The CAP for Turkey? Potential Market Effects and Budgetary Implications

Etendre la PAC à la Turquie? Conséquences possibles pour le budget et les marchés

Die GAP für die Türkei? Mögliche Auswirkungen auf Markt und Haushalt

Harald Grethe

At the EU Council in December 2004, European heads of governments followed the proposal of the European Commission and decided to open EU accession negotiations with Turkey in October 2005. The prospect of Turkish membership is a controversial issue in the EU because of its geopolitical and security aspects, the compatibility of political institutions, income divergence and potential labour mobility, along with the budgetary consequences for current EU member states stemming from EU structural and cohesion policies. When compared to these issues, the consequences of applying the CAP to Turkey are not at the forefront of the discussion.

However, aspects of agricultural market integration, budgetary consequences of applying the CAP to Turkey, and necessary adjustments of the CAP and Turkish agricultural policies are certainly part of the debate.

This article reviews potential market effects of Turkish accession, based on a simulation model and potential budgetary outlays following the application of the CAP to Turkey. As the period of accession negotiations is expected to last for ten years or longer, results are subject to significant uncertainties (see Box). They should, therefore, only be considered as indicative and their purpose is to contribute to a timely policy debate.

Most EU budgetary concerns focus on the size of the Turkish agricultural sector in terms of area, production and agricultural employment, along with the low level of income in Turkey. These concerns are comprehensible.

Figure 1 shows that in terms of population size and agricultural production value Turkey is comparable to the 10 new member states (NMS-10). In terms of income,

Uncertainties of the Analysis

Budgetary outlays from applying the CAP to Turkey are subject to considerable uncertainties. The most significant of these lie in the terms of accession. For example, if direct payments were phased in instead of granted fully in 2015, a scenario which has already been mentioned by the European Commission (and which would be in accordance with phasing in direct payments for the NMS-10 and Bulgaria and Romania), budgetary outlays for the CAP in Turkey would be €2.9 billion lower in 2015 than presented here.

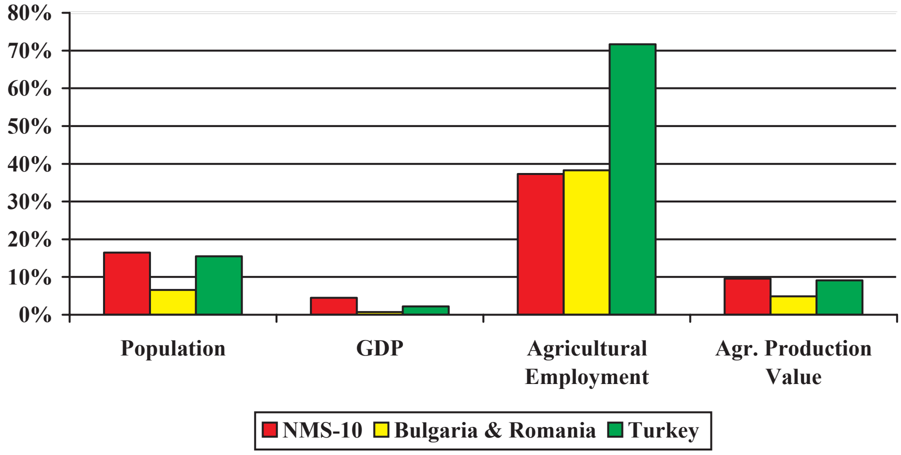
The size of the base ceilings for arable and livestock premium payments is also questionable. Base ceilings applied for the results presented here are based on product composition and yield levels projected with a simulation model, which may be arguable. If, for example, the cereal and oilseed area (which accounts for about 30 per cent of total arable payments) were 10 per cent lower than projected, budgetary outlays for direct payments would be €0.1 billion lower than presented here.

More important than details of product composition is the issue of whether ceilings for direct payments will be negotiated in 5 years or so based on reference yields and areas. The implementation of the Simplified Area Payments Scheme (SAPS) for eight of the NMS-10 has set precedents for uniform per ha premiums. Fixing direct payments per ha based on the level of the SAPS for Latvia at about €80/ha and applying it to the Turkish agricultural area leads to a level of direct payments which is €0.8 billion lower than the figure presented above.

Another important uncertainty is the state of the CAP itself at the moment of accession. One percentage point change in the assumed annual nominal reduction of direct payments by 3 per cent makes a difference of about €0.4 billion in the outlays for direct payments in Turkey.

“Die zu erwartenden Auswirkungen auf den Haushalt durch die Anwendung der GAP auf die Türkei sind beachtlich, jedoch im Vergleich zu anderen Ländern nicht zu hoch ... die im Rahmen der Strukturpolitik der EU zu erwartenden Ausgaben und Nettotransferleistungen sind vermutlich sehr viel höher.”

Figure 1. Size of the economy and the agricultural sector of Turkey and other accession countries compared to the EU-25



Source: Grethe (2005)

however, Turkey is smaller than the NMS-10; total Turkish GDP is only slightly more than 2 per cent of the EU-25 GDP. But with respect to labour in agriculture Turkey is large; the agricultural workforce is more than 70 per cent of that in the EU-25, which mainly reflects the low state of mechanization and the small-scale agricultural structure in Turkey. The average farm size in Turkey is about 6 ha compared to 19 ha in the EU. About 65 per cent of Turkish farms have fewer than 5 ha of land and keep about 50 per cent of the national ruminant herd.

Agricultural markets

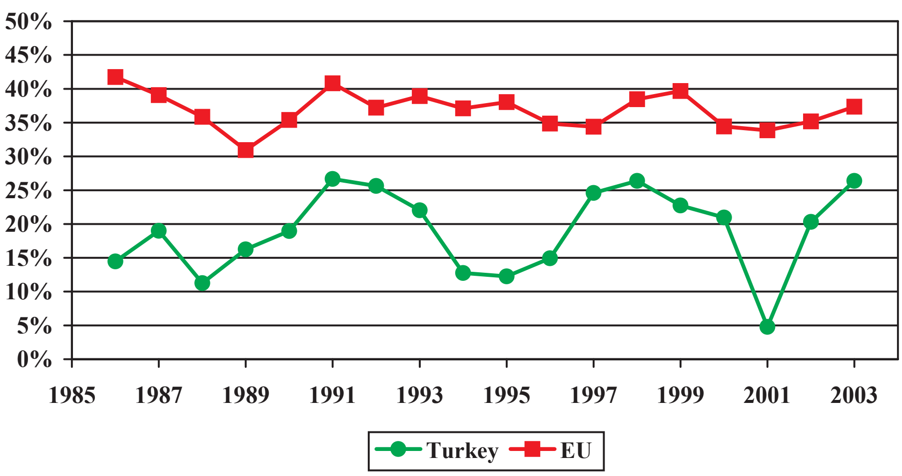
As a first overview, Figure 2 displays the percentage producer support estimate (PSE) for Turkey and the EU, which is calculated by the OECD as the share of domestic production value (including direct income transfers to farmers) that results from government intervention.

The PSE in the EU was between 30 and 42 per cent of agricultural production value between 1986 and 2003. During the same period, the PSE was much more volatile in Turkey and at a significantly lower level. The greater variation in the PSE in Turkey results from a more unstable farm policy as well as high volatility in the exchange rate, for example, the sudden devaluation of the Turkish Lira in 2001. The composition of the total PSE varies greatly between Turkey and the EU. In the EU, the market price support component declined significantly after the MacSharry reform in 1992 and is now below 60 per cent, with much of this support component having been replaced by direct payments. In Turkey, the market price support component was 70 to 80 per cent in this period.

Since 1996 Turkey has had a customs union with the EU for industrial products. Agricultural markets between Turkey and the EU are also integrated to a large extent within a framework of mutual preferential market access regimes. Yet markets for some products, such as cereals, beef and dairy products, are more highly protected in Turkey than in the EU. Figure 3 shows that Turkish exports to the EU-15 are concentrated on fresh as well as processed fruit and vegetables and Turkey currently has an agricultural trade surplus with the EU.

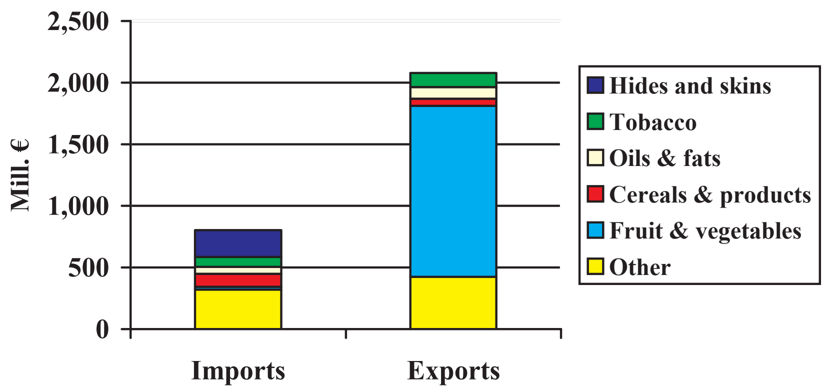
Recent model-based simulation analyses (Grethe, 2004; Cakmak and Kasnakoglu, 2002) show that Turkey would become a major importer of animal products in the case of full market integration with the EU, and would thus ease market pressure for these products for which the EU is a net exporter. It is only for a few selected fresh and processed fruit and vegetable products that Turkey is projected to increase its exports to the EU significantly in case of full market integration. Figure 4 displays projected changes

Figure 2. Percentage producer support estimate in Turkey and the EU, 1986–2003



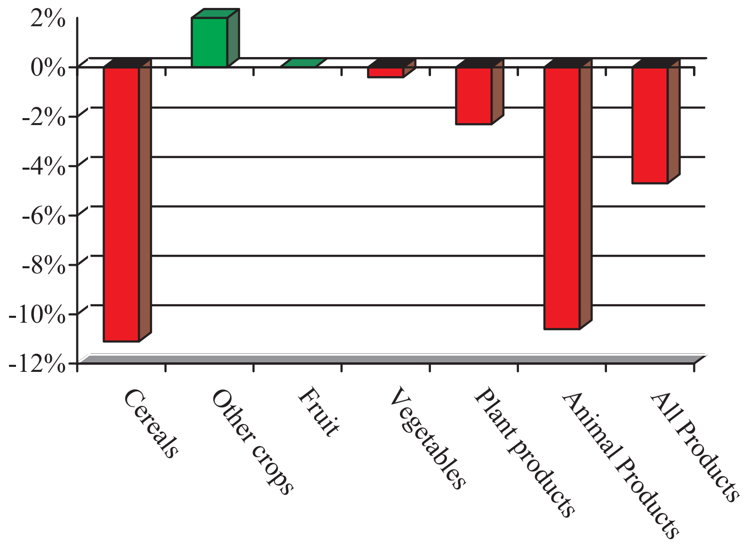
Source: OECD (2004)

Figure 3. Turkish agricultural trade with the EU in 2003



Source: Eurostat

Figure 4. Price changes at farm level in Turkey with full agricultural market integration with the EU



Source: Grethe (2004)

in Turkish agricultural prices with market integration with the EU, i.e. abolishment of all trade policies between Turkey and the EU.

On average, over all agricultural products, Turkish prices would drop by about 5 per cent. The drop in prices would be especially strong for cereals and animal products, reflecting the current high price level. Only for the aggregate 'other crops' would prices increase significantly, which results from the high EU price for sugar that is still applied in model simulations, but will probably be significantly reduced by the date of Turkish accession.

Budgetary implications

Due to the large agricultural sector in Turkey, the implementation of the CAP is expected to be costly to the EU budget. Main budgetary items include the direct payments to producers under the first pillar of the CAP, and payments for rural development measures under the second pillar. Due consideration should be given to the long period before accession when analysing the effects of applying the CAP to Turkey.

Four areas of interest will be important, not least the state of the CAP itself. Many reforms of the CAP yet to be implemented are already determined, including partial decoupling of direct payments under the 2003 reform. However, 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.

> “Les conséquences budgétaires prévisibles de l'application de la PAC à la Turquie seront donc réelles, mais pas excessives, si on compare avec d'autres pays … les politiques structu-relles européennes conduiront à des transferts nets et des dépenses d'une ampleur potentiellement bien plus grande.”

However, Turkey's share in the total GDP of a potential EU-29 (including Romania, Bulgaria, Turkey and Croatia) 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.

Table 1 displays potential outlays from applying the CAP to Turkey

Table 1. EU budgetary outlays for applying the CAP to Turkey (full direct payments)

	Budgetary outlays and revenues (2004 €bn.)	
	2015	**2025**
CAP		
Direct payments	3.8	2.4
Second pillar	1.5	2.0
Other policies	1.0	1.0
Total CAP	**6.3**	**5.4**
Structural Policy	**7.7**	**Up to 25.6**

Source: Grethe (2005).

under the assumption that direct payments are reduced annually by 3 per cent in nominal terms due to the budget ceiling in the first pillar of the CAP, set by the European Council in October 2002. This is likely to result in significant reductions in EU direct payments from 2007 onward when Bulgaria and Romania are scheduled to become EU members and budgetary outlays for direct payments for the new member states increase in the course of phasing in.

The implementation of the CAP in Turkey without any phasing in of direct payments would result in EU budgetary outlays of about €6.3 billion in 2015. More than half of this amount would be for direct payments, which are calculated as product-specific EU rates for: cereals; oilseeds and protein crops; tobacco; olive oil; cotton; milk; beef, sheep, and goat meat; applied to Turkish areas, yield and production quantities from a partial equilibrium model analysis of full integration of Turkish and EU agricultural markets. Aggregate estimates for direct payments are roughly in line with other studies (Oskam *et al*., 2004; Togan, 2004) but significantly below those presented by the European Commission (2004).

About €1.5 billion of EU budgetary outlays for Turkey in 2015 would be for the second pillar of the CAP. This estimate is based on the EU budgetary outlays for rural development policies in the first years of membership for Bulgaria and Romania. The

> “Budgetary effects as a result of applying the CAP to Turkey are projected to be significant, but not excessive compared to other countries… outlays and net transfers under the EU structural policy will be potentially much higher.”

category ‘other policies’ includes outlays for market and other policies which are not included under the direct payments and second pillar categories, and is estimated at €1 billion based on the current composition of the CAP budget.

In 2025, direct payments would be further reduced, second pillar policies would be fully phased in, and total outlays for the CAP in Turkey are projected at €5.4 billion, which would be about 12 per cent of Turkish agricultural production value. So for the agricultural sector, transfers resulting from the CAP are substantial. On the other hand, applying the CAP in Turkey would lead to significant price reductions leading to an estimated loss in producer income of about €1 billion (Grethe, 2004), and probably also an abolition of transfers to agricultural producers under the current Turkish system of direct payments.

From a EU perspective, Turkey would be a significant recipient of CAP funds. The above projections would estimate Turkey receiving about 5.7 to 10.2 per cent of the future CAP budget. This is not especially high compared to other large EU countries. For example in 2002 France received about €9.9 billion, which was 21 per cent of the CAP budget of the EU-15 (Grethe, 2005).

If total EU budgetary outlays resulting from membership of Turkey are taken into account, it becomes clear that the CAP is not the main budgetary factor determining the financial consequences of Turkey gaining EU membership. Rather it is the future development of EU structural policy and the results with respect to any phasing in period for this policy that will largely determine the level of total budgetary outlays and net transfers from the EU-28 to Turkey. Based on the examples of Bulgaria and Romania as well as the 4 per cent of GDP limit after full phasing in, payments under the EU structural policy to Turkey could amount to about €8 billion in 2015 and increase to more than €20 billion in 2025. In 2025, with fully phased in direct payments, the share of the CAP in total net transfers to Turkey may therefore be below 20 per cent (Grethe, 2005).

Turkey’s development needs

More important from the Turkish perspective than the resulting net transfers, however, seems to be the degree to which the CAP fits Turkish needs for the development of the agricultural sector. Direct payments in the first pillar of the CAP simply shift money to agricultural producers. As long as payments are linked to area, this money, for the most part, ends up in the pockets of land owners. Such transfers may even inhibit the necessary process of improvement of the Turkish agricultural structure that currently displays an average farm size of about 6 ha.

Transfers of EU funds to Turkey under the second pillar of the CAP may hold more interest for Turkey than high direct payments. This is because payments under the second pillar can be targeted at measures that are aimed at improving productivity and thus agricultural incomes. Such measures might include training for farmers 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 farms (e.g. reparcelling).

The same holds for the use of pre-accession funds for Turkey. Improving productivity in agriculture as well as processing of agricultural products may be their main target, next to the enormous challenge of adapting Turkish institutions such that they can apply the CAP and necessary investments in the Turkish animal health system in order to prepare Turkey for EU accession (see Oskam *et al*., 2004).

Overall assessment

The effects of Turkish accession on EU agricultural markets are likely to be relatively small. It is mainly the EU that would gain additional export opportunities for cereals and animal products. The effect of full market integration on Turkish agricultural exports to the EU will probably be limited to a few fruit and vegetable products because of the comprehensive preferential market access for Turkish products already in place, coupled with high transportation costs and significant quality differences.

Budgetary effects as a result of applying the CAP to Turkey are projected to be significant, but not excessive compared to other countries. For example, budgetary outlays for applying the CAP to Turkey are projected to be about half as much as for France and the net transfers which would result from the CAP are projected to be below €5 billion. Outlays and net transfers under the EU structural policy will be potentially much higher.

Nonetheless, the accession of Turkey may be an additional incentive among many to fully decouple and phase out direct payments in the EU, which constitute the largest single agricultural policy category in the above projections.

Further Reading

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summary

The CAP for Turkey? Potential Market Effects and Budgetary Implications

EU accession negotiations with Turkey are scheduled to start in October 2005. The period of accession negotiations will probably last for ten years or longer, but the effects of applying the Common Agricultural Policy (CAP) to Turkey are currently a controversial discussion in the EU. Effects of Turkish accession on EU agricultural markets are likely to be small. The EU would gain additional export opportunities for cereals and animal products. On the other hand, Turkish agricultural exports to the EU are projected to increase for only a few fruit and vegetable products. EU budgetary outlays for the application of the CAP to Turkey could total between €3.5 and €6.3 billion in 2015 – depending on whether direct payments are phased in or not – and €5.4 billion in 2025. Most of these outlays would be for direct payments to agricultural producers and that may not be in Turkey's best interest. This is because direct payments tend to be capitalized in land prices and may thus inhibit the necessary process of improving the Turkish agricultural structure. Transfers under the second pillar of the CAP may hold more interest for Turkey, because they can be targeted at improving productivity and thereby income. Projected outlays for the CAP take a backseat to projected transfers to Turkey under the structural policy of the EU.

Etendre la PAC à la Turquie? Conséquences possibles pour le budget et les marchés

Les négociations sur l'adhésion de la Turquie à l'UE doivent commencer en octobre 2005. Les préliminaires vont sans doute durer au moins une dizaine d'années, mais les effets de l'application de la Politique Agricole Commune (PAC) à la Turquie font déjà l'objet de controverses au sein de l'UE.

Sur les marchés, on s'attend à des effets plutôt faibles. L'UE gagnerait certaines possibilités d'exportation de céréales et de produits animaux. Par ailleurs, les exportations de la Turquie vers l'UE ne s'accroîtraient que pour quelques fruits et légumes.

Les dépenses budgétaires totales qui résulteraient pour l'UE de l'application de la PAC à la Turquie se situeraient en 2015 entre 3,5 et 6,3 milliards d'Euros, selon que les paiements directs seront ou ne seront pas progressivement éliminés . Elles atteindraient 5,4 milliards en 2025. Il s'agirait pour l'essentiel de paiements directs aux producteurs agricoles, ce qui ne correspondrait pas forcément à l'intérêt bien compris de la Turquie. De fait, les paiements directs tendent à être capitalisés en valeurs foncières. Ils pourraient par conséquent inhiber le processus d'amélioration des structures, pourtant bien nécessaire. Les transferts liés au second pilier de la PAC pourraient être plus utiles, parce qu'ils peuvent être ciblés sur les accroissements de productivité et donc de revenus. C'est pourquoi il y a lieu d'envisager des transferts à la Turquie au titre des politiques d'amélioration de structures en arrière plan des budgets prévisionnels pour la PAC.

Die GAP für die Türkei? Mögliche Auswirkungen auf Markt und Haushalt

Im Oktober 2005 sollen die EU-Beitrittsverhandlungen mit der Türkei beginnen. Diese Verhandlungen werden wahrscheinlich über einen Zeitraum von zehn Jahren oder länger geführt werden, die Auswirkungen der Gemeinsamen Agrarpolitik (GAP) auf die Türkei werden im Moment in der EU jedoch kontrovers diskutiert. Der EU-Beitritt der Türkei wird sich wahrscheinlich nur geringfügig auf die EU-Agrarmärkte auswirken. Die EU erhielte zusätzliche Exportmöglichkeiten für Getreide und tierische Erzeugnisse. Die Agrarexporte der Türkei in die EU hingegen würden vermutlich nur bei einigen wenigen Obst- und Gemüseprodukten zunehmen. Durch die Anwendung der GAP auf die Türkei würde der EU-Haushalt im Jahr 2015 mit 3,5 bis 6,3 Milliarden Euro (je nachdem, ob die Direktzahlungen schrittweise eingeführt werden oder nicht) und im Jahr 2025 mit 5,4 Milliarden Euro belastet. Der größte Teil dieser Kosten entstünde aufgrund von Direktzahlungen an landwirtschaftliche Erzeuger. Dies dürfte für die Türkei nicht die bestmögliche Alternative darstellen, da Direktzahlungen zumeist in den Bodenpreisen kapitalisiert werden, wodurch der notwendige Prozess zur Verbesserung der türkischen Agrarstruktur ins Stocken geraten könnte. Transferleistungen im Rahmen der zweiten Säule der GAP dürften für die Türkei interessanter sein, da sie auf eine Produktivitätssteigerung ausgerichtet werden könnten, um so die Einkommenssituation zu verbessern. Die zu erwartenden Ausgaben für die GAP im Rahmen der Strukturpolitik der EU spielen im Vergleich zu den zu erwartenden Transferleistungen an die Türkei eine untergeordnete Rolle.

summary