# CHAPTER IX
# EFFECTS OF THE CUSTOMS UNION

## A-EFFECTS ON THE NATIONAL REVENUE

The abolition of customs duties in trade between member states represents certainly a loss of revenue which can be replaced by Value Added Tax which is the common tax in the Community. Customs duties collected by the member states under the CCT represent one of the Community's "own resources" and, subject to a 10 % deduction for administrative expenses, have to be remitted to the Community. Here again the VAT will compensate for the loss. Since only the VAT base is determined in a uniform manner according to Community rules the actual rate of rates are within the discretion of the member states. At present, until 1992, 1.4 % of the VAT base has been designated as the Community own resource and this has to be remitted to the Community. However, in order to avoid penalizing countries where private consumption represents a considerable share of the national wealth, there is a limit of 55 % of GNP on the VAT base. Thus, in order to calculate the rate of the VAT to be set in Turkey in the event of joining the Community the government will have to take into consideration the potential loss of revenue as well as the anticipated financial commitment to the Community.

In addition to customs duties, a proportion of the VAT and agricultural levies there is also a fourth source of Community revenue based on the national GNP. This is determined each year according to each member state's wealth, or ability to pay. Thus, instead of increasing the revenue from the VAT in order to satisfy the needs of the Community, the richer countries have agreed to contribute more than the poorer countries. This principle benefits the poorer states, i.e. Greece, Spain, Portugal and Ireland. Since Turkey's GDP is low, if compared with the richer countries, Turkey is likely to benefit also.

## B- EFFECTS ON THE INDUSTRY

It is common ground that the greater the volume of trade with the Community the better for each member state provided, of course, that its industry is in a strong competitive position. If it is not, the benefit of the membership may prove to be illusory. The freedom of trade means penetration of the national market and free competition. The liberalization of trade means the removal of national restrictions on import and restraint of state subsidies to exports. National laws in this respect have to be adjusted accordingly.

The other consequence follows the right of establishment of firms who will be free to set up business in Turkey and compete on equal terms with Turkish enterprises. The effects on Turkish firms has to be evaluated. Broadly speaking, export orientated (especially towards the Community) firms should experience no difficulties. However firms orientated towards the domestic market may experience difficulties if they are unable to cope with competition and penetration of the market by firms coming from the Community. Those which have a strong hold of the market will be able to withstand the wind of change and with the more active market will flourish and expand. Others may have to diversify their activities or even close down.

If a firm has to close down employment and adverse social consequences will follow. It is possible that workers made redundant will find employment in other, expanding, industries since local workforce will be attractive to the newcomers. There even may be a shortage for skilled workers for the expanding industries. If, on the other hand, local industries disappear and their workforce cannot be absorbed elsewhere, unemployment will hit it, especially the unskilled workers, with dire social consequences. The government must be aware of this truism and the industry itself must be prepared for the challenge. It seems that, instead of speculating on the possible effects of industry, each sector ought to be examined and its prospects be evaluated.

## C- THE COST OF NON-MEMBERSHIP

There is a political and economic cost of non-membership of the Community. The former amounts to non-participation in the political developments of the European continent which is tantamount to acquiscence in the decisions of the member states of the Community. Therefore the aspiration to membership must be primarily politically motivated.

The economic cost of non-membership is more difficult to assess because some countries are more likely than others to benefit materially from the common market and the political union in exchange for the diminution of their sovereignty. However as far as the firms and industries are concerned their costs of non-participation in the enlarged common market is the cost to the nation because the risk of their gradual elimination from the theatre of intense competition would render them ineffective. The threat is in the spectre of the "Fortress Europe" as the Commission White Paper of 1985 (para.8) opined that "the commercial identity of the Community must be consolidated so that our trading partners will not be given the benefit of the wider market without making concessions themselves". The prospect of a Fortress Europe has provoked an emotional reaction on the other side of the Atlantic where the influencial Wall Street Journal predicted in 1988 that the next frontier of protectionism will emerge from the EC. The response of the Rhodes meeting of the Heads of State or Government in December 1988 was reassuring: "The Europe of 1992 will be a partner, not a fortress. The Single Internal Market will make a substantial contribution to the liberalization of international trade on the basis of the GATT principles of reciprocity and advantageous agreements for all concerned". However, despite this assurance there is a lingering fear that a consolidated and integrated Community may become inward-loking and tough towards the outside world.

The economic outlook for Turkey has to be seen in the context of the EC policy and Turkey's pattern of trade with the EC and other major economic powers.

Turning now to the possible effect of the "Fortress Europe" on future trade with Turkey this must be seen in the context of the EC Mediterranean Policy and the now emerging new order in Europe.

Notwithstanding the Ankara Agreement any further concession which Turkey may negotiate, when all barriers to intra-Community trade have been lifted, Turkish products are likely to become less competitive than the goods produced in the Community. Moreover, in view of the increased standardization which will bring about a greater uniformity of products, and marketing rules, the costs of the intra-Community trade is expected to be reduced because of the saving of certain costs. Penetration of the common market will be more difficult. Thus trading within the Community will become more efficient and more effective to the detriment of the outside world. There is no guarantee that the Community will not, in the future impose any new barriers to trade with third countries, including even the associated countries. If the economic recession continues or if at any time it re-emerges there is a real threat of the Community becoming protectionist. Non-member Mediterranean countries remain subject to non-tariff barriers should the EC consider it expedient not to impose such barriers. Whilst, therefore, the removal of internal barriers will effect considerable savings for the enterprises and the citizens of the EC the cost of non-membership is likely to increase. This is quite obvious if one compares the position of Turkey with the three Mediterranean newcomers to the Community. Greece, Spain and Portugal which already enjoy the benefit of the elimination of non-tariff barriers to trade whilst the disadvantage to non-members increase. Should there be a conflict of interests between these three countries and a non-member Mediterranean country there is no doubt that the EC, could give preference to its members. A foretaste of that could already be observed in connection with Turkey's application for membership of the Community.

The recent development in Europe, especially the demise of the COMECON and the unification of Germany, may also work to the disadvantage of non-members standing on the peripheries of these developments.

Turkey is not a member of EFTA and, therefore, cannot count or rely on the collective bargaining power of the EFTA conutries. Representing a trading bloc (albeit weakened by the possible desertion of Sweden, Norway, Finland and Austria ) EFTA is in a stronger negotiating position than any non-aligned country and, if EFTA manages to strike a bargain the benefit thereof will accrue to its own members only.

The EC reacted swiftly and positively to the developments in Eastern Europe giving a moral support to the emerging democracies and encouraging the transition from state controlled to market economy. It has to be borne in mind that a European bank for Reconstruction and Development has been set up specifically to finance projects in Eastern Europe and to help generally to construct the infrastructure necessary for the developing market economy. Investments and direct involvement of EC enterprise will follow. After a period of depression marking the transition towards market economy the East European markets will, no doubt, have period of intense economic activity. It remains to be seen whether the benefits of economic revival will benefit the EC only or countries, like Turkey, as well. However pre-occupation with Eastern Europe has a negative effect on the EC interest in Turkey as already indicated in the EC Commission's opinion on Turkey's application for membership.

The re-unification of Germany is another factor which must weigh upon the relationship between the EC and Turkey. The great emotional rejoicing following the breakdown of the Berlin wall and the disintegration of the German Democratic Republic had to give way to a sober assessment of the political and economic consequences of the absorption of some 17 mil. people and a derelict state economy into a united Germany. The cost of the re-unification has to be borne not only by the Federal German Republic but also by the EC because the integration of the new Germany commands perforce a priority over the East European approaches both in action and expenditure. The drain on German national and Community resources has an obvious effect upon the trade pattern of the Community affecting indirectly the non-member countries.

The death-throes of the Soviet empire have presented the West with great opportunities. Not only has the threat of an armed conflict receded and the USSR-led COMECON disintegrated but the USSR towards the end of its existence has also adopted a co-operative attitude to the EC in its direct relations with it as well as a non-antagonistic attitude in the world councils as witnessed, e.g. during the Gulf Crisis (1990-1991). Whilst the end of the odious regime is welcome the West has no interest in seeing the region destabilised or torn by wars of secession. Hence the cynical condonation by the West of the forcible inclusion of the Baltic States in the Soviet Union despite the common understanding that these States have lost their independence as a result of Stalin-Hitler conspiracy. The States regained their independence on the final collapse of the USSR. The politics. of trade reflect this ambiguity as well as the lack of conviction based on results rather than blueprints that the death bed conversion to the virtues of the market economy has marked, in effect, the end of the communist regime. Whilst it is common ground that economic health of the countries forming the former USSR is in everybody's interest, the idea of a cash reward for the prospect of democratization has not met with universal approval. Yet an interprising investor can perceive rich pickings from a reformed Soviet economy. The EC has not, so far, adopted that attitude. Instead of cash it has offered advice and sympathy. However the fact reamins that there is a great potential for trade where the natural and human resources of that rich but mismanaged landmass in Europe and beyond the Urals, have been properly marshalled and utilized.

The meeting of the so-called G.7 (the Group of Seven main economic powers) attended also by the President of the EC Commission in London in July 1991 offered little comfort to the last President of the USSR when, having completed its agenda, it heard his plea for economic aid. This, however, did not preclude unilateral action of the members of G.7. Indeed following the G.7 meeting President Bush was to bring to Moscow to meet President Gorbachev a USA present in the form of most favoured nation trading status which would reduce greatly the tariffs imposed on Soviet imports, thus enabling the USSR to earn more so badly needed hard currency, but it was too late for Gorbachev and the USSR.

In many respects the Russian Republic, as the largest country in the region, is regarded as the successor to the USSR (she inherited a permanant seat in the Security Council of the UNO) whilst the now independent republics are associated in the Commonwealth of Independent States (CIS). Being independent they conduct their own external relations not only between themselves but also with the world at large, including the EC.

Facing destabilisation and failure of the budding democracy the elected President of Russia Boris Yeltsin was more successful than Gorbachev in attracting Western aid and financial support for his country. Apart from the USA and Japan individually, the G-7 offered a financial package worth $ 43 billion on tied to continued economic and political reform and co-operation on foreign policy issues. The bulk of the multi-lateral aid package comprises the existing commitments of assistance from international financial institutions such as the World Bank and the International Monetary Fund which have been brought together for the first time[1].

The EC reacted positively by making trade arrangements and providing aid in the form of package deals to groups of countries, i.e. the Baltic States[2]; the Visegrad countries (Hungary, Poland, and Czech and Slovak Republics)[3]; Albania, Bulgaria and Romania[4]; and the independent states of the former USSR[5]. As aid to and investment in the former USSR and COMECON countries becomes a Community policy the trade pattern may reflect a temporary cost to the Community but a permanent cost to non-members including Turkey in so far as their trade with those countries may well become marginalized.

## D- EFFECTS ON INDIVIDUALS

In the context of the cost of non-membership to the nation at large one has to consider the effect o membership or non-membership upon the individual as consumer and taxpayer.

As already stressed membership of the EC leads to the removal of customs duties in trade with the EC and their replacement by VAT. The substitution will have an effect on relative prices. If VAT replaces customs duties and the substitution is neutral to revenue the absolute level of prices should not change but relative prices would. The same applies to the price of services.

VAT would be levied on imported raw materials, intermediate goods for industry, capital goods and other imported products which are, at present, free from import duties. The prices of such goods will rise automotically by the introduction of VAT except in cases where the goods are exempted or zero rated under the EC VAT directives.

The effect of VAT on imported goods on which customs duty is paid at present would depend on the level of VAT and the level of duties.

The end result should be that the prices of certain imported goods would come down, others would remain unaffected but there also would be a minimal increase of prices of hitherto undutiable goods.

VAT and a general tax increase will, of course, raise the cost of living which is never popular and hits hardest the disadvantaged section of the population. The government should try to alleviate hardship by compensating this section through income tax concessions and social security benefits. VAT has been widely accepted throughout the world as a fair tax and it has been adopted by the EC as the Community consumption tax. Its consequences for the population at large cannot be ignored.

It is generally considered that a stimulus to national economy arising from an enlarged market will ultimately bring benefits to the consumer. This is based on the assumption that the national industry will be stimulated to greater efforts and that increased competition will give the consumer a better choice in the variety of goods, their quality and their prices. In realtiy much depends on the competiveness of the national industry.

We have not considered in this section the effect of Community policies especially of the Common Agricultural Policy, Regional Policy, Industrial Policy etc. A relatively poor country can look for Community support in order to modernize its economy. Thus certain sectors and certain regions will benefit directly and in the long run the consumer should be better off too. The same applies to the labour market but, on the other hand, labour-intensive industries, in particular, may have to reduce their labour force. Redundancies and unemployment are the unwelcome effect of the modern technological society of which the EC is a prime example.

NOTES:

1 Financial Times, 16 April 1993

2 XXVI the General Report, 1992, p.260

3 Ibid.p.258 - 9

4 Ibid. p.257-259

5 Ibid. p.260 - 266.