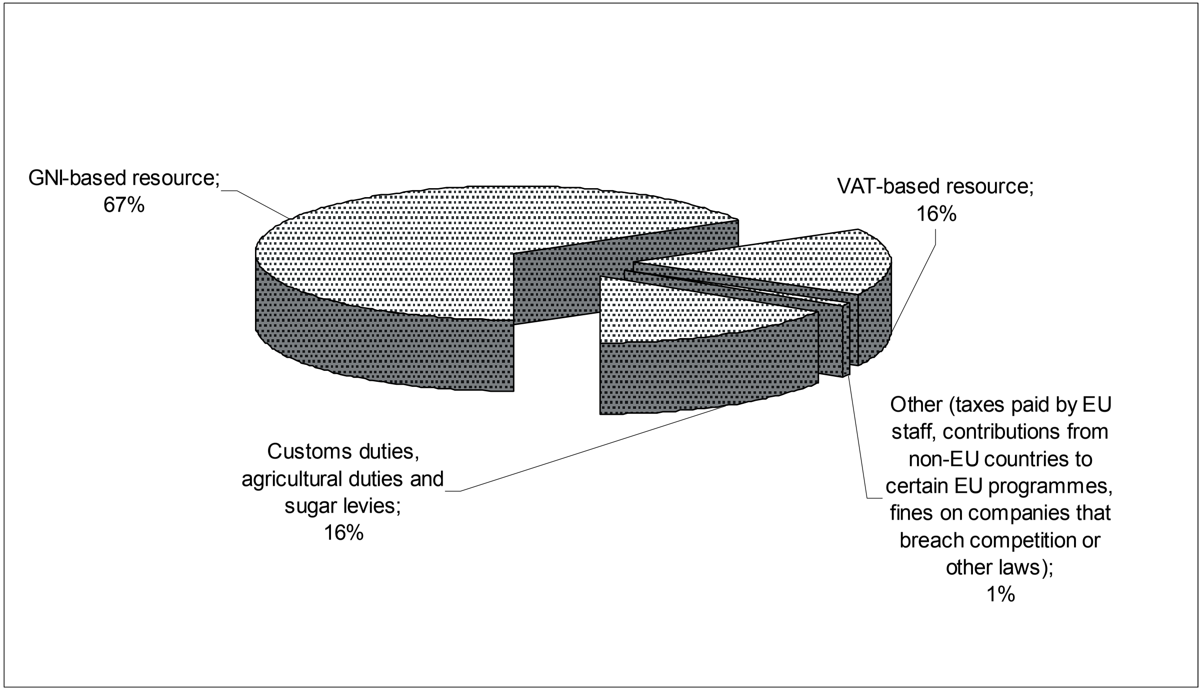
[3] Agricultural duties are tariffs on agricultural goods that are imported from non-members.

receipts. In order to reduce the effect of the regressive character of this tax, VAT base is capped at 50 percent of each Member State's GNI. The relative importance of this resource is rapidly declining.

The fourth resource of the budget is based on the GNI of Member States. The problem of inadequacy of current resources arising from the expansion of Union policies and commitments and the difficulties of controlling spending on the CAP led to the creation of GNI based resource. Because it is used to provide the revenue needed to cover expenditure when all other resources have been exhausted, it is generally called as the "residual resource". It is levied as a uniform rate in proportion to the GNI of each member state. There is no particular limit on this rate other than the own resources ceiling that limits the total amount of all own resources to a maximum 1.24 percent of the Union's GNI. Today, the Union budget largely (about 67 percent of own resources) depends on Member State's contributions.

Rest of the EU revenue is obtained from other resources. Taxes and premiums levied on salaries of the EU's employees, interests from outstanding amount dues, budgetary surpluses, income from activity of some institutions are in this group. That kind of revenue of the EU is irregular.

Figure 1.6. Allocation of Revenue in the EU Budget – 2008

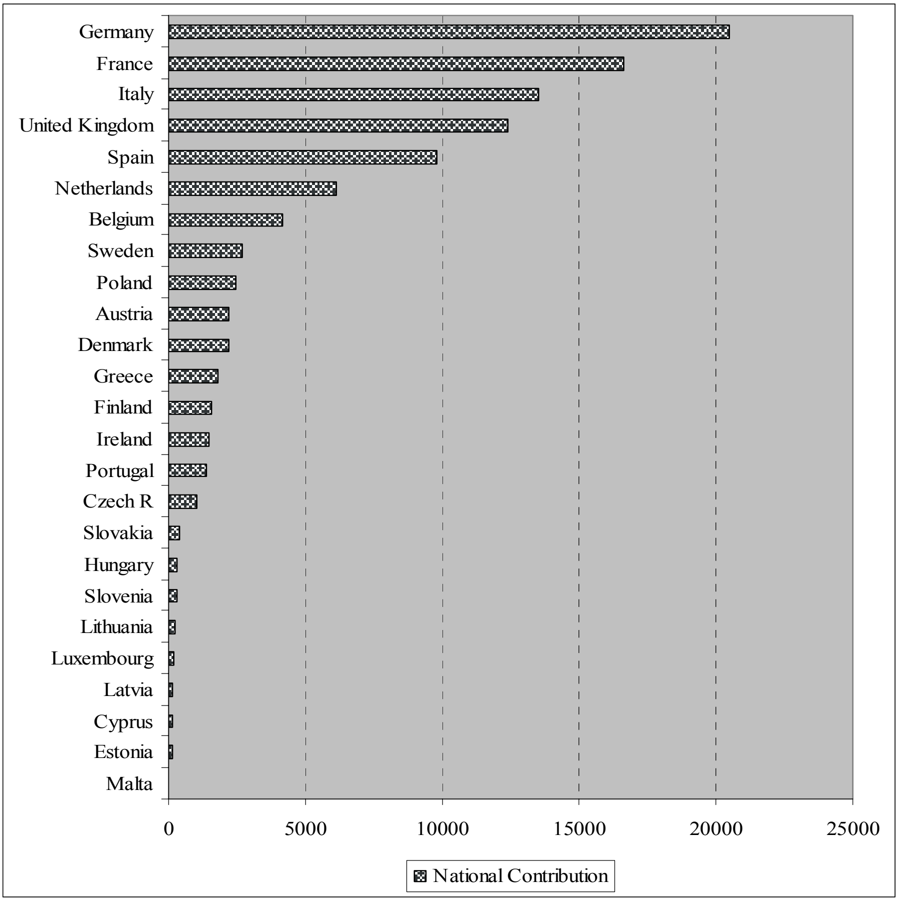


Source: http://ec.europa.eu/budget /index_en.htm

In 2008, the total amount of revenues collected by the Union is 129.1 billion Euros. About two thirds of the revenue comes from Member States as a percentage of their Gross National Income, while another 16 percent is obtained from a slice of the VAT collected locally. Customs duties, agricultural duties and sugar fees constitute 16 percent of all budget revenue in 2008.

Figure 1.7. Contribution by Member States (2006)

(Million Euros)

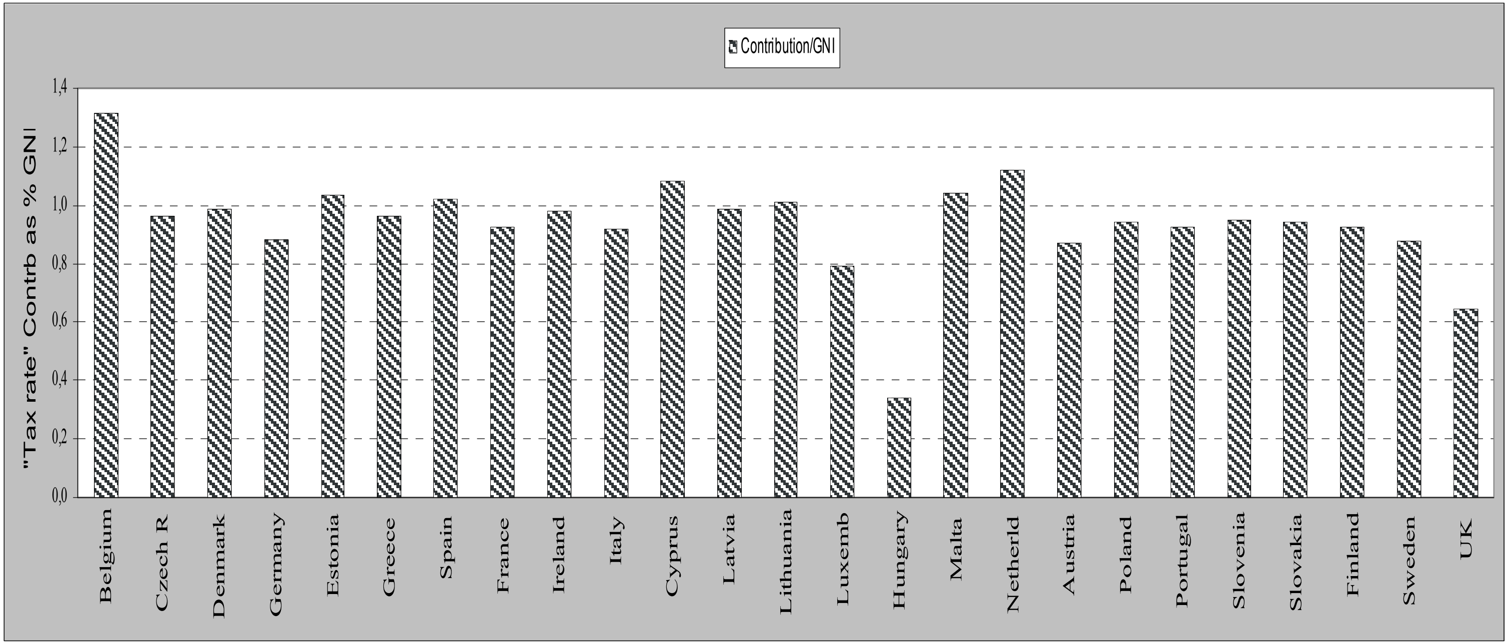


Source: http://ec.europa.eu/budget /index_en.htm

Contributions by Member States differ drastically in the EU budget. In nominal terms, revenues coming from the Germany, France, Italy, United Kingdom and Spain constitute a considerable share of the budget in 2006. However, when we look at the contributions by Member States, in terms of proportion to GNI, we see that the highest tax rate (contribution) is 1.3 percent for Belgium, the lowest figure is Hungary’s slightly less than 0.4 percent share.

Figure 1.8. Contribution by Member States (2006)

(% of GNI)

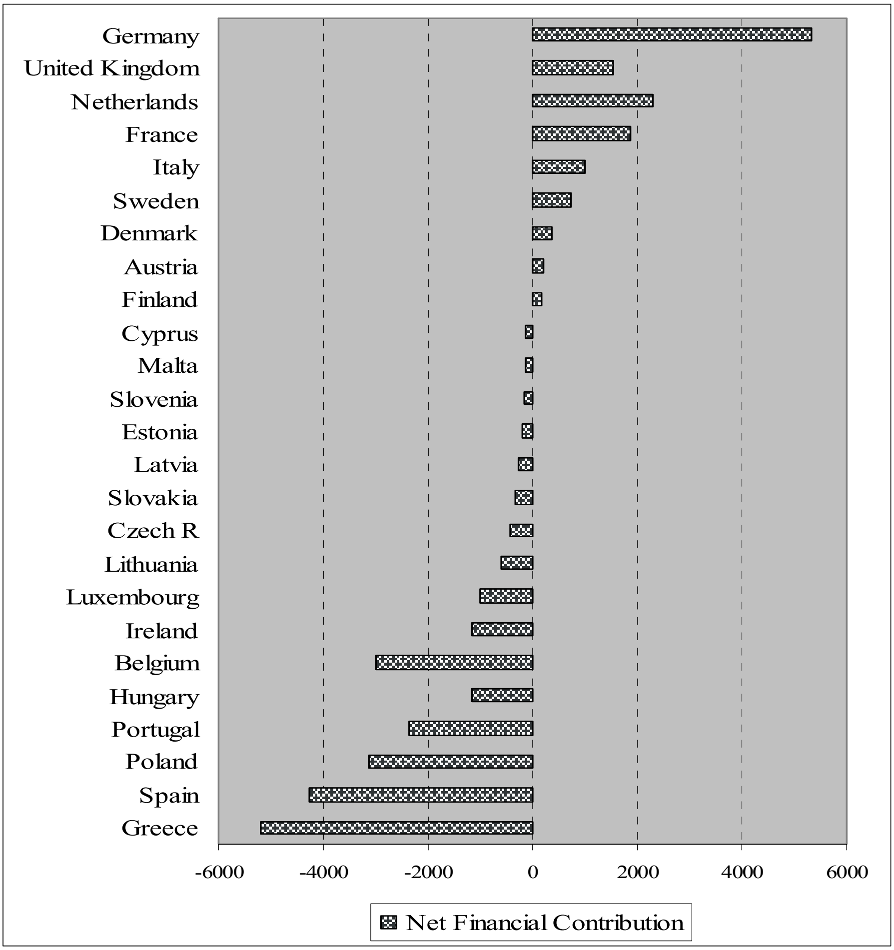


Source: http://ec.europa.eu/budget /index_en.htm

Considering together the receipts and the contributions by Member States allows us to assess the net financial contributions.

Figure 1.9. Net Financial Contribution by Member States (2006)

(Million Euros)



Source: http://ec.europa.eu/budget /index_en.htm

As the main budgetary expenditure items are agriculture and structural policies, also revenues from the European Union budget differ strongly across member states, depending on the importance of their agriculture in the economy, and on the incomes of the regions compared to the EU average. Net contributions by nation are shown in Figure 1.9. Nine of the EU-25 are net contributors with Germany beings by far the largest. Greece, Spain, Poland, Portugal, Hungary, Belgium, Ireland, Luxemburg, Lithuania, Czech R., Slovakia, Latvia, Estonia, Slovenia, Malta and Cyprus are the net recipients of the budget.

1.2. Importance of the Common Policies in the Context of the Budget

There are two main common policies in the EU affecting the EU budget; common agricultural policy and the regional and structural policy.

1.2.1. The Common Agricultural Policy

One of the main common policies of the EU is the CAP. It is a policy which is directly declared in the Treaty and hence considered as the treaty-based budgetary obligations[4]. The CAP constituted the main policy framework for the development of the EU's agricultural economy. It was originally put in place to expand production and provide secure food supplies for Europe. However, it does not prevent change. For four decades, it has evolved considerably, in particular over the last decade (Ahner, 2003).

The CAP started as a system of guaranteed prices. When the CAP was established in the 1960s, primary focus was internal price support to promote food self-sufficiency within the Member States. Protection was achieved by controlling market access through import tariffs and other means and by providing domestic support as well as export subsidies (Halderman, Nelson, 2004). If the market price dropped under the guaranteed minimum level, intervention agencies had to buy production from farmers at the fixed price. The politically fixed prices were generally higher than prices on the world market. Therefore, the system required high tariffs to prevent cheaper imports and export subsidies to enable the selling of expensive European products for a lower price on the world market.

Because of rapid technological improvements and because the high prices encouraged farm investment, EU food production rose much faster than the EU food demand. As a result, the prices EU agricultural producers

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[4] It should be noted that the Treaty itself does not include any definition on the volume of EU funds which could be devoted to the CAP.

received tended to be well above international levels. Price support system stimulated massive production in the Union. This surplus was disposed by storing or dumping on the world market. While storage was expensive and wasteful, the second way had serious international repercussions because it tended to ruin world markets for non European Union producers. The combination of budget constraints and pressure from trade partners of the Union forced a major reform of the CAP in the 1990s (Baldwin and Wyplosz, 2004: 238).

Until the 1990s, the CAP market policy relied almost exclusively on price support systems combined in a few cases with strict quantitative production controls. In many respects, some of these support systems are still in place, but their importance has diminished. The 1992 reform introduced for a few key agricultural sectors partial, but the most significant part of the reform was the shift from price support to direct payments. With Agenda 2000 reform, the shift to direct support continued (Ahner, 2003).

The CAP reforms of 1992, 1999 and 2003 have changed the method of farm support in the Union. The main inclination of all the reforms has been to cut the guaranteed prices and partially compensate farmers with direct payments. The reforms helped bring the Union in line with the GATT/WTO rules on world agricultural trade.

At the beginning of the 1990s, both internal pressures (budgetary problems) and external pressures (US pressure in the GATT negotiation) forced agricultural policy-makers to reform the CAP (Daugbjerg, 1999). In mid-1992, the first reform package, which was called the MacSharry reforms[5] was adopted. The basic results of the reform package were; i- reduction of guaranteed prices, ii- introduction of compensatory direct payments, iii- introduction of a compulsory set-aside and other supply management instruments, and iv- introduction of Agri-Environmental Programmes and other accompanying measures. As a result, arable sector spending rose from 10.4 bn ECU in 1992 to 17.5 bn ECU in 1997, pushing

[5] For details of 1992 reforms see Alan Swinbank (1993), "CAP Reform, 1992", Journal of Common Market Studies, Vol.31, No 3, pp.359-72; William Coleman and Stefan Tangermann (1999), "The 1992 CAP Reform, the Uruguay Round and the Commission: Conceptualizing Linked Policy Games", Journal of Common Market Studies, Vol.37, No 3, pp.385-405.

total CAP guarantee spending from 31.4 bn ECU in 1992 to 40.7 bn ECU in 1997. This rise was an inevitable consequence of replacing support based on high prices with direct payments from the Union budget (Ackrill, 2000).

Agenda 2000 was another important step in the reform process. In 1999, the European Union leaders decided to launch a further reform of the CAP in the context of the medium-term budget plans for 2000-2006. For agriculture, leaders suggested continuing the reform path taken by MacSharry in 1992. This implied substantial further cuts in the institutional prices for cereals, arable crops, beef and milk, compensated partially by direct payments to farmers. Agenda 2000 suggested some changes in the financing of agriculture and introduced a system of support for rural development. In terms of the Structural and the Cohesion Funds, the Commission proposed to concentrate expenditure much more on smaller areas within the Union and to reduce the number of policy objectives and initiatives (Pelksman, Gros and Ferrer, 2000). This reform committed the Union to fixing agricultural spending in real term.

In 1999, when the final decisions concerning the Agenda 2000 reform were taken, it was also decided to undertake a number of mid-term reviews around 2002/2003, re-examining market development as well as the situation of the agricultural budget. In July 2002, the European Commission presented its proposal for the CAP, and after a year of negotiations over this proposal, European leaders agreed on how to reform the CAP on 26 June 2003. This reform which was adopted at the Copenhagen summit made further price cuts, but also brought substantial new changes. In sum, the reform broke the link between direct payments and production, instead linked direct payments to environmental and other obligations and shifts some money from the first pillar to the second pillar.

The reform of the Common Agricultural Policy agreed on 26 June 2003 marked a significant shift in the nature of agricultural support across the European. The key elements of the new CAP are (Kosior, 2005):

- single payment scheme and decoupling (making direct payments independent of production);
- cross-compliance (making direct payments dependent on compliance with certain conditions);

- modulation (reducing direct payments for the largest farms) and
- strengthening rural development policy.

The most important step of the June 2003 reform was to decouple the direct payments to farmer. The introduction of a single payment scheme, which replaced most of the existing direct payments under different common market organizations was decided under this reform. In the current system, countries can choose if the payment will be established at the farm level or at the regional level. Farmers receiving the single farm payments have the flexibility to produce any commodity on their land except fruit, vegetables and table potatoes.

The second important component of the 2003 reform is cross-compliance which refers that there are some specific conditions for payments. Payments are conditional on compliance with statutory management requirements, maintaining the land in good agricultural and environmental condition, set-aside and maintaining permanent pasture. Farmers are obligated to keep their land in good agricultural and environmental condition.

Another characteristic of 2003 reform is modulation. Modulation involves the redistribution of funds from the first pillar of the CAP to the second one via the reducing direct payments for bigger farms. With modulation, direct payments as formerly defined in the first pillar decreased by 3 percent in 2005 and by 4 percent in 2006. It is expected direct payment cuts will reach 5 percent between 2007 and 2013.

Strengthening rural development is the other objective of the 2003 reform. With this reform, it was aimed to strengthen the CAP second pillar by increasing the amounts of money available under the rural development regulation and by adding new rural development instruments. New measures are designed to promote the protection of the environment, improve the quality of agricultural products, animal welfare and to provide farmers with additional support to meet the EU production standards.

1.2.2. The Regional and Structural Policy

In analyzing the EU budget, after the CAP, regional policy and the structural funds are the most important headings which should be examined.

Promoting regional development of its member states and speeding up the convergence process is one of the deepest goals of the European Union. Various policy measures have been introduced in achieving this goal over the years. Structural funds are the most favorite instrument used by the Union to reach this goal.

The main aim of the structural policy is to decrease the regional disparities within the European Union: the reduction of economic and social disparities between richer and poorer regions. The Structural and the Cohesion Funds are the European Union's main instruments for supporting social and economic restructuring across the European Union. They are used to tackle with regional disparities and support regional development.

The origin of the structural policy goes back to the Treaty of Rome. In its preamble, member states committed "to ensure their harmonious development by reducing the differences existing among the various regions and the backwardness of the less-favoured regions".

Reducing disparities and backwardness and redressing the main regional imbalances were main tasks pointed out in the Treaty. Such deep targets imply not simply avoiding greater divergence among European regions, but effectively counteracting the possible centripetal effects of European integration and of all other factors contributing to the concentration of economic activity in core areas (Rodriguez-Pose&Fratesi, 2004).

Regional policy was a domestic matter in the Union before 1973. Several factors such as the proposed enlargement to include the United Kingdom and Ireland and contemporary initiatives for a deepening of European integration led to a greater focus on regional policy in the Union. Creation of the European Regional Development Fund was very important step towards the regional policy. By establishing it, the European Union aimed to redistribute part of the Member States' budget contributions to the poorest regions. Although modest at first, EU regional support through the structural funds has grown in importance over the years (Cappelen, et.al, 2003).

Almost ten years after the creation of European Regional Development Fund, The Single European Act created an incentive for a more substantive regional policy by bringing the concept of "economic and social cohesion". The Single European Act was a reform in this context. This reform was implying the coordination of the three Structural Funds (ERDF, ESF and EAGGF-Guidance Section) under the principles of territorial and financial concentration, programming, partnership and additionality. But, this reform implied not just the coordination of all existing funds under the umbrella of Structural Funds and comprehensive restructuring of the principles that guided their action, but also the doubling in relative terms of the monies committed to regional development from 15.1 percent of the European budget in 1988 to 30.2 percent in 1992 (Rodriguez-Pose&Fratesi, 2004).

Reducing inequality among member states was a priority for the EU. At the beginning of the 1990s, with the inclusion of economic and social cohesion as one of the Union's priorities alongside the Single Market and economic and monetary union, the Treaty of the European Union took the commitment one step further (De Rynck, McAleaey, 2001). In 1992, the European Union decided to the creation of the "Cohesion Fund" to support the least prosperous Member States in their efforts towards economic convergence for preparation of economic and monetary union. Ireland, Greece, Spain and Portugal were the poorest Member States who had a gross national product of less than 90 percent[6]. The Maastricht Treaty (1993) upgraded the importance of regional policy by making economic and social cohesion one of the three pillars of the Community reforms between 1994-1999, increasing the programming period from five to six years (Porqueras and Garcilazo, 2003).

The importance of the structural funds has increased over the years. This is evidenced by the percentage of the Union's budget devoted to the funds. The structural funds, along with the cohesion fund, are one of the largest items of expenditures in the EU's budget. It should be noted that, the major impetus for this development came in February 1988 with the agreement of a five-year budget package that contained a commitment to double, in real terms, the resources available to the structural funds. The

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[6] For further information see Oktayer, N. (2007), "Regional Policy and Structural Funds in the European Union: the problem of Effectiveness", Ankara Review of European Studies, 7 (1), 113-130.

reform of the structural fund regulations in the same year was also central to the evolution of the policy sector. The regulations agreed in 1988 introduced a new framework through which the structural funds delivered financial aid aimed at reducing economic disparities among the Union's regions (Sutcliffe, 2000).

Today, the Structural Funds and the Cohesion Fund are the main instruments of the European Union's structural policy. Commonly known as cohesion policy, it entails the funding of infrastructure and employment projects in lagging regions of the Member States. Structural Funds comprise four different types of funds: i-European Social Fund (ESF)[7], ii-European Agricultural Guidance and Guarantee Fund (EAGGF)[8], iii-European Regional Development Fund (ERDF)[9], iv-The Financial Instrument for Fisheries Guidance (FIFG)[10].

The Structural Funds are allocated for three objectives (Edverveen and Gorter, 2002):

-Objective 1 is to help lagging regions to catch up with the rest of Europe by providing basic infrastructure and encouraging business activity. Regions with a GDP per capita of less than 75percent of the Union average qualify for this type of funding.

-Objective 2 is to help the economic and social restructuring of regions dependent on industries in decline, agriculture, fishery or areas suffering from problems related to urbanisation. In order to qualify for Objective 2 funding, industrial regions must have an unemployment rate above the European Union average, a higher percentage of jobs in the industrial sector than the European Union average, and a decline in

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7 European Social Fund was set up in 1958 to improve job opportunities in the Community by promoting employment and increasing the geographical and occupational mobility of workers.
8 European Agricultural Guidance and Guarantee Fund was set up in 1958 to finance rural development measures and provide aid for farmers, mainly in regions lagging in development.
9 European Regional Development Fund was set up in 1975 to promote economic and social cohesion within the European Union through the reduction of imbalances between regions or social groups.
10 The Financial Instrument for Fisheries Guidance was established in 1994 to modernize the fishing industry.

industrial employment. In addition, regions must not be eligible for Objective 1 support.

-Objective 3 is to modernise education and increase employment. This objective refers to the whole of the Union. Any region can be eligible for Objective 3 funding, provided it does not receive Objective 1 funding.

The structure of the Cohesion Policy was changed in instrumental sense from the beginning of 2007-2013 financial period. Some new regulations were adopted. The Structural Fund Regulation for 2007-2013 has introduced significant changes to the rules governing European Union funding. There are three new "Objectives" in 2007-2013 programming period. These objectives are achieved by three financial instruments; Cohesion Fund, European Regional Development Fund and European Social Fund[11].

[11] For further information see Oktayer, N. (2007), "The Changing Structure of Structural Funds in the European Union", Marmara Journal of European Studies, 15 (1), 61-81.

Table 1.3. Structural Funds: Instruments and Objectives in the Past and Today

<table>
<tr><th colspan="2">2000-2006 Financial Period</th><th colspan="2">2007-2013 Financial Period</th></tr>
<tr><th>Objectives</th><th>Financial Instruments</th><th>Objectives</th><th>Financial Instruments</th></tr>
<tr><td>Cohesion Fund</td><td>Cohesion Fund</td><td rowspan="2">Convergence and Competitiveness</td><td rowspan="2">Cohesion Fund
ERDF
ESF</td></tr>
<tr><td>Objective 1</td><td>ERDF
ESF
EAGGF (Guidance)
FIFG</td></tr>
<tr><td>Objective 2</td><td>ERDF
ESF</td><td rowspan="2">Regional Competitiveness and Employment
-regional level
-national level: European Employment Strategy</td><td rowspan="2">ERDF
ESF</td></tr>
<tr><td>Objective 3</td><td>ESF</td></tr>
<tr><td>Interreg*</td><td>ERDF</td><td rowspan="4">European Territorial Cooperation</td><td rowspan="4">ERDF</td></tr>
<tr><td>Urban*</td><td>ERDF</td></tr>
<tr><td>Equal*</td><td>ESF</td></tr>
<tr><td>Leader +*</td><td>EAGGF (Guidance)</td></tr>
<tr><td>Rural development and restructuring of the fisheries sector</td><td>EAGGF (Guidance)
FIFG</td><td></td><td></td></tr>
<tr><td>Nine Objectives</td><td>Six Instruments</td><td>Three Objectives</td><td>Three Instruments</td></tr>
</table>

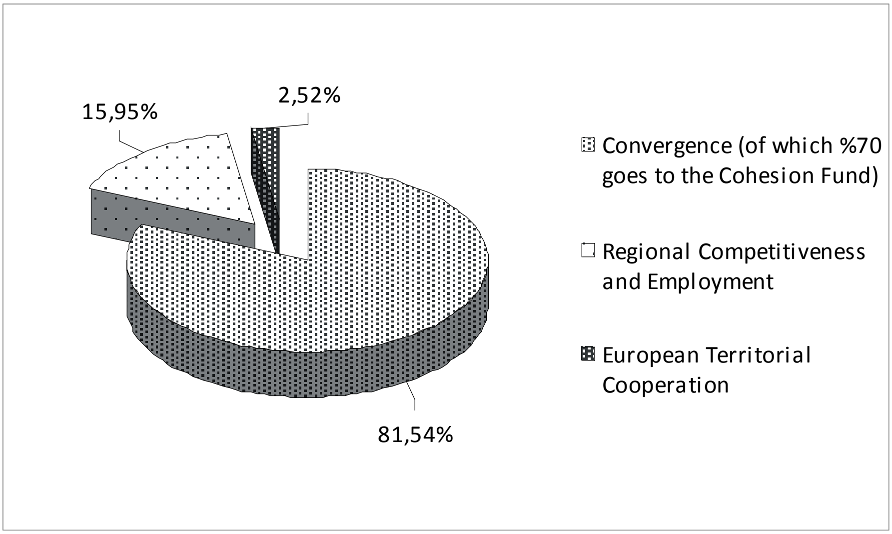
Source: European Commission, 2004.
* Interreg, Urban, Equal and Leader + are programs initiated by the Union to promote interregional cooperation in solving common problems. They are called as Community Initiatives. Beside the three priority Objectives, the Structural Funds was also providing finance through these Initiatives before 2007-2013 Period.

“The convergence objective” replaced the Objective 1 and the Cohesion Fund of the 2000-2006 period. It supports the economic convergence of the poorest Member States and regions of the Union. Regions with Gross Domestic Product per head are less than 75percent of the EU average are eligible for Convergence funding from the European Social Fund and European Regional Development Fund. Furthermore, Members States whose Gross Domestic Product is less than 90percent of the EU average are eligible for the Cohesion Fund, which continues to finance programs in the areas of transportation and the environment.

“The Regional Competitiveness and Employment Objective” replaced the Objective 2 and 3. It supports projects to strengthen competitiveness, employment and skills in all areas that are not eligible for the Convergence Objective. This Objective aims at increasing regions’ competitiveness and attractiveness, as well as employment through a two-fold approach. First, development programs help regions to anticipate and promote economic change through innovation and the promotion of the knowledge society, the protection of the environment, and the improvement of their accessibility. Second, more and better jobs are supported by adapting the workforce and by investing in human resources (Inforegio-Factsheet, 2006). This Objective is performed through the European Social Fund and European Regional Development Fund.

“European Territorial Cooperation Objective” is the last objective of the current financial period. It replaced the Interreg Community Initiative and finances cross-border and transnational cooperation projects. The fund serving for this objective is the European Regional and Development Fund.

Figure 1.10. Allocation of the Structural Funds by Objectives in 2007-2013 Period

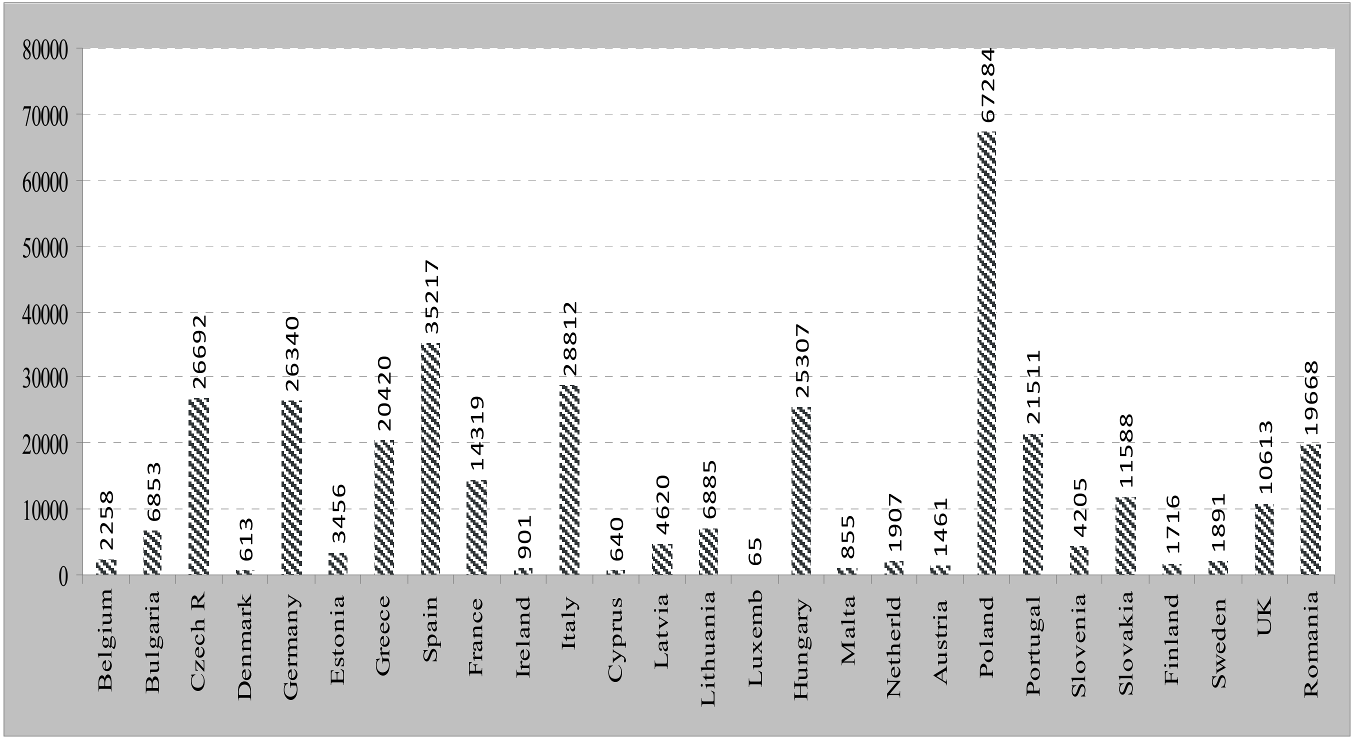


Source: http://ec.europa.eu/budget /index_en.htm

European Union structural policy is the second biggest item in the Union budget, making up about one third of total expenditure. In the 2007-2013 financial period, structural policy will benefit from 35.7 percent of the total EU budget or 347.41 billion euros at current prices. 283.7 billion euros for convergence, 54.9 billion euros for regional competitiveness and employment and 8.7 billion euros for European territorial cooperation objectives will be allocated in this period. In terms of the allocation of the Funds by Member States the biggest share goes to Poland in 2007-2013 period with 67.284 million euros (http://europa.eu.int/pol/reg/).

Figure 1.11. Allocation of the Structural Funds by Member States in 2007-2013 Period

(Million Euros)



Source: http://ec.europa.eu/budget /index_en.htm

Although the Structural Funds cover an important share of the Union budget, recently questions have been rising about their effectiveness. To what extent the Structural Funds have succeeded in their objective of reducing disparities between the levels of development of the various regions? Do they help the Member States in achieving greater economic and social cohesion and in reducing the gap between the centre and the periphery of the European Union?

According to Rodriguez-Pose and Fratesi, two key factors play an important role behind these doubts. First comes the remarkable stability of the regions eligible for Objective 1, as 43 of the original 44 regions that qualified for the Objective in 1989 remain in it 14 years after the reform. Only Abruzzo in Southern Italy managed to come out at the end of 1997. Four other original regions (Corsica, Lisbon and the Tagus Valley, Molise, and Northern Ireland), plus parts of the Republic of Ireland, are being phased out of the Objective and will lose their support at the end of 2005 or 2006. The second factor behind the scepticism over the capacity of European regional policies to deliver has been the lack of convergence across European regions since the implementation of the reform of the Structural Funds (Rodriguez-Pose and Fratesi, 2004).

The EU Structural Funds has both proponents and critics. The critics argue that the funds haven't reached any success to correct regional disparities. From the very beginning, instead of correcting the mechanism, they served to distort the market allocation of resources as firms and regional authorities make decisions in order to get financial transfers from the European Commission, instead of being guided by efficiency and other market-led criteria. Proponents point to the need for a long-term perspective in the pursuit of convergence and cohesion, and argue that already there are signs of such convergence. Moreover, the policy has already created a greater awareness of the need for strategic and co-ordinated regional planning, bringing together sub-national, national and European authorities to address regional inequalities in a comprehensive manner (Farrell, 2004).

However, financial transfers alone cannot reduce regional disparities the short-term. These funds are important as supplementary financing mechanisms to fund infrastructural investments in catching up countries. On the other hand, some other factors play a crucial role in regional development. In particular, the quality of the productive resources and the nature of the national government policy within a broader strategic framework for development and growth are very critical factors in that sense (Farrell, 2004).

1.3. Enlargement of the European Union and Budgetary Consequences

In December 2000, The European Council paved the way for the fifth enlargement of the European Union. At the European Council summit in Copenhagen in 1993, the European Union invited the Central and Eastern European Countries (CEEC) to enter the Union and formulated the three accession criteria: democracy, market economy, acquis communautaire. In early 1998, accession negotiations started with Luxembourg, Czech Republic, Estonia, Hungary, Poland, Slovenia and Cyprus. In early 2000, negotiations were also opened with Bulgaria, Latvia, Lithuania, Slovakia, Romania and Malta and then the biggest expansion started (Breuss, 2002).

The EU has undertaken several expansions since its beginning, increasing in size from the original six members in 1957 to the current 27 in 2007. The process of enlargement has progressed with little difficulty up until the Eastern enlargement. Eastern enlargement of the Union however was a far more intricate process (Read and Bradley, 2001).

Eastern countries have recently emerged from almost five decades of central planning and an essentially self-sufficient growth process. Transition and the process of economic, political and social reform began in 1989. In these countries, transition has involved reducing the role of State, including privatization, the reduction or complete withdrawal of subsidies to loss-making ventures, the reorganisation and retraining of management and the introduction of market based prices and contracts for inputs, including wages and output. Some of the Eastern countries have made significant progress over the transition process in introducing many political, institutional and market-based reforms. Some, like Czech Republic and Slovenia, have experienced substantial improvements in economic prosperity, as revealed in their per capita income (Read and Bradley, 2001).

The reforms of the CAP and the structural policy in the Agenda 2000 and some other institutional reforms made the European Union fit for this enlargement. The progress of the candidate countries was permanently assessed during the ongoing negotiations according to the road map agreed upon at the Nice summit and was certificated by the European Commission in its annual progress reports (Breuss, 2002).

There were some significant differences between the fifth and previous enlargements. The first of the last two enlargements was to the South. The accession of Greece, Portugal and Spain in the 1980s brought relatively low-income partners in the Union. This enlargement changed the economic geography and the budgetary structure of the Union. However, both the population dimension and the average income gap of the countries then involved the southern enlargement were about half those relating to the CEECs. The second of the previous enlargement was to the North. This enlargement of the 1990s actually raised the average per capita income of the European Union. Accession of Austria, Finland and Sweden brought a net positive contribution to the Union's budget (Brenton, 2002). For this reason, the last enlargement of European Union was expected to pose a heavy burden for the Union budget.

The budgetary dimension of the fifth enlargement was one of the important issues. The new accession countries were significantly poorer than the existing members, compared to the Union average per capita gross domestic product (Mayhew, 2003). This enlargement was expected to have a significant impact on traditional European Union behaviour towards budget financing. Many authors anticipated that the existing net contributors would increase considerably their budgetary outlays, while net beneficiaries would loose considerable benefits after enlargement (Pelksman, Gros and Ferrer, 2000).

It should be noted that, even without enlargement, budgetary negotiation within a Europe of fifteen would still have been complicated. These negotiations became more complicated with enlargement. The arrival of the new Member States led to a 20 percent increase in the Union's population but with only a 5 percent increase in its GNI. The new Member States were far less rich. Their accession had a very important impact on the functioning of common policies. This obliged the European Union to reanalyze not merely the great financial equilibrium but also the very definition of these policies (Lefebvre, 2005).

1.3.1. The Common Agricultural Policy and Enlargement

The adaption of the Common Agricultural Policy to the CEECs had been a very critical issue since enlargement was first considered in 1989 (Read and Bradey, 2001). Accession countries yet more than a decade ago were part of the Communist Bloc with its own model of agriculture. Agricultural sectors of the Central and Eastern European countries were therefore characterised by structural deficiencies left as a legacy of the Communist period. Moreover, agriculture in the CEECs proved a relatively recalcitrant economic sector. The adjustments to the new conditions of a market economy had generally been proceeding far more slowly than in other economic sectors (Kosior, 2005).

It was clear that the CAP would become a major problem in integration the CEECs into the EU. The new Member States have large areas of farmed land, but are relatively poor, and this meant that, if the CAP were to be fully implemented in the new Member States, it would substantially increase the CAP's budget cost.

The candidate countries had bigger agricultural populations, many on small, quasi-subsistence holdings, had poorer and rural infrastructure than the existing Member States (Rollo, 2003). Their GDP per capita at purchasing power parities was on average only 40 percent of that of the average of the Union. The contribution of agriculture to GDP was on average between 3 or 4 times that in the EU. The proportion of the workforce employed in agriculture was also considerably higher (Mayhew, 2000). The high average agricultural employment rate in the applicant countries was largely due to the figures for Poland, Lithuania and Latvia.

Table 1.4. Agriculture as a (%) of GDP in Central and East European Countries Before Their Accession (2002)

	Agricultural employment (millions)	Agricultural share of employment (%)	Agricultural share of GDP (%)
Czech Rep.	0,23	4,9	1,7
Estonia	0,04	7,1	3,2
Cyprus	0,01	4,9	3,9
Latvia	0,15	15,1	3,0
Lithuania	0,25	16,5	3,1
Hungry	0,24	6,1	3,8
Malta	0,00	2,1	2,2
Poland	2,74	19,2	3,1
Slovenia	0,09	9,9	2,0
Slovak Rep.	0,13	6,3	1,9
Newcomer total	3,9	13,2	3,1
EU-15	6,7	4,2	1,7

Source: Baldwin, Wyplosz, 2004: 37.

In addition to the problem of huge population working in agricultural sector, there were some further issues. Agriculture in the transition countries was characterised by a certain dualism; on the one hand there were market oriented, larger individual holdings and company holdings and, on the other, there was a large proportion of small, subsistence and semi-subsistence farms. These specific features were the reason for low labour and land productivity in agriculture of the CEECs (Kosior, 2005).

The existing Member States feared that they would lose their current benefits in favour of applicant countries. Because, providing the new member states with equal eligibility to receive transfers was either requiring redistribution of resources from current recipients or a large increase of the EU budget (Hildebrandt, 2002).

One of the main issues in the pre-enlargement period had been whether or not direct aid payments should be extended to the new Member States. It was argued by the EU negotiators that direct subsidies could create a wrong sort of incentives to consolidate semisubsistence farming in the CEECs, and hence hamper restructuring (Kosior, 2005). On the other hand, adaption of direct payments to new comings was leading to a considerable increase in the Union budget. According to Münch (2000) the complete integration of the Czech Republic, Estonia, Hungary, Poland and Slovenia into the CAP was resulting in a €10 billion increase in CAP expenditures - compared to €3.5 billion without direct payments - with the biggest share of this increase attributable to direct payments in the arable market regimes. Poland was alone leading nearly 60 percent of the €10 billion increase (Daugbjerg and Swinbank, 2004).

Beyond budgetary cost, there were some further difficulties in integration of these poor countries into the CAP. One of them was concerned supply management measures, production limits and quotas. The problems for the CEECs in this area resulted from the fact that agricultural production declined significantly from the start of the transition. Food safety was another key issue in the EU accession negotiations in the agriculture chapter with the CEECs. The EU Member States put a great deal of pressure on the candidate countries to adopt their legislative systems in food safety, veterinary and phytosanitary fields to the EU standards and to ensure their efficient implementation upon accession. However, many farms and food-processing establishments in the CEECs were lacking capital to upgrade rapidly to the EU requirements and hence could not fully participate in the Single European Market (Kosior, 2005).

In the second half of the 1990s, it had been widely accepted that enlargement of the European Union to embrace the CEECs would lead to CAP reform; indeed that CAP reform would be a necessary prerequisite for enlargement (Daugbjerg and Swinbank, 2004).

CAP reform which was decided at the Berlin European Council in 1999 was not only the result of needs of enlargement. It was determined by the obvious risk that high levels of price support would lead again to overproduction, with a limitation on export subsidies imposed through the

Uruguay Round. There was a growing awareness that agriculture cannot be totally separated from the rest of the economy and should be competitive on world markets. It was a reaction to the demands of the net contributors to the budget to maintain overall budgetary rigour and tackle the problems of unequal burden sharing (Mayhew, 2000).

The logic behind the CAP reform proposed in Agenda 2000 was to shift subsidy from prices to direct income transfers in order to reduce incentives to produce for intervention rather than for the market (Mayhew, 2000).

In agriculture, Agenda 2000 proposed reforms to policy in several products areas and in the organisation of rural development support. These proposals were intended to take forward the reforms begun in the early 1990s, in response to the needs of the WTO Uruguay Round. Price reductions in the cereals and beef sectors and to a lesser degree in milk were to be compensated by increasing direct income subsidies to the farmers affected in the move from price subsidies to income subsidies (Mayhew, 2003).

Several assumptions were made in the Financial Framework agreed in Berlin with respect to enlargement. Regarding to agricultural budget, it was argued that six new Member States would not qualify for direct income payment. In Agenda 2000, the Commission proposed not to pay direct income subsidies to farmers in the new member states in the 2000-2006 financial framework. Because direct income payments were a significant part of the CAP, this decision was allowing an important saving in the resources required for enlargement (Mayhew, 2003).

Despite much opposition from EU-15 Member Countries against extending the direct payments to CEEC farmers, all the candidate countries had been united in their insistence on "equal" treatment of their farmers from the moment of accession, i.e. that they should get the same subsidies as the EU-15 farmers, including direct payments. The budgetary implications and the efficiency effects have caused much debate and uncertainty (Swinnen, 2003).

After the Agenda 2000, the Commission realized that the proposal that the EU should not provide area and headage payments in the CEECs was not logical. In a reversal of his previous position, the Agriculture Commissioner suggested that direct payments had to be extended to the CEECs. In its issue paper, outlining its thoughts on accession, the Commission proposed that direct payments at 25 percent of the level in EU-15 would be paid in that year, increasing to 30 percent in 2005 and 35 percent in 2006. There would then be further percentage increase for the remainder of a 10-year transitional period, harmonizing on the rate applied in the old Member States in 2013. Because the subsidy cheques are only sent out to farmers late in the calendar year, the impact on the 2004 budget would be negligible, and the budget impact in 2005 and 2006 could be absorbed within the overall expenditure limits of the present financial framework (Daugbjerg and Swinbank, 2004).

The reform process was very slow and problematic because of the intervention of some Member States at the Berlin Summit. But the Commission claimed and obtained a mid-term review allowing them to return to the issue in 2003 (Rollo, 2003).

Finally, what was supposed to be just a mid-term review of the Agenda 2000 turned into a major reform. In December 2002, an agreement was reached with the candidate countries at the Copenhagen summit. With regard to direct payments, it was agreed that basic direct payment would start at 25 percent in 2004, 30 percent in 2005 and 35 percent in 2006 of the level of payments applicable in the old Member States and that they would rise by percentage steps to reach 100 percent in 2013. These payments can be topped-up to 55 percent of the EU level in 2004, 60 percent in 2005 and 65 percent in 2006; from 2007 the maximum top-up rate, to be entirely financed from national budget, was set at 30 percentage points above the applicable phasing-in level in the relevant year. Following the EU policy on supply-control measures, the finally negotiated reference quantities and reference yields reflected recent production figures. Therefore, in most instances the quotas and limits negotiated by the CEECs were fundamentally lower than the quantities requested. Basically, in less-sensitive sectors, the CEECs received production quotas close to those proposed; however, in more sensitive sectors the accession countries, particularly the larger ones, had to accept quantities by 30 percent or more lower. The accession agreement also provided for a number of transitional periods, extended over a period of three to four years, for farms and food-processing establishments not complying with the EU food safety, veterinary and phytosanitary standards (Kosior, 2005).

1.3.2. The Structural Policy and Enlargement

In contrast to the agricultural reform, the enlargement of the Union was the major impetus in the reform of the structural funds. The calculation of the budgetary transfers required for the new accession countries under existing rules was dramatic. High cost of the fifth enlargement led old Member States to change the rules and introduce an overall ceiling to the level of transfers which could be made (Mayhew, 2000).

One of the clearest characteristics of the new acceding countries was the great regional disparities. Almost all of them were meeting the strictest criteria for both the structural funds in the narrow sense and the cohesion fund. Most of the regions in the whole area had a GDP per capita under the 75 percent level of average per capita GDP in the Community. The lack of infrastructure of all kinds such as transport, environmental, educational and social was denoted in many reports prepared by the International Organisation and the European Union (Mayhew, 2000).

Before enlargement, there was an ongoing discussion about whether net contributors should only put in their net contributions and receive no receipts from the Regional funds. For example, the British Government has proposed repatriating regional policy spending in Britain and only paying the net contribution to Brussels. On the other hand, The Sapir Group (2003) proposed concentrating funds on the new members and the cohesion states in the long run with the focus on increasing growth. Their upper limit proposition was around 0.35 percent of GDP (Rollo, 2003).

Another issue concerning structural spending was the desire of the Member states to maintain their current position. Some of these countries were regarding this contribution as their acquired right. For example, although its GDP at current prices was estimated to be 120 percent of the

EU-15 average, rich Ireland[12] wanted to keep its share in 2000-2006 period (Rollo, 2003).

Before enlargement, an important consideration was that with the accession of new countries with income level below the EU average, the cut-off rate for Objective 1 financing would reduce as the average Union income level would reduce. If the rule had remained as it was at that moment, many of the regions benefiting from Objective 1 support would possibly no longer qualify. The study by Weise (Weise, 2002) suggested that two-thirds of the Objective 1 regions in the EU-15 would not have qualified after enlargement under a strict implementation of the 75 percent rule. For example, many Spanish regions benefiting from Objective 1 support would no longer have qualified if same rules had been applied after enlargement[13].

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[12] For regional policy purposes, Ireland was a single region until the last revision of region. Then magically it became two regions. One, including Dublin and with a GDP per head well over 100% of EU-25 GDP per head and the other close to the limit of 75% of EU GDP. According to Prof. Jim Rollo, this situation is one of the illustrations of the political economy of the structural funds.

[13] It should be noted that, according to Weise's results, even without enlargement, nearly 25% of current Objective 1 regions are no longer qualify for Structural Funds after 2006 because of convergence of these regions (Weise, 2002).

Table 1.5. Regions and Populations Eligible for the Objective 1 of the Structural Funds

	EU of 15	EU of 25	EU of 27
EU of 15, number of eligible regions	48 regions	30 regions	18 regions
EU of 15, covered population	18 % , that is to say 68 million people	12%, that is to say 47 million people	6%, that is to say 24 million people
10 new member states, number of eligible regions		37 regions	36 regions
2 new member states, covered population		92% that is to say 69 million people	90%, that is to say 67 million people
2 new member states, number of eligible regions			13 regions
2 new member states, covered population			100 %, that is to say 30 million people
Total number of regions	48 regions	67 regions	67 regions
Total of the covered population	18 %, that is to say 68 million people	25 %, that is to say 116 million people	25 %, that is to say 121 million people

Source: Laffineur and Vinçon, 2005.

Under all these discussions, Agenda 2000 proposed a reform of the Structural Funds, with the basic objective of not exceeding an expenditure limit of 0.46 percent of European Union GDP. The core of the reform was the strict application of conditionality for access to the funds. This figure was automatically leading to many regions which formerly received structural funds losing them in the future (Mayhew, 2000). This establishment set an upper limit on what share of the Union budget can be spent on the overall package for the Structural Funds and on the total amount available.

In addition, in order to avoid financial transfers rising to unbearable levels, the Union decided to limit the transfers from the Structural Funds and the Cohesion Fund to 4 percent of the recipient country's GDP (Mayhew, 2000). Since the Berlin Summit, the Structural Funds allocations now include a ceiling of 4 percent of the GDP of the recipient country. All new member states can access to the structural funds but with a cap on their receipts of 4 percent of GDP. The principle followed reveals the so-called absorption capacity of the candidate countries. This ceiling limits the total amount of funds that countries can receive from the Union budget.

1.4. The Cost of Enlargement

In the first major study of enlargement, Richard Baldwin (1994) argued that Central and Eastern European Countries were too poor and too agricultural to be full member of the Union. According to Baldwin, an enlargement of the Union to include these Countries was unlikely to take place for at least two years. The point of this argument was that if money is the lifeblood of the Union then eastern enlargement was unaffordable in the short term unless the Central Europeans received second-class treatment (Rollo, 2003).

In budgetary terms, Baldwin (1994) presented an estimate of ECU 26,7 billion per year for the ten new members measured on 1991 income and economic structure. This estimate essentially assumed the application to the new Member States of existing policies under existing eligibility rules. He considered this as being a very low estimate and suggested that the true cost would be much higher.

After Baldwin, the structural differences between the countries of central and Eastern Europe and the Union led many authors to estimate the economic effects of the European enlargement. In the literature, there are a number of studies with different model approaches estimating the economic effects of enlargement. They analyse the potential welfare effects of enlargement either for the European Union and Central and Eastern European Countries (Baldwin et. al., 1997; Neck et. al., 2000; Breuss, 2001; Lejour et. al., 2004) or for individual countries (Brown et. al., 1997; Breuss and Schebeck 1999; Keuschnigg and Kohler, 1999; Keuschnigg et. al., 1999; Breuss, 2002).

The main conclusion to emerge from these studies is that enlargement is likely to produce considerable economic benefits for the EU-15 and other the accession countries. Depending on the methodology used, estimates of the economic gains to be expected from enlargement in terms of the cumulative increase of GDP range from 0.5 percent to 0.7 percent for the EU-15 as a whole and from 6 percent to 19 percent for the new members in the first ten years after accession. These gains include both the static and the dynamic effects of integration.

According to the findings of most of the studies, new member states are likely to gain relatively more than the older members because of the relatively modest size of their economies. For example, Breuss (2002) arrives that due to the differences in size of the regions involved on average the Central and Eastern European Countries will gain around ten times more from enlargement than the EU. According to the author, while Hungary and Poland can increase their real GDP by around 8 to 9 percent over a 10-year period, the Czech Republic gains around 5-6 percent. The Union on average would gain approximately 0.5 percent of real GDP over a 6-year period. On average, enlargement seems to be a win-win game, but the impact is quite different in the separate EU Member States, with Austria, Germany and Italy gaining the most and losses for Spain, Portugal and Denmark. Therefore, the fifth enlargement of Union acts like an exogenous shock leading to asymmetric disturbances in the EU (Breuss, 2002).

Besides general economic effects of enlargement, some studies concentrated on the budgetary cost of accession. Early studies of the cost of extending the CAP to the CEECs arrived at very large numbers. Estimates of the increase in the annual cost of the CAP alone led to estimates in the first half of the 1990s of over ECU 40 billion. Nevertheless, most of these studies pre-dated the 1999 Berlin Council and the Agenda 2000 reforms agreed there. These early budgetary impact estimations are now considered inaccurate.

The estimates of the budgetary cost of enlargement declined over the years up to the Copenhagen European Council. There are two reasons behind this decline. The first reason is that some of the Union policies were amended and this adjustment led to overall reductions in financial allocations. Especially, the reform of the CAP in the early 1999s and the application of the Agricultural Guideline led to a slowing of expenditure on agriculture. Structural Fund spending was also reigned in over the period 2000-2006 as some regions were 'graduated out' and the funds were concentrated on the more needy regions. Secondly, the Union decided not to treat the new member states as budgetary equals until well after accession. Although the existing Member States insisted on receiving full contributions from the new member states from the first day of accession, they introduced transition periods for payments to the new members, lasting up to 2013 in agriculture for instance, and capped certain other expenditure, notably the structural funds (Mayhew, 2000).

Besides all these academic researches, many West European people thought that eastward enlargement would be so costly for the Union budget. The survey conducted before enlargement showed that more than three-quarters of all people in Germany and the Netherlands expected enlargement to be very costly for their countries. This share was lower in Ireland, Spain and Greece, at 60-65 percent, but it was still substantial. Since the CEECs are too poor and much more agricultural than the most of the old Member States, many people expected the fifth enlargement to substantially increase the budgetary expenditures (Barysch, 2006).

However, in order to limit transfers to the newcomings, the European Union found several ways, and thus kept the overall size of the budget small. Regarding to the agricultural policy, the original structure of the CAP, with its highly protectionist stance and generous farm price supports for a wide range of products, consuming almost 70 percent of the EU's annual budget was highly attractive to the relatively poorer new countries with large agricultural sectors. Nevertheless, initial expectations of large CAP transfers to the newcomings have been seriously reduced by successive reforms by the EU authorities. During the negotiations, the Union had initially decided that the new member states would be excluded from the direct payments that make up the bulk of CAP spending[14]. As it can be imagined, this decision greatly upset the accession countries. After their rejection, the EU-15 accepted to compromise. Finally, it was decided East European farmers initially will obtain 25 percent of the levels of direct payment. This share would rise gradually, to reach 100 percent by 2013. But the current CAP will not be to the advantage of the new comings. Since the share of non-direct payments, such as help for rural development, remains at 10-15 very small percent of total agricultural spending. Second, because the CAP disproportionately benefits large agricultural enterprises. In many new member states, farms are highly small to qualify for any support (Read and Bradey, 2001; Barysch, 2006).

The second measure taken by the EU to limit the transfers to the new Member States was related to structural operations. Most of the new countries were qualified for the structural and cohesion funds. If the rule had remained unchanged, many of the regions benefiting from Objective 1 support in old Member States would possibly no longer qualify. For this reason, the European Leaders decided to cap the flow of funds to the new comings at 4 percent of their respective GDPs, arguing that they lacked the capacity to "absorb" larger amounts (Barysch, 2006).

[14] The reason of this decision was that direct payments were designed to compensate farmers for price decreases that resulted from market liberalisation. Since farm prices in Central and Eastern Europe were lower than in the West, the extension of the CAP could be expected to result in prices rises, not falls. Thus, it wouldn't make sense to compensate the farmers from New Member States (Barysch, 2006).

Chapter 2

STRUCTURE OF THE TURKISH ECONOMY: AGRICULTURE AND REGIONAL INCOME DISTRIBUTION

2.1. Key Features of the Economy

Turkish economy displays almost all characteristics of a developing country in terms of per capita income, economic growth, inflation rate, unemployment, income distribution, government debt, public balance and labour productivity. Table below shows economic indicators for Turkey, Bulgaria, Romania, the EU-15 and the EU-27 countries. For purposes of comparison, GDP is given in purchasing power standards. Turkey's average per capita GDP in purchasing power standards is lower than the EU-27 average, but similar to that of Bulgaria and Romania.

Table 2.1. Main Economic Indicators for Turkey and the European Union (2007)

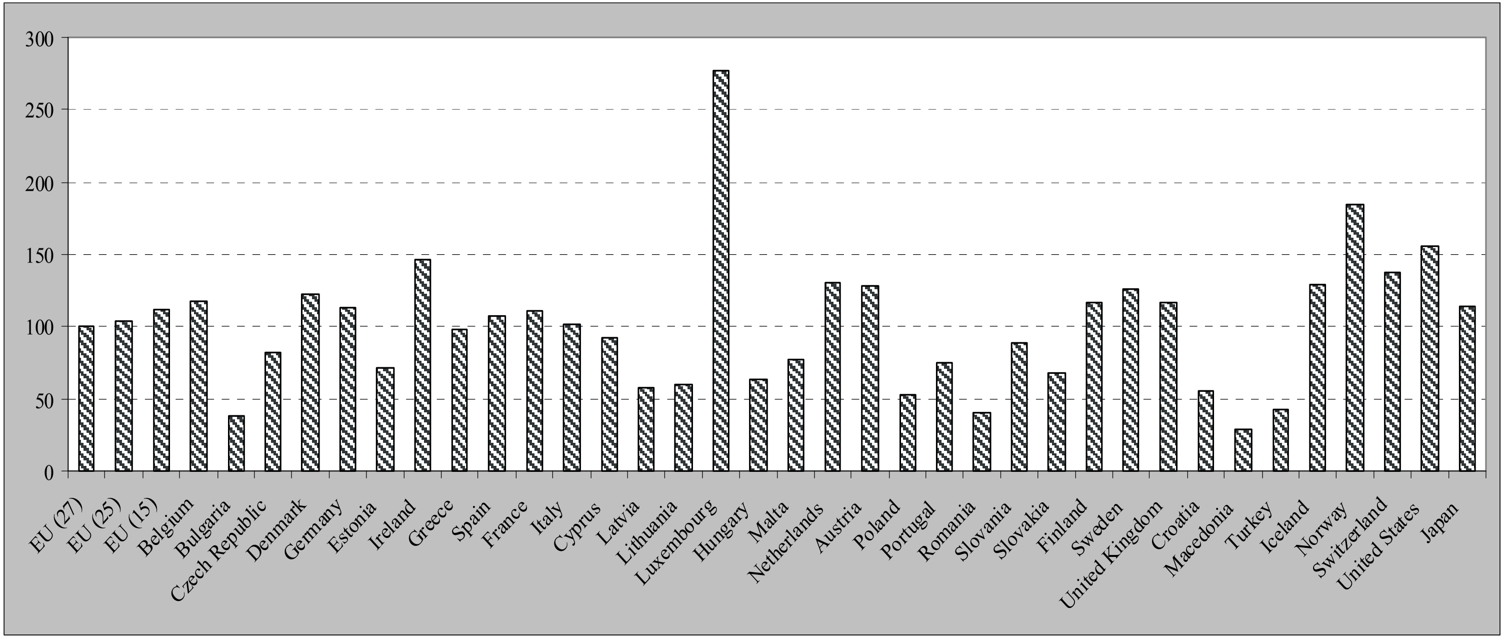
Indicator	Turkey	Bulgaria	Romania	EU-15	EU-27
GDP per capita in PPS (EU-27=100)	42.4	38.1	40.7	111.6	100
Real GDP growth rate	4.5	6.2	6.0	2.7	2.9
Inflation rate	8.8	7.6	4.9	-	2.3
Government debt (% of GDP)	38.8	18.2	13.0	60.4	58.7
Public balance (% of GDP)	-1.2	3.4	-2.5	-0.8	-0.9
Labour productivity per pers.	62.4	35.7	41.0	110.2	100
Unemployment rate (%)	8.5	6.9*	6.4	7.0	7.1
Population (1000 inhabitants)	70.586	7.719	21.610	389.555	492.975

Source: Eurostat, http://ec.europa.eu/eurostat (accessed on 16 September 2007), SPO, *Main Economic Indicators*, http://www.dpt.gov.tr (accessed on 28 October 2007),

* In Bulgaria, the rate of unemployment was 19.5 in 2001.

Figure 2.1. GDP per capita in Purchasing Power Standards – 2006

(EU-27=100)



Source: Eurostat, http://ec.europa.eu/eurostat (accessed on 16 September 2007)

Opening up of the Turkish economy started in 1980, after the major crises of the previous model of import-substituting industrialization in the late 1970s. Parallel to the global and regional developments, significant changes have occurred in economic policies adopted and implemented in Turkey over the years.

The Turkish economy suffered from serious fluctuations in national income and a very high level of inflation since its opening up. The 1990s were highly unstable for the Turkish economy. Following the capital account liberalization in 1989, Turkey experienced a "boom-bust" cycle. Average growth rates were low, annual inflation was above 60 percent of GDP, reaching sometimes more than 80 percent (Akyüz and Boratav, 2003). The economy was hit by a series of crisis. Especially, recent economic crisis experienced in 1994, 1999 and 2001 caused harsh recessions in the economy. Exchange market crisis in 1994 led to a decline in real GDP, triggered by a loss of confidence in economic policy and concerned over Turkey's ability to service external and internal debt. In 1999, fragile global economy, political uncertainty and severe earthquakes led to a decrease in real GDP. The most severe recession occurred as a result of the banking and currency crisis at the beginning of 2000s in the country. The crisis of February 2001 was particularly too costly in terms of its economic consequences. A major collapse of output was accompanied by a dramatic increase in unemployment (Öniş and Bakır, 2007). This crisis caused a serious decline in growth rate in 2001 (–7.5 percent).

In the late 1990s and at the beginning of 2000s, a series of standby agreements were made with IMF and the objectives of these programs focused on inflation targeting and macro economic stabilization. Program of "Transition to a Strong Economy" adopted in the aftermath of 2001 crises was a new period of stable growth for the Turkish economy. In the framework of the new economic plan, a comprehensive and intense transformation process has started. The program set in motion a process of low inflation and high growth. As a result, remarkable improvement was observed in macroeconomic indicators within the last six years. In addition to high growth, significant success was achieved in the fight against inflation, with inflation coming down from around 70 percent to single-digit figures (Tüsiad, 2008).

2.2. Agriculture in the Economy

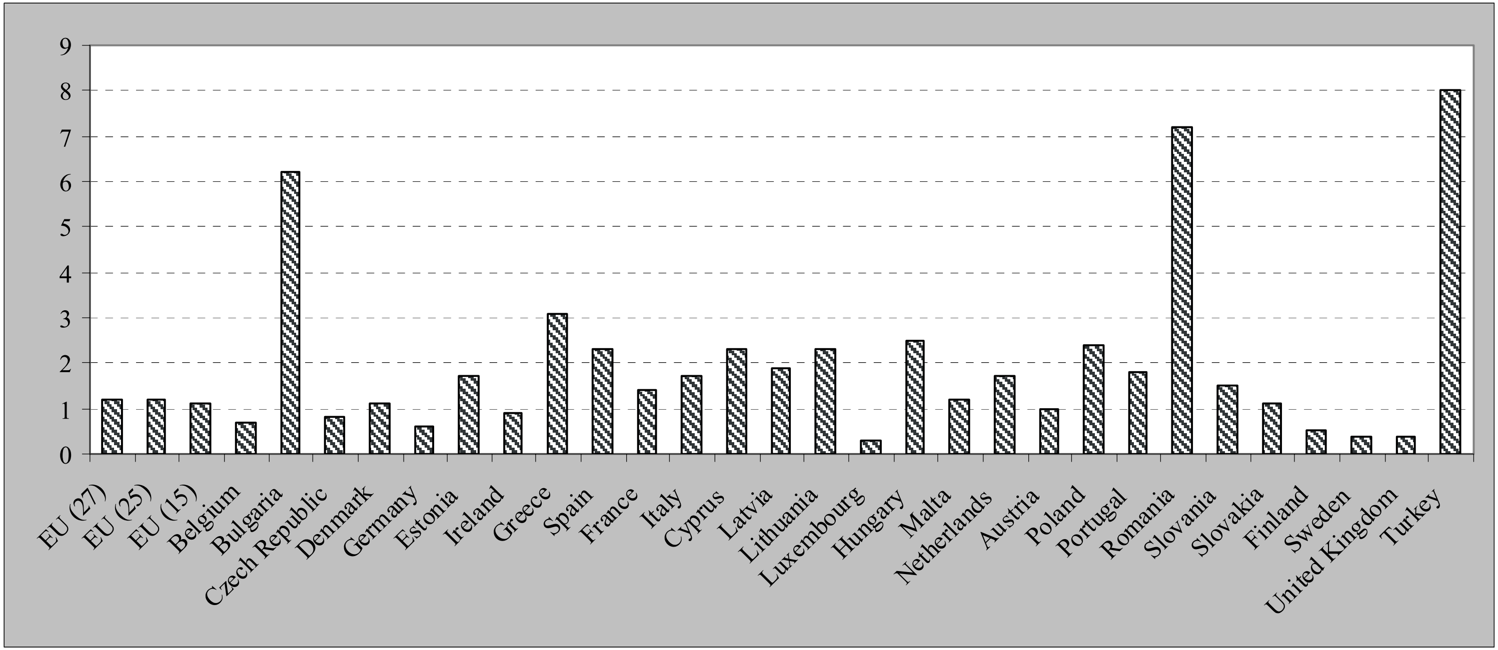
Agriculture is an important sector of the Turkish economy, both in social and economic terms. Turkish agriculture contributed about 8.0 percent to GDP and provided 27,3 percent of total employment in 2006.

In absolute numbers, Turkey employs about the same number of people in agriculture as the EU-15. In terms of the area used in agriculture, about half of Turkey's area is used for this sector. This is approximately in line with the EU-27 average (% 48). If Turkey joins the Union, this accession would add about 39 million hectares to the European Union's agricultural area and this would represent 23 percent of the EU-25 agricultural area (European Commission, 2004b).

Agriculture always had an important role in the Turkish economy; the sector has been Turkey's largest employer and a major contributor to the country's GDP, export and industrial growth. However, especially after 1930's, the main focus of the economic policies has been on industry. Therefore, as the country developed, the relative weight of agricultural sector in the economy has fallen relative to the rapidly growing industry and services sectors. At early times of the Republic, the share of agriculture in the GDP was around 47 percent, but this ratio fell to less than 40 percent in early 1940s as a result of the industrialization-oriented policies (SIS, 1994). The share of agriculture in the GDP gradually fell from 26.1 percent in 1980 to 17.5 percent in 1990, and 7.4 percent in 2007. However, in Turkey, the fall in the share of agriculture is relative; in other words, value added of industry and services has been higher than that of agriculture (Akder and Kıral, 2000). It should be noted that although the share of agriculture in the Turkish economy has tended to decline over the years due to the increase in industrial and services sectors, it still accounts for a relatively larger share of total output and employment than in many other coutries.

Figure 2.2. Share of Agriculture in the GDP – 2006

(%)



Source: Eurostat, http://ec.europa.eu/eurostat (accessed on 13 Oct 2007)

Table 2.2. Share of Agriculture in the Economy

Year	GDP (million USD)	Share of Agriculture (percent)	Year	GDP (million USD)	Share of Agriculture (percent)
1980	65.382	26.1	1994	129.856	15.5
1981	71.827	24.2	1995	169.708	15.7
1982	65.576	22.4	1996	181.497	16.9
1983	63.208	20.9	1997	189.622	14.5
1984	61.103	21.2	1998	200.118	17.5
1985	67.491	19.7	1999	184.265	15.3
1986	76.237	19.5	2000	199.749	14.1
1987	86.885	17.8	2001	145.594	12.1
1988	90.366	17.3	2002	184.331	11.6
1989	107.228	16.6	2003	240.955	11.7
1990	150.597	17.5	2004	302.678	11.2
1991	150.745	15.2	2005	363.369	10.3
1992	159.151	15.0	2006	402.709	8.0
1993	179.516	15.4	2007	-	7.4

Sources: SPO, *Main Economic Indicators*, http://www.dpt.gov.tr (accessed on 2 Sep 2007); Republic of Turkey Primeministry Undersecretariat of Treasury, *Statistics*, http://www.treasury.gov.tr (accessed on 2 Sep 2007), The World Bank, *World Development Indicators*, http://www.worldbank.org (accessed on 1 Sep 2007)

Turkey is one of the largest producer and exporter of agricultural products in the Eastern Europe, Near Eastern and North African region. Despite the overall trade deficit of Turkey, the agricultural trade balance is significantly positive, providing some relief to external accounts (Uçak, 2006). Table 2.3. presents a comparison of agricultural sectors of Turkey and the European Union for 2000 and 2006. It shows that, the share of agriculture in GDP, employment and exports remains high in Turkey relative to the EU-27. Around six million people are employed in Turkish agriculture, about the same number as in the entire EU-15. The share of agricultural imports in total imports is smaller than the EU average in

Turkey. Similarly, agricultural exports have a smaller share of total exports in our country. Although the share of agricultural exports in total exports declined between 2000 and 2006 both in Turkey and the EU-15, the decline is much stronger in Turkey.

Table 2.3. Agricultural Economic Indicators in Turkey and the European Union

Agricultural economic indicators	Turkey		EU-15		EU-27	
	2000	2006	2000	2006	2000	2006
Share of agriculture in GDP (%)	13.2	8.0	2.0	1.1	-	1.2
Employment in agriculture (number 1000 persons)	7.8	6.0	7.1	6.2	-	12.5
Share of ag. in civilian employment (%)	36.0	27.3	4.2	3.7	-	5.9
Agricultural imports/total imports (%)	3.6	3.3	5.7	5.1	-	5.0
Agricultural exports/total exports (%)	6.0	4.0	6.2	6.0	-	6.1

Sources: SPO, *Main Economic Indicators*, http://www.dpt.gov.tr (accessed on 1 Sep 2007); Republic of Turkey Primeministry Undersecretariat of Treasury, *Statistics*, http://www.treasury.gov.tr (accessed on 2 Sep 2007); Eurostat, http://ec.europa.eu/eurostat (accessed on 3 Sep 2007); European Commission, 2002.

2.2.1. Population in the Rural Areas

Although the contribution of the agricultural sector to Turkey's GNP is gradually falling, the population living in rural areas is still very high. About two-thirds of Turkey's population lives in urban areas. The total population of Turkey was 35,6 million in 1970 and 28,7 percent of this population was living in urban locations with 10 million or slightly more inhabitants. This rate increased to 62.7 percent in 2006 due to migration from rural to urban areas. Since 1990, more people have been living in urban regions than in rural areas.

Table 2.4. Urban and Rural Population (mio inhabitants)

	Urban Number	%	Rural Number	%	Total Number
1927	3,306	24,2	10,342	75,8	13,648
1940	4,346	24,4	13,475	75,6	17,821
1950	5,244	25,0	15,703	75,0	20,947
1960	8,860	31,9	18,895	68,1	27,755
1970	10,222	28,7	25,384	71,3	35,605
1980	16,065	35,9	28,672	64,1	44,737
1985	23,238	45,9	27,426	54,1	50,664
1990	28,958	51,3	27,515	48,7	56,473
1995	38,336	62,1	23,401	37,9	61,737
2000	38,661	57,3	28,759	42,7	67,420
2001	39,709	58,0	28,698	42,0	68,407
2002	40,823	58,8	28,565	41,2	69,388
2003	41,924	59,6	28,439	40,4	70,363
2004	43,036	60,3	28,296	39,7	71,332
2005	44,747	62,1	27,318	37,9	72,065
2006	45,754	62,7	27,220	37,3	72,974

Sources: Turkstat, *Statistics*, www.turkstat.gov.tr (accessed on 6 June 2007); SPO, *Main Economic Indicators*, http://www.dpt.gov.tr (accessed on 6 June 2007)

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Although the importance of agriculture in GNP decreased sharply over the years (from 47 percent to 7.4 percent), still 37.3 percent of population lives in rural areas of the country and 27.3 percent of active population works in agriculture. This figure shows that socio-economic structure of the society has not changed in parallel with the decline of the importance of agriculture in the economy and productivity in agriculture is still at very low levels.

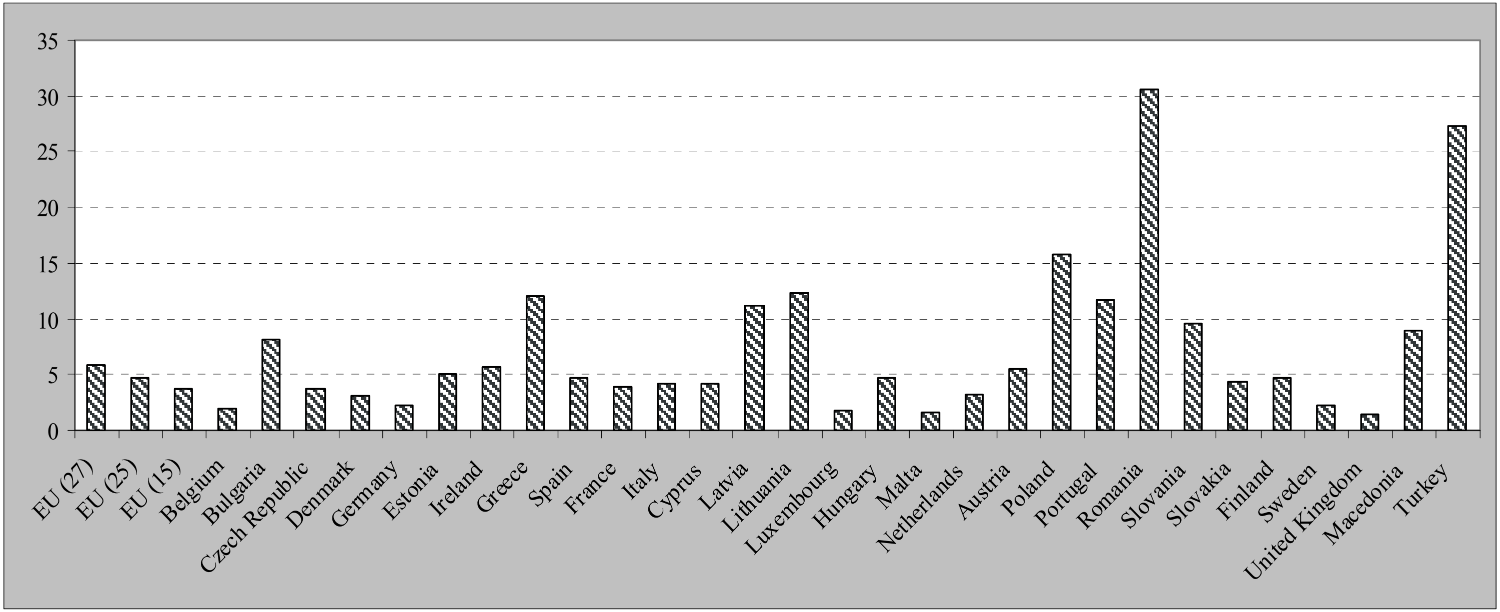
2.2.2. Agricultural Labour

In Turkey, the share of agricultural employment in the total employment, which was 46.9 percent in 1990, gradually decreased to 27.3 percent in 2006. Yet it varied in a wide range between geographical regions; it was as high as 58 percent in the Black Sea region and only 14.8 percent in the Marmara region. The decline in agricultural employment was a natural outcome of the development process. As the income elasticity of most of the agricultural products is less than unity, their demand increased less than the rise in income. Rapid mechanization of production, improved seed quality and other technical advances augmented labour productivity and agricultural employment inevitably fell. In addition, reduced government subsidies to the agricultural sector probably would accelerate the detachment from agriculture (Tunalı, 2003).

Recently, Turkey entered into a new phase of employment structure transformation as the agrarian sector started to decline not only in relative terms but also in absolute terms (Tunalı, 2003). Nonetheless, the share of agriculture in total employment is still very high compared to EU countries. The average of agricultural employment is still close to one third of total employment in Turkey, while 5.9 percent in the EU-27. The high share of employment in agriculture indicates the low level of technological development of agriculture in our country.

Figure 2.3. Employment in Agriculture (Share in Employed civilian Working Population) – 2006

(%)



Source: Eurostat, http://ec.europa.eu/eurostat (accessed on 23 September 2007)

In Turkey, agricultural employment is characterised by high rates of unpaid family labour, particularly amongst woman. Almost half of the agricultural workforce is women in the country. In 2003, 51 percent of agricultural employment was classified as unpaid family labour while 44 percent were either employer of self-employed. The fact that half of agricultural labour consists of unpaid family labour is a key element in explaining the high labour force participation rates and low unemployment rates in the rural population (Çakmak, 2004; Burrell, 2005).

2.2.3. Agricultural Production

In Turkey, the climatic and geographical conditions allow a wide range of different farming activities. Using world prices to calculate the value of output quantities, FAO states that in 2005, Turkey's top commodity was wheat, followed by cows' milk, tomatoes, grapes and indigenous chicken meat. Other important commodities are barley, indigenous cattle meat, apples, hen eggs and sugar beets. By international standards, Turkey is a major agricultural producer. Turkey ranked on the top of the world producers for apricots, cherries, figs, hazelnuts in 2005. It was in the top two with production of melon and cucumbers and in the top three with production of apples, beans, chick-peas, chillies and peppers, lentils, pistachios, sheep milk, sour cherries and tomatoes (FAO, http://www.fao.org, accessed on 1 Sept 2007).

Most of the arable land and the greater part of the farm population have been dedicated to producing cereals; as of 2004, cereals occupied about 14 million hectares, a very high percentage of the total, as the total cultivated area of Turkey is about 18 million hectares. Wheat accounted for about 9.4 million hectares of this area, and barley for 3.5 million hectares.

Table 2.5. Area Harvested for Product Groups 1980-2004
(Five Year Averages) (ha)

	1980-84	1990-94	2000-04
Cereals	13,378,998	13,898,344	13,807,149
Oil Crops	1,828,212	1,942,458	1,968,606
Pulses	1,074,809	2,065,340	1,551,117
Industrial Crops	1,216,886	1,325,779	1,298,727
Vegetables	761,095	830,799	1,034,264
Fruits	1,090,397	1,021,648	1,035,576
Nuts	427,819	453,191	505,685
Tuber Crops	272,999	295,669	307,102

Source: Turkstat, *Statistics*, www.turkstat.gov.tr
(accessed in Aug 2006)

Crop production in Turkey is highly diversified due to the range of climatic and topographical conditions. Most of the agricultural production originates from the coastal regions, with the highest production in the Mediterranean and Aegean regions which are highly suited to fruit and vegetable production. More extensive agriculture (crops and livestock) occurs in the more mountainous areas (especially east and south-east) (Yılmaz, 2006). Crops are the most important products with 55.8 percent of total value of agricultural production. They split between cereals (11.6 percentage), industrial crops such as sugar beet and tobacco (6.4 percentage), vegetables (13.7 percentage), fruits (17.4 percentages) and other crops. Wheat is the most important single crop with 7.9 percentage of total output value. Livestock production and animal products contribute with 24.9 percentages and 19.3 percentage of total value respectively (European Commission, 2003).

Table 2.6. Agricultural Output of Turkey

(2000)

	bio Turkish Lira	%
Crop Output	**14 920 080**	**55,8**
Cereals	3 092 936	11,6
Wheat	2 100 502	7,9
Barley	645 117	2,4
Maize	244 583	0,9
Rice	54 687	0,2
Other cereals	48 046	0,2
Industrial crops	1 708 728	6,4
Vegetables	3 674 327	13,7
Fruit	46 44 860	17,4
Other crops	1 799 229	6,7
Livestock	**6 652 065**	**24,9**
Sheep	1 401 603	5,2
Cattle	4 212 035	15,8
Hens	650 068	2,4
Other livestock	388 359	1,5
Animal Products	**5 152 206**	**19,3**
Milk	2 239 262	8,4
Meat	1 388 298	5,2
Other animal products	1 524 646	5,7
TOTAL	**26 724 351**	**100**

Source: European Commission, 2003

2.2.4. Farm Structure

According to 2001 agricultural census (the last one), there are 3 million agricultural holdings in Turkey as compared to approximately 5.8 million (2005) in the EU-15 and 14.4 million (2005) in the EU-27 (Eurostat). The pattern of land ownership is highly skewed and varies regionally due to differences in incomes and the crops grown. A large number of farmers own and cultivate a small area of the land. Farms in Turkey are generally family-owned, small and fragmented. The average farm size was around 6 ha in 2001, compared to an average around 19 ha in the EU in 2000. Approximately 65 percent of them have less than 5 ha land and 83 percent less than 10 ha. About 6 percent of the holdings have a size larger than 20 ha (European Commission, 2003).

Table 2.7. Holdings by size classes (1000 holdings)

	1991		2001	
Size classes	number	% of total	number	% of total
Total	4 060	100,0	3022	100,0
0-2 ha	1 454	35,8	1008	33,4
2-5 ha	1 260	31,0	951	31,5
5-10 ha	722	17,8	560	18,5
10-20 ha	399	9,8	327	10,8
20-50 ha	185	4,6	154	5,1
50 ha and more	38	0,9	22	0,7

Source: European Commission, 2003

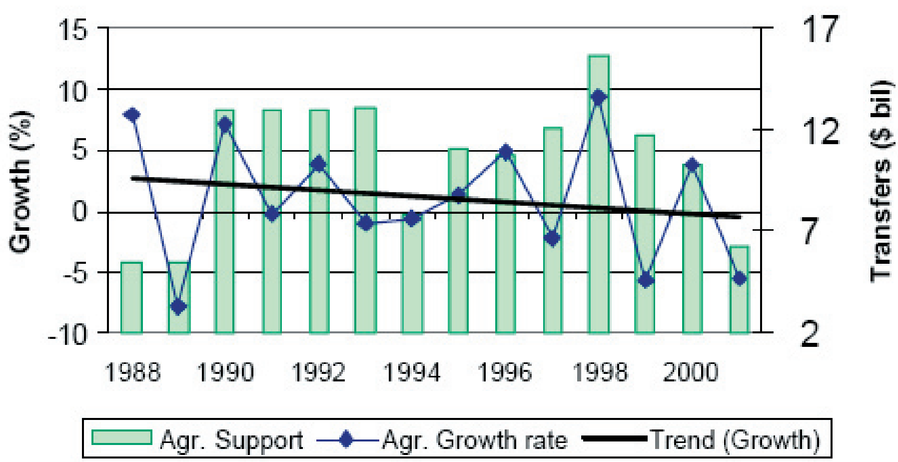
2.2.5. Agricultural Policies in Turkey

Until a few years ago, input subsidies, guaranteed output prices, some limited control of supply, free or low cost services to farmers, import protection and export subsidies were very important components of the Turkish agricultural policy. History of the agricultural support policies in Turkey goes back to 1932. With the aim of preventing likely decrease in the price of wheat as a result of the increase in production, Ziraat Bank entered into the market as the buyer of the wheat. In 1935, Agricultural Sales Cooperatives were recognized. Since that dates, along with the needs of the agricultural sector and the development of the Turkish economy, different types of agricultural support mechanisms have been developed in terms of policy tools and institutions (Doğruel, Doğruel and Yeldan, 2003; Eraktan, 2001).

In Turkey, especially price supports have been very important part of agriculture. Agricultural sales cooperatives and state economic enterprises have been commissioned to buy some agricultural products such as, cereals, tobacco, tea and sugar beet from farmers at prices set by the government. The second most important component of the policy has included various subsidies, grants and exemptions lowering the cost of inputs, including capital, fertiliser, seed, pesticides and water. On the other hand, the output of tobacco, hazelnuts, tea and sugar beet has been controlled in various ways. General services to farmers, such as research, training, extension and inspection, disease control services were provided free or at low cost (Flam, 2004). Direct payments had no importance in the Turkish agricultural support policy.

Over the last four decades agricultural GDP grew about three times slower than the overall economy. This trend resulted in a declining share of agriculture in GDP from 35 percent in 1960 to 7.4 percent in 2007. During the same period, the share of agricultural labour in total force declined by much less, from 55 percent in 1960 to 27.3 percent in 2006. Though labour productivity in agriculture showed an upward trend between 1960 and 2000s, growth rates declined steadily and turned negative in the mid 1990s (Lundell, et. al, 2004).

Figure 2.4. Agricultural Transfers and Growth



Source: Lundell et. al, 2004

Agricultural subsidies generated unbearable fiscal costs, and high import tariff policies placed a heavy burden on low and middle income consumers. Since input and price subsidies disproportionately benefited large farmers, this type of agricultural support contributed to income inequality in Turkey (Lundell, et. al, 2004).

2.2.6. Agricultural Reforms in Turkey

Turkey recently embarked on a set of reforms to address elimination of producer price subsidies in its agriculture, and replacing them with a targeted direct income transfer program. The present reforms in Turkey are a result of the Uruguay Round agreement on agricultural trade, Turkey's own efforts to adjust to the CAP, and the conditions of the IMF program. Under the reform program output price supports and input subsidies and grants in various forms have been phasing out and replacing by direct payments to farmers through a uniform per hectare payment unlinked to the production of any specific crop. On the other hand, tariffs have been gradually reducing under this program (Togan, 2004). As partial compensation for the removal of output support and input subsidies, the government introduced direct income support which involves a flat-rate payment per hectare (SPO, 2000). The program was started in 2001 with a cap at 20 hectares, but this created an incentive to split up larger farms in order to receive more direct payments. Although the land registration is not completed yet, all land users are eligible to apply for direct income support, as long as they can demonstrate that their land is legally cultivated and is registered in the land registry, or that they can show a document from the village head that they are legally users of the land (Lundell, et.al., 2004; Çakmak, 2004).

The second part of the program has been domestic price reforms through privatisation of national parastatal enterprises, including Turkish Sugar Company and Turkish Alcohol and Tobacco Company, and restructuring of Turkish Grain Board. On the other hand, quasi-governmental Agricultural Sales Cooperative Unions, which in the past intervened to support certain commodity prices, have been restructuring by the Government. These two efforts are very important steps in reducing the state's direct role in agricultural area (Lundell, et.al., 2004).

One of the obvious results of the agricultural reforms in Turkey is the reduction and, for some items, complete removal of input subsidies. Reduction in the fertiliser subsidy started in 1997 and was completed in 2001. Although the subsidy was nearly 50 percent of the fertiliser price in 1997, the real price to farmers certainly did not double over the period of abolition. Part of the subsidy used to go to fertiliser industry and the organisations distributing the fertiliser, and presumably its abolition was partly absorbed by them. Following the subsidy removal, fertiliser use has fallen by 25 to 30 percent (Lundell, et.al., 2004).

The agricultural reform program in Turkey was accelerated in 2001. Producer price subsidies through state procurement were replaced with direct income transfer program. The primary objective of the Agricultural Reform Project of 2001-2005 period was to help implementing the Government's agricultural reform program, which was aimed at reducing artificial incentives and government subsidies. Agricultural Reform Implementation Project brought radical changes in agricultural support system (Yılmaz, 2006). Ratio of credit, price and input supports in total support was 97.2 percent in 1995. This ratio was decreased gradually to 18.5 in 2005.

After the ending of the Agricultural Reform Project of 2001-2005 period, a new strategy was decided for 2006-2010. The strategic objectives, principles and priorities of agricultural policies to be implemented after the 2001-2005 period were set in the agricultural policy paper 2006-2010. The primary objective of this paper is to readjust the agricultural policies in line with the national development plans and strategies conducted in the EU.

Table 2.8. Agricultural Support Tools in the Period 2006-2010

(%)

Direct Income Support	45
Deficiency Payments	13
Livestock Supports	12
Rural Development Supports	10
Compensatory Payments	5
Crop Insurance Supports	5
Environmentally based Agricultural Land Protection Support (Çatak)	5
Other Supports	5
Total	100

Source: SPO, *Main Economic Indicators*, http://www.dpt.gov.tr (accessed on 2 Dec 2007)

If the reforms are totally completed, Turkey will have an agricultural policy similar to the CAP; high intervention prices and protection from the world market will have been replaced by direct income support, lower protection and prices approaching world market prices. Implementing the programme requires extensive administrative reforms. For example, substantial investments are needed in improving land registration, collecting agricultural data, and raising veterinary and phytosanitary standards[15].

The ongoing agricultural reforms can be seen as a result of accession as well as the need to reduce public expenditure. This will in the short run lead to considerable efficiency gains, but also to substantial reduction in farmers' income (Togan, 2004). The fundamental principles of the agricultural reforms maintained in Turkey are consistent with the long-term policy direction of the Common Agricultural Policy of European Union.

[15] For further information on agricultural reforms in Turkey see Eraktan, 2001; Togan, 2004.

2.3. Income Distribution in Turkey

2.3.1. Household Income Distribution

Income inequality is one of the continual characteristics of Turkey. Tables below show the distribution of income since 1963, looking at the share of income by quintiles and Gini coefficients.

Table 2.9. Distribution of Annual Total Household Income by Income Shares

Quintiles	1963	1973	1987	1994	2002	2003	2004	2005
Lowest 20%	4.50	3.50	5.24	4.86	5.3	6.0	6.0	6.1
Next 20%	8.50	8.00	9.61	8.63	9.8	10.3	10.7	11.1
Next 20%	11.50	12.50	14.08	12.91	14.0	14.5	15.2	15.8
Next 20%	18.50	19.50	21.15	19.03	20.8	20.9	21.9	22.6
Highest 20%	57.00	56.50	49.94	54.88	50.1	48.3	46.2	44.4
Gini Coefficient	n/a	0.51	0.44	0.49	0.44	0.42	0.40	0.38

Source: Turkstat, *Statistics*, www.turkstat.gov.tr (accessed on 3 July 2007)

Table 2.10. Distribution of Annual Total Household Income by Average Income

Quintiles	1963	1968	1973	1986	1987	1994	2002	2003
Lowest 20%	1	1	1	1	1	1	1	1
Next 20%	1.9	2.3	2.3	2.2	1.8	1.8	1.9	1.7
Next 20%	2.6	2.9	3.6	3.2	2.7	2.6	2.6	2.6
Next 20%	4.1	6.7	5.6	6.0	4.0	3.9	3.9	3.5
Highest 20%	12.7	20	16.1	14.3	9.5	11.3	9.5	8.1

Source: Turkstat, *Statistics*, www.turkstat.gov.tr (accessed on 3 July 2007)

Gini coefficient is the most widely used tool in specifying the income inequality in countries. In order to measure income inequality, the total number of households is divided into 5 equal groups of 20 percent according to their incomes from the lowest to the highest. The first 20 percent represents the poorest households. Over the past three decades, the richest 20 percent of households received 50 percent or more of total disposable income (SPO, 2001).

Table 2.9. and 2.10. clearly illustrate the extent of income inequality in Turkey. The share of income accruing to the poorest quintile was 5.3 percent in 2002 and 6.1 percent in 2005. In contrast, the share of the richest quintile was between 50.1 percent and 44.4 percent, respectively. In 2002 and 2005, the average household income in the top quintile was 9.5 and 7.2 times higher than from households in the bottom quintile, respectively. Moreover, the average household income rises quite slowly until the fourth income quintile. In 2005, the rise in the average household was 81 percent from the first to the second income quintile, 42 percent from the second to the third, and 43 percent from the third to the fourth. The jump from the fourth to the last income quintile was, however, much more dramatic; average household income in the top quintile was 96 percent.

Table 2.11. Gini Coefficient Comparison
(Turkey and some European Union Countries)

Country	Survey Year	Gini Coefficient
Czech Republic	1996	0.25
Ukraine	2005	0.28
Bulgaria	2003	0.29
Hungary	2004	0.30
Romania	2005	0.32
Greece	2000	0.34
Poland	2005	0.35
Spain	2000	0.35
Turkey	**2005**	**0.38**

Source: The World Bank, *World Development Indicators*, http://www.worldbank.org (accessed on 28 Dec 2007);
Turkstat, *Statistics*, www.turkstat.gov.tr (accessed on 26 Dec 2007)

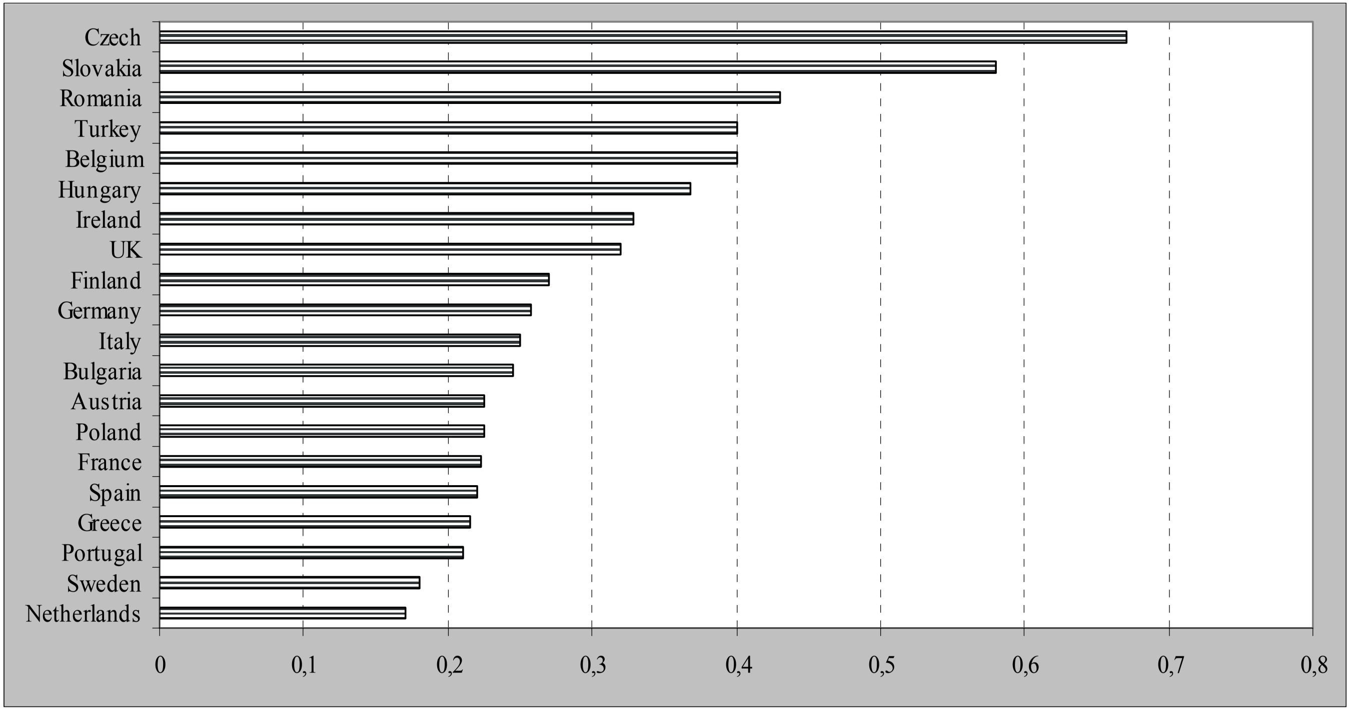
Table 2.11. shows the Gini coefficient comparison between Turkey and some of the European Union countries. Income inequality in Turkey is clearly very high when compared to the EU countries. Even when compared to Spain and Poland, the most unequal Union countries, Turkey fares poorly. Inequality in Turkey stems from differences in endowments such as land, labour and capital, opportunities faced in the labour market and education and employment level (World Bank, 2000).

2.3.2. Regional Income Distribution

Turkey suffers from not only personal income inequalities but also regional development disparities. The country demonstrates high regional income disparities when compared to some EU countries (Oskam, Longworth and Yıldız, 2005).

Regional disparities are of long historical standing and arise partly because of less advantageous levels of natural and human resources. In addition, the fact that the coastal areas along the Mediterranean sea enjoy better access to world and regional markets. Another reason of these disparities is differences in types of economic activities pursued, together with differences in productivity between sectors. For instance, poorer regions generally have a bigger share of their resources employed in agriculture, where productivity is usually lower (World Bank, 2000). It is clear that improving the productivity of agriculture would improve the situation of underdeveloped regions.

Figure 2.5. Variability of Regional GDP Per Capita in Turkey and the EU (2001)



Source: The World Bank, 2008

Figure 2.6. Development of Regional Income Variability (1995-2001)

Source: The World Bank, 2008

Turkey suffers of large regional development disparities which are more serious than almost all EU-15 countries. However, Figure 2.5. shows that variability of regional GDP per capita in new accession countries such as Czech Republic, Slovakia and Romania is much stronger than Turkey. As in much of the EU, regional income disparities in Turkey have stayed more or less constant over the last few years. Regional disparities run largely along the east–west axis. Advanced regions (those with an average income per capita higher than the 75 percent of the national average) include Marmara, Aegean, Mediterranean and Central Anatolia, while the remaining three regions, Eastern Anatolia, Southeastern Anatolia and Black Sea, are classified as lagging (World Bank, 2008).

Chapter 3

BUDGETARY IMPACT OF TURKISH ACCESSION TO THE EUROPEAN UNION

3.1. Future of the European Union Budget and Turkish Accession

The structure of the current system of the European Union revenue and expenditure is such that the financial resources are transferred from the rich member states to poor ones. Nevertheless the relation between income per capita and net transfer is far from straight. Some rich countries give proportionately more than others, while some poor countries receive a disproportionate share of the transfers. Because Turkey is poor relative to the EU-15, much attention has been given to the budgetary effects of this accession, on the presumption that enlargement will be very costly for the Union. The present net recipients from the EU budget seem to fear that transfer to them will be cut, and the net contributors fear that they will be required to increase their contributions (Togan, 2004).

Because of its size and level of economic development, Turkey's accession would undoubtedly have a significant impact on the Union's budget. Technically, it would be possible to estimate the budgetary effects of Turkey's accession based on the current acquis. But any such estimates would need to be treated with caution taking into account the likely timetable and some ambiguities. First of all, it is very difficult to predict some developments in advance in Turkey which are directly related with the EU's spending policies. Secondly, the EU's spending policies may undergo severe modifications prior to Turkey's accession. On the other hand, it is unlikely that current arrangements for the funding of EU expenditure to remain the same. Like expenditure side, the revenue side of the European Union budget will also be rearranged (European Commission, 2004b). It is clear that these arrangements cannot be predicted with any certainty at this present time.

Currently, financial allocations laid down by the multi-annual financial plans play crucial role in determining the EU budget. After expiration of the present framework in 2013, the next multi-annual financial outlook will come into force from the beginning of 2014 for the period 2014-2020. Likely, full membership will not take place before negotiating the framework covering the period 2021-2027. According to this figure, Turkey will have no or very limited influence over the next financial framework, running until 2020. Supposing 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 (Derviş, et.al, 2004).

Since Turkey will not be able to join the Union before 2015, it will have only a limited influence for the following financial framework. The size of financial transfers for the initial years accession will have been decided by a group of country consisting of existing Member States and Croatia. On the other hand, Turkey probably will not benefit fully from the Union's budgetary facilities before 2020. This is because, all current Member States did not benefit from their accession until about 5 to 10 years after becoming a part of the Union (Derviş et.al, 2004).

3.2. Determinants of the Budgetary Cost of Turkish Accession

CAP and the structural and cohesion policy are the most important components of the EU budget. For any candidate country, the budgetary effects of accession result from both applications of these policies. There is no doubt that, under the current rules, Turkey would be eligible for a substantial support.

3.2.1. Turkish Accession and Implementation of the CAP

Most EU budgetary concerns focus on the size of Turkish agricultural sector in terms of area, production and agricultural employment. Turkey has a large agricultural sector, measured by production value as well as agricultural GDP. In terms of population size and agricultural production value, Turkey is comparable to the 10 new Member States joined in 2004. With regard to the role of the agricultural sector in the economy and of per capita income, Turkey equals Bulgaria and Romania in shares of agriculture in employment and GDP, and per capita GDP in purchasing power standard (Grethe, 2005b). The size of the agricultural sector in Turkey, both in absolute terms and in respect of its economic and social role, represents an important element in budgetary considerations.

Basically, there are two types of payments under the present CAP system; i- CAP first pillar payments, separated into market and price support, and direct income support, ii- CAP second pillar payments. Direct income support to producers under the first pillar of the CAP, and payments for rural development measures under the second pillar are the main items of the EU budget.

3.2.1.1. Payments under the First Pillar of the CAP

Direct payments are one of the most essential items of the EU budget. The Union spent around EUR 30 billion on direct payments to agricultural producers in 2004. This is more than 60 percent of total agricultural budget. Since decoupled direct income support is the dominant instrument of the current system, budget payments to Turkey for market and price support would be very small. The essential part of the transfers under the first pillar of the CAP is supposed to come from the direct income support.

According to Grethe, there are two alternative approaches in estimation of the level of direct payments to Turkey. In the first approach, product-specific EU rates for cereals, oilseeds and protein crops, tobacco, olive oil, cotton, milk, beef, sheep, and goat meat are applied to Turkish areas, yield and production quantities from a partial equilibrium model analysis of full integration of Turkish and EU agricultural markets. These results cover all market effects due to full market integration, but don't cover any reactions of the Turkish producers to the CAP. The second approach is based on the total agricultural area only. Total agricultural area of Country is multiplied by a per ha rate for comparable countries under the Simplified Area Payments Scheme (Grethe, 2005b).

In terms of direct payments, Grethe departs from two different scenarios. The first scenario is based on the implementation of the CAP in Turkey without any phasing in of direct payments. Under this scenario, budgetary cost for fully applying direct payments to Turkey in 2015 would amount to EUR 5.3 billion. Because the full implementation of current direct payment system is not realistic, Grethe considers the second scenario which is based on the reduction of direct payments. This scenario describes the case in which the nominal level of direct payments in the EU is reduced by an annual rate of 3 percent up to 2015. Under this assumption, budgetary cost of full implementation of direct payments in Turkey drops to EUR 3.8 billion (Grethe, 2005b).

Another estimation was made by the European Commission. It was concerned with the cost of direct income support for Turkey and was made under the assumption that 100 percent of direct payments would be due in the first year of accession. The European Commission finds out the cost of fully implementing direct income payments at EUR 5.3 billion in 2004 prices or EUR 6.6 billion in 2015 prices (European Commission, 2004b). The study of the Commission is very general and far from explaining the details of estimation.

Nevertheless, because of the Commission's decision in October 2002 there will be a shift of emphasis within the CAP, affecting the share of Turkey. Direct payments under the first pillar of the CAP may shrink over time. Instead, a basket of rural development policies may gain in importance for Turkey (Schultz, 2005).

Instead of high direct payments, transfers of EU funds to Turkey under the second pillar may hold more interest for Turkey. Under the second pillar of the CAP payments can be directed at measures which are aimed at improving productivity in Turkish agriculture. Such measures might contain training farmers in order to increase their productivity in agriculture or to enable them to leave the sector, public investment in rural infrastructure, modernization of the food processing industry, and measures to improve the distribution of land among farmer (Grethe, 2005b).

3.2.1.2. Payments under the Second Pillar of the CAP

Contrary to direct payments, the importance of the second pillar of the CAP is expected to rise in the following years. 18 percent of the expenditure on agricultural policies was spent on this policy in 2004. The share of the second pillar is supposed to arrive about 23 percent at the end of the 2007-2013 Financial Perspective (Grethe, 2005b).

The amount of payments to Turkey under the second pillar of the CAP was estimated by the European Commission (2004b) and Grethe (2005b). The European Commission estimates the cost at about EUR 2.3 billion in 2004 prices (European Commission, 2004b). Grethe provides a detailed formula based on agricultural land, agricultural labour and relative GDP in purchasing power standards to calculate the rural policy funding for Turkey in comparison to new member states.

Because of uncertainity about the rule of allocating second pillar funds to individual member states, Grethe makes “guess” to find out the future level of payments to Turkey under the second pillar. He uses new member states as reference. His guess is based on the level of rural development funds being allocated to the new member states for the period 2004-2006 and to Bulgaria and Romania for the period 2007-2009, as well as on the criteria of agricultural area, employment and GDP in purchasing power standards (Grethe, 2005b).

Taking new member states as reference, Grethe estimates that Turkey would receive about EUR 2.5 billion of rural development funds in 2015. When he takes Bulgaria and Romania as reference[16], he arrives at a total cost of EUR 1.5 billion for Turkey in 2015 for the second pillar of the CAP (Grethe, 2005b).

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[16] Rural development funds foreseen for Bulgaria and Romania for the period 2007-2009 are EUR 1 billion annually.

However, there are mainly four important points in terms of agricultural outlays. First of all, many reforms of the CAP yet to be implemented are already determined, including partial decoupling of direct payments under the 2003 reform. But, major decisions on the future level of outlays for direct payments and rural development policies are yet to be made. Secondly, the state of the Turkish agricultural sector will determine the budgetary cost and net transfers to Turkey resulting from the CAP at the time of accession. As a result of changes in world market prices, technological progress, increasing incomes and population, and many other factors, the Turkish agricultural sector will be different in 2015. In addition, accession itself will affect the allocation of resources in Turkish agriculture. Thirdly, Turkey's contribution to the EU budget in case of accession will determine the resulting budgetary net transfers. As the contribution of member states to the EU budget is mainly determined by the size of their GDP, shares in GDP are a good indicator for shares in the EU budget. However, Turkey's share in the total GDP of a potential EU-29 in 2014 may be different from that today, as economic growth in the EU-28 up to 2015 may be different from that in Turkey. Finally, the conditions of Turkish accession to be negotiated between the EU and Turkey will significantly determine budgetary flows. For example, any transition periods for fully applying direct payments, the level of payments under the second pillar of the CAP, and the base ceilings for arable and livestock payments are all negotiable factors (Grethe, 2005a).

3.2.2. Turkish Accession and Implementation of the Structural and Cohesion Policy

The eastern enlargement changed the structure of the Union in economic and social terms. It shifted the Union from a group of largely rich industrial countries to a heterogeneous club of states with economic disparities. After 2004, the significance of the cohesion countries has grown. If we compare the old EU-15 in 2001 with a EU-29 including Turkey in 2015, it's clear that the number of cohesion countries will increase from three to at least fifteen (Quaisser and Wood, 2004).

As regards the structural and cohesion policy, Turkey would be eligible for substantial levels of support from the Union's budget. First of all, its GDP per capita would be lower than that of any member country of the Union. Secondly, it is clear that, one of the specific characteristics of Turkey is the significant regional disparities within the country. Under the current support regime, with a level of per capita GDP at about 29 percent of the EU-25 average, which is close to Bulgaria and Romania, Turkey would be eligible for substantial levels of structural operations expenditure (European Commission, 2004b).

Oskam et. al. (2005) tries to estimate the impact of implementing the structural policy in Turkey on the eligibility of Member States in the EU-27 for structural aid. In this study, they assume that structural and rural development policies will remain unchanged when Turkey enters the European Union. The second assumption of this study is that regional incomes grow at the same rate as the corresponding national income. According to their result, after Turkish accession, around 160 billion people will be living in regions with GDP per capita in PPS below 75 percent of the European Union average. Their model predicts that 71 regions will qualify as "convergence" regions under Objective 1. Only 12 million of these people will live in the EU-15; the majority will be in the new member states (69 million) and Turkey (79 million; that is, all Turkish NUTS II regions expect the region of Kocaeli). This model predicts that with Turkey inside the EU in 2015, average EU per capita income measured in PPS decreases from EUR 27,610 to EUR 25,090. This reduces the per capita GDP threshold defining eligibility for the convergence regions under Objective 1 of the structural and cohesion funds by EUR 1894 in 2004 prices. This model suggests that the total population of regions losing eligibility of convergence funding under Objective 1 is 33 million; 6 million in the new member states joined in 2004 and 27 million in the EU-25 (Oksam, Longworth and Vilches, 2005).

In terms of cohesion fund, accession of Turkey has potential consequences for EU-27 recipients of cohesion funds as well. Currently, member states with per capita GNI in PPS less than 90 percent of the EU average qualify for cohesion funds. Because of Turkey's low level of GNI, 90 percent of average EU per capita GNI will be lower with Turkey as a EU member.

However, it should be kept in mind that, the existing rules have never been applied to a country of similar size, similar level of economic development and similar intensity of regional disparities as Turkey. On the other hand, it is not clear that if Turkey will be able to reach the existing upper limit of 4 percent of GNI on the level of total annual structural and cohesion funds transfers (European Commission, 2004b).

3.3. Budgetary Cost of Turkish Accession

The budgetary cost of Turkish accession to the European Union can be considered from two perspectives;

i- Pre-accession payments; short-term payments to Turkey before accession,

ii- Post-accession payments; long-term payments flows after Turkey becomes eligible for member programmes.

3.3.1. Pre-Accession Transfers

As an integral part of the Union's accession strategy, candidate countries are invited to make use of financial resources designed to pave the way to the envisaged accession. This will also apply to Turkey (Schultz, 2005).

The new member states from Central and Eastern Europe benefited from modest amounts of preaccession aid, originally under a programme, PHARE[17], whose primary justification was to support the transition to a market economy. These funds were later augmented by two additional programmes: SAPARD[18] and ISPA[19]. The original justification for PHARE funding does not apply in the case of Turkey; but no doubt that a substantial

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[17] PARE: "Poland and Hungary assistance for restructuring their economies" was developed in 1989. This program was intended to act as a bridge for candidate countries in acquiring the *acquis* and preparing for structural funding.

[18] SAPARD: "Special accession program for agriculture and rural development" was designed to help candidate countries in solving problems of structural adjustments in the sector of agriculture and to provide assistance in implementation of the *acquis* in the area of Common Agricultural Policy.

[19] ISPA: "Instrument for structural programs for preaccession" was created in 1999. This fund was used in financing important projects for the protection of the environment and in building transport infrastructure.

amount of funding for democracy-building will appear needed viewed from the EU side (Derviş et.al, 2004).

During the period 2007-2013 and beyond there will be three main instruments[20]; i-Instrument for Pre-accession Assistance (IPA), ii- European Neighbourhood and Partnership Instrument (ENPI), iii- Development and Economic Co-operation Instrument.

During 2007-2013 financial period, Turkey will be treated under the IPA heading. The equality of treatment is so crucial from the EU perspective. Therefore, it is likely that as negotiations proceed, a similar amount of financial support given to Bulgaria for the preparation for accession will become available for Turkey as well. Scaling the funds available for Bulgaria[21] (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. This would correspond to approximately 1-1.2 percent of GDP for Turkey (0.03 percent of the European Union's GDP or 2-2.5 percent of its budget) (Derviş et.al, 2004).

3.3.2. Post-Accession Transfers

In regards to the post accession payments, the literature has emphasized three different starting points to analyse the budgetary effects of the Turkish accession.

i-How much would Turkey receive if it were a member state today?

ii-How much will Turkey roughly receive under the current rules by a likely accession date?

iii-How much will Turkey roughly receive under a reform scenario by a likely accession date?

[20] In order to consolidate all dispersed financial aid programs, the EU Commission created a new Instrument for Pre-Accession Assistance (IPA) from January 2007. The new IPA superseded the five preceding instruments- Phare, Ispa, Sapard, Turkey pre-accession instrument and Cards.

[21] Over the 2000-2003, the total support going to Bulgaria has been around EUR 300 million per annum, with about half coming from PHARE, one-third under ISPA and the remainder under SAPARD.

In literature, there are a number of studies concerned with the cost of Turkey's potential membership. In these studies, the cost of Turkish membership is calculated in various ways.

Before reviewing, it should be noted that it is not easy to compare the results of these studies. Within these studies, there are some differences in terms of the degree of comprehensiveness, timing and methodology used for estimation. Some of these studies try to provide a full coverage of all budget costs, but some of them concentrate on just one type of budgetary item such as agriculture. Timing is also different; the budget estimate may relate to the first year of accession or to a later year if phasing in of certain payments is assumed. On the other hand, estimation methodology used by authors ranges from "best guesses" to more structured ways of calculating budgets using details on the situation in Turkey. Another difference of these studies is related to *acquis*. While some studies are based on the current *acqui*, some of them are estimated under the expected future rules. And finally, the gross approach calculates only the costs to the EU budget, whereas the net approach also deducts Turkey's contribution to the EU budget (Oskam, Longworth and Vilches, 2005). Although not fully comparable, they are a good indicator of the wide range of estimates. The main characteristics of these studies are presented in Table. 3.1.:

Table 3.1. Overview of Budget Cost Estimates

Athor(s)/ Year	Status quo/ Reform Scenario	Main characteristics	Results (billion Euros)	
			Status quo	Reform scenario
Grethe (2005b)	Status quo + Reform Scenario	Based on an equilibrium modelling of the Turkish agricultural sector. Real devaluation of nominal fixed amounts is applied for direct payments. Second pillar is based on a Formula. Some variables are compared to Bulgaria and Romania. In different reform scenarios, a 3 percent cut in direct payments yearly is assumed.	CAP (1. Pillar) 5.3 CAP (2. Pillar) 1.5-2.5	CAP (1. Pillar) 3.8 CAP (2. Pilar) 1.5-2.5 Net Transfers i-) 10.4 (base growth assumption) ii-) 9.3 (catch-up growth assumption) iii-) 11.3 (slow growth assumption)
Flam (2004)	Status quo	Estimation of the contribution per capita in the EU-15 based on income per capita and of the receipts per capita based on per capita Council votes and the level of development in broader sense.	Net Transfers 12	

Togan (2004)	Status quo	Regressions based on existing expenditures, income levels and voting powers of the EU-15. The result is obtained under the assumption that there are no upper bounds on the receipts of the candidate countries.	Net Transfers 14
Derviş et al. (2004)	Status quo	Two different estimations; -Turkey in the European Union today; based on the calculations of the receipts and contributions in billion of Euros. -Turkey in the European Union in 2015; based on the calculations of the receipts and contributions in % of the European Union budget.	Net Transfers in the first post-membership years 9-12 Net Transfers in 2020 15-20
Hughes (2004)	Status quo	Estimations are based on 4 percent GDP limit for structural funds and on the financial package for Bulgaria and Romania.	Agriculture 1.9 Structural Action 8.1 Total Transfers for 2015 11.4 Total Transfers for 2017 19
European Commission (2004b)	Status quo	(2004 prices) Phasing in of direct income payments over a 10-year period Estimates based on 2025.	CAP (1. Pilar) 6 CAP (2. Pillar) 2.3 Turkey's Contribution 5.6 percent of GNI

Quaisser & Reppegather (2004)	Status quo	Different scenarios with different levels for -phasing in direct income support, -structural funds as share of GDP, -contribution of Turkey to the European Union budget.	CAP (1. Pillar) 1.4-4.5 Structural funds 3.9-11.3 Other 1.6 Turkey's contribution 1.7-3.4 Net Transfers 5.2-14	
Quaisser & Wood (2004)	Status quo	Different scenarios; -Entry scenario with 35 percent direct payments -Second scenario of full integration in European Union policies with 100 percent of direct payments (2014).	Entry Scenario	Second Scenario
			Total Transfers 10.2 Agriculture 2.9 Structural Funds 4.7 Other 2.6 Net Transfers 8.5	Total Transfers 24.2 Agriculture 8.2 Structural Funds 13.4 Other 2.6 Net Transfers 20.9

Derviş et al. estimates that ceiling for the net cost of Turkish accession to the Union will be about 0.20 percent of EU-15 GDP. They try to provide a full coverage of all budget costs.

In regards to agricultural cost, they estimate that the cost of the CAP applied to Turkey in 2015 will be about 0.08 percent of EU-28 GDP. Their first assumption in reaching this result is that Turkey would grow quicker than the European Union over the next decade, and Turkish GDP would be around 4 percent of that of the EU-28 GDP in 2015. Another assumption of this calculation is that the share of agricultural sector in Turkey would be 10 percent of the GDP at that time. Under these circumstances, if the current

EU-15 level of budgetary outlays for the CAP, relative to agricultural GDP of about 20 percent is maintained[22], agricultural receipts would be 0.08 percent[23] of EU-28 GDP.

In terms of Structural Funds, Derviş et.al, start with the basic assumption that the budget expenditure ceiling of 4 percent of Turkey's GDP would determine expenditure on structural policy. Under the growth scenario (Turkish GDP at about 4 percent of that of the EU-28 GDP), this implies that the cost of extending current Structural Funds to Turkey would cost at most 0.16 percent[24] of EU-28 GDP.

After calculating the total receipts from the EU budget, Derviş et.al estimate contribution that Turkey would have to make to the Union. According to the authors, Turkish transfers to the EU budget (this contribution rate is equal to the share of the EU budget in overall GDP) would be in the order of 1.2 of its own GDP. Under these assumptions, total receipts would amount to around 0.048 percent of the EU GDP. Consequently, the ceiling for the net costs should be around 0.20 percent[25] of the Union GDP.

According to their final result, net transfers to Turkey would be around EUR 9-12 billion in the first post-membership years and EUR 15-20 billion in the 2020's.

Referring to Grethe, Quaisser and Reppegather (2004) estimates the total cost of extending the CAP to Turkey at EUR 4.4 to 5.4 billion. Their study is based on a regression analysis. The authors applies regression analysis to the EU-25 sample with agricultural value added and agricultural production value in the individual member states as explanatory variables for EU budgetary outlays for full implementation of the CAP. The weakness of

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[22] Turkish farmers will obtain the same 20 percent of value added from the CAP as Western European farmers in the EU-15.

[23] 0.04*0.2*0.1 = 0.008

[24] 0.04*0.04 = 0.016

[25] Structural Funds = 0.16 %
CAP Receipts = 0.08 %
Total Receipts = 0.25 %
Contribution = 0.05 %
Net Receipts for Turkey = 0.20 %

this study is not taking into account some variables such as per capita income, agricultural area and agricultural employment which play a crucial role in the distribution of rural development funds. This study also does not take consider the characteristics of production structure in Turkey (Quaisser and Reppegather, 2004). On the other hand, as Grethe cites, it seems hardly possible that the current level of direct payments to agricultural producers in the Union, which accounts for more than 60 percent of CAP outlays, will survive by 2013, which Quaisser and Reppegather take as a potential year of accession.

In 2004, Quaisser and Wood revised the earlier study (Quaisser and Reppegather, 2004) by using new GDP figures for Turkey. They also changed the price basis and possible year of entry to the Union in this new projection. By using new data, they arrived at a net of contribution of EUR 8.5 billion for an accession in 2014. According to their result, if in 2014 Turkey is fully integrated into the EU's expenditure policies, the net transfers would rise to EUR 20.9 billion. If reforms are enforced, these estimates would be reduced to EUR 16.4 billion (Quaisser and Wood, 2004).

The commission prepared an impact study to estimate the budgetary effects of Turkish accession in the framework of the current acquis. In the first version of this study, net costs of accession was announced between EUR 16.5 billion and EUR 27.6 billion for the year 2025 (http://news.bbc.co.uk/2/hi/europe). This indicated that agricultural costs alone could reach EUR 11.3 billion per year. But later, this was revised to EUR 8.2 billion per year (European Commission, 2004). The basic presumption of this study is that the total costs arising from the Turkish accession could only be assessed on the basis of the financial perspective from 2014 (Quaisser and Wood, 2004).

Grethe (2005a) predicts a lower cost of about EUR 7.5 billion (max) with status quo conditions in terms of agricultural support. His calculations are "based on the equilibrium modelling of the Turkish agricultural sector, taking its structural specificities into account. The main difference between his and the Commission's calculations is that Grethe applies the real devaluation of nominal fixed amounts for direct payments. In different reform scenarios he additionally assumes a 3 percent cut in direct payments yearly (Quaisser and Wood, 2004).

According to Schultz, Grethe makes a good point in defending the idea of assessing the magnitude of payments well in advance because unforeseen budgetary outlays may jeopardise Turkish accession altogether and/or, given the envisaged accession, long-term pressure must be maintained within the Union to lay the ground for successful integration of the country into Community structures by organising and implementing the necessary internal reforms first (Schultz, 2005).

Togan's study is based on voting powers. He departs from the present distribution of votes among the EU-15 and current rules for contributions and receipts of the Union. His way of calculating the budgetary effects of Turkish accession is to estimate the contribution per capita in the EU-15 based on income per capita, and the receipts per capita based on per capita Council votes and on the level of development in a broader sense. The weakness of this study is that it doesn't take into account the upper bounds on the receipts of the candidate countries (Togan, 2004).

Flam estimates annual EU budgetary outlays for Turkey as a Union member, including structural policies, at EUR 17 billion and Turkey's contribution to the EU budget at about EUR 5 billion. This estimate is based on a regression analysis for the EU–15 sample, which takes GDP as the explanatory variable for the contribution to the EU budget, and eligibility for the cohesion funds and council voting power as explanatory variables for receipts from the Union budget (Grethe, 2005b).

CONCLUSION

It is commonly believed that the accession of a relatively poor Turkey will increase the budgetary burden for the richer Union members. However, as it has been explained in chapter one, the EU has adapted the inclusion of new members and has changed its policies related to the budget. The changes decreased the beneficiary entitlements of new Member States. This suggests that the transfers from the EU to Turkey are not likely to affect the Union's budget significantly.

Although it is feared that accession of new member states to the Union would increase the budgetary burden for the existing member states, the underlying mechanism is much more intricate than a simple transfer from the rich to the poor. The fear is mainly rooted in the experience with previous enlargements. They transformed the EU from a club of relatively rich industrious countries into an organization with high member diversity. Accession of more relatively poor countries is believed to bring more changes and higher costs, which is highly undesirable. However, the EU has shown to be able to adapt to the new memberships and tailor its rules accordingly so that to keep the budgetary transfers within limits.

One of the most important changes was with regard to the agricultural policy. Under the new arrangements, new members have very limited amounts of direct payments to the country farmers in the first years of accession. Initially, they obtain 25 percent of direct payments that would rise gradually to reach 100 percent by 2013. Although agricultural payments for new members are set to increase, the exact amounts will depend on some unknown facts such as world prices for farm goods and future decisions of the CAP reform. For two reasons, it is possible to say that the current CAP will not be to the advantage of the new Member States and Turkey. First, the share of non-direct payments, such as help for rural development, remains very small. Secondly, farms are too small to qualify for any support in most of the new member states and Turkey.

Second adjustment of the EU was with regard to the structural policy. Before last enlargement, the Union decided to cap the flow of funds to the new member states at 4 percent of their respective GDPs, with the argument that the new members lacked the capacity to “absorb” larger amount. Thus this requirement places an upper limit on the amount that Turkey can receive from the Union under the structural and cohesion funds, as long as the rules on structural funds and cohesion fund are not changed.

On the other hand, estimations made by the different authors show that the cost of Turkish accession will not reach the unmanageable amounts. Turkey will not be a significant recipient of the CAP funds. Estimated funds are not high compared to other large Union countries. Studies show that Turkey will receive about 5.7 to 10.2 percent of the CAP budget. The share of France, in 2002, was 21 percent of the CAP budget of the EU-15.

Another issue is related to the timing of Turkey’s accession. After expiration of the present framework in 2013, the next multi-annual financial outlook will come into force from the beginning of 2014 for the period 2014-2020. Likely, Turkey’s full membership will not take place before negotiating the framework covering the period 2021-2027. Since Turkey will not be able to join the Union before 2015, it will have only a limited influence for the following financial framework. The size of financial transfers for the initial years of accession will have been decided by EU-28. On the other hand, Turkey probably will not benefit fully from the Union’s budgetary facilities before 2020.

Turkey is still poor, compared to the present EU members, but also very dynamic. History has showed that, problems are much more likely to arise from established rich member countries with stagnant economies than from initially poor, but more dynamic states such as Ireland today. With respect to the overall economic and political project of including Turkey in the Union, costs resulting from the budgetary transfers will be highly inconsiderable.

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