

Part V

**Turkey and Transatlantic Relations:
Mutual Expectations**

Chapter Seventeen

Assessing the Possibility of a Modernized EU-Turkey Customs Union with a View to the TTIP Process

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Despite upheavals in Turkey-EU and Turkey-U.S. relations in recent years, the economic aspect of these ties continues to rise in importance. Turkey's economic and trade relations with the EU, primarily through the EU-Turkey customs union agreement, constitute the bulk of Turkish foreign economic relations. However, the same cannot be said about Turkey-U.S. economic relations. In 2016, Turkey exported 8 billion dollars' worth of goods to the U.S., while importing 9.38 billion dollars' worth. For the EU, Turkey's exports amounted to 66.7 billion euros, while its imports reached 78 billion euros. In terms of its share in foreign trade, the EU ranks first among Turkey's export markets, making up 48 percent of total exports, while the U.S. ranks 5th—constituting 4.4 percent of Turkish total trade.¹ Turkey ranks 33rd of U.S. importers, and is the 5th largest importer into the EU market.

Adopting an export-oriented economic model, Turkey's quest to increase its trade share in world markets began to gain traction. The EU-Turkey customs union agreement constituted one of the main mechanisms to expand trade and economic relations with the EU and increase its share in the EU market. Turgut Özal, the former Turkish prime minister and president (from 1989 until his passing in 1993), pioneered bilateral U.S.–Turkey trade relations, frequently referring to the need to improve economic and trade relations in parallel with strategic and security relations. Özal expressed the need for more trade with the U.S. (during his visit to U.S. in 1985) in a joint press conference with President Reagan: “We don't want more aid, we want more trade.”² Following the visit, the Turk-

¹ Ministry of Economy of the Turkish Republic, “Türkiye ile Ticaret [Trade with Turkey].” <http://bit.ly/2gaGoLJ>.

² Güler, Hülya. “Zor Zamanlarda Kapıyı Koç Açtı [Koc Opened the Door in Difficult Times].” *Hürriyet*, June 6, 2015, <http://www.hurriyet.com.tr/zor-zamanlarda-kapiyi-koc-acti-29206842>.

ish-American Business Council was founded becoming a flagship business council that led to the establishment of the Foreign Economic Relations Board of Turkey (DEİK).

The Transatlantic Trade and Investment Partnership (TTIP) negotiations, (which began in 2013 between the U.S. and the EU), were of particular concern to Turkey, mainly because of the customs union relationship. TTIP was hailed as not only an economic but also a strategic initiative, embedding the potential to bring two giant trade actors together in establishing a joint bloc against the rising powers of East Asia.³ TTIP was relevant for Turkey for two reasons: 1) the trade effects that the agreement was expected to create by lifting barriers for U.S. goods and services in the European and Turkish markets, (while excluding Turkey from a similar privilege in the U.S. market), and 2) the potential costs of adhering to regulatory harmonization as a result of such an agreement.⁴ Turkey wanted to take part in the negotiations and has engaged in lobbying activities, with the U.S. and the EU. It was both a challenge and opportunity for Turkey, as this trade deal could liberalize access to the U.S. market if Turkey were included in TTIP as a customs union partner. In a scenario where the TTIP agreement would enter into force without the adoption of any mechanism to anchor Turkey, it would lead to significant losses for Turkey in the EU market. Free entry of U.S. products to the Turkish market (through the EU) without any reciprocal arrangements with Turkey would also create significant losses for Turkey. The upgrading of the existing customs union was urgent. It could clear the problem of free trade agreements (FTAs) and pave the way for Turkey's inclusion into TTIP. The suspension of TTIP negotiations following President Donald Trump's election relieved this urgency to upgrade the customs union. Still, considering the fact that 20 years old customs union has become outdated, both Turkey and the EU continued preparations for the start of formal negotiations to modernize the customs union.

³ For a detailed account of the importance of TTIP for world trade, see: Low, Patrick. "TTIP and the World Trading System," in M. Sait Akman, S. J. Evenett, P. Low eds. *Catalyst: TTIP's Impact on the Rest*, (London: CEPR Press, 2015, pp.13-18, pp.13-14.

⁴ Barker, Tyson. "The Transatlantic Trade and Investment Partnership: An Economic Agreement to Foster the Transatlantic Community," in *Smarter Power: The Key to a Strategic Transatlantic Relationship*, Aude Jehan, A. Simonyi (eds.), (Washington D.C.: Center for Transatlantic Relations, 2014) pp. 127-146, p.133.

The Modernization of the Turkey-EU Customs Union: Rationale and Progress

Turkey's relations with the EU date back to the 1963 Ankara Agreement, establishing an Association between Turkey and the then- European Economic Community (EEC). The Ankara Agreement foresaw a gradual progress towards association, stipulated by three major phases: A preparatory, transitional, and final stage. The purpose of the transitional phase was to lay down the timetable and conditions to reach the final stage, based on a customs union. The customs union would entail the abolition of all customs duties, quantitative measures, and all other charges and measures with equivalent effect, in respect to trading of goods. Hence, trade between the two parties would be liberalized and the partners would gain unlimited access to each other's markets. In addition, the customs union would require Turkey's adoption of the Common Customs Tariff and adaptation to the Common Commercial Policy. This would include "approximation to the other Community rules on external trade."⁵ According to the Ankara Agreement, the association was also envisioned to include trade in agricultural products, aiming to create freedom of movement for workers, freedom of establishment, freedom to provide services, and freedom of capital flow.

The 1970 Additional Protocol laid down the basis for the transition to the customs union based on the lowering of tariffs (according to two timetables). The European Community (EC) abolished customs duties levied on Turkish industrial exports in 1970. However, Turkey required some time to lower and eventually abolish duties levied on EU imports. The final target date was 22 years from the entry into force of the Additional Protocol, in 1995. Events throughout the 1970s hindered the gradual implementation of Turkey's lowering of trade barriers, and Turkey asked for the suspension of its commitments under the protocol.⁶ The military takeover of 1980 led to the freezing of Turkey-EU relations until the return of democratic governance in 1986.

In the meantime, following the economic crises and economic stagnation in the 1970s, the economic stability package (from January 24, 1980),

⁵ Article 10, Ankara Agreement, *Official Journal of the EC*, no: L 361/8, December 31, 1977.

⁶ Stivachtis, Yannis A. "From Association to Accession Negotiations: EU-Turkish Economic Relations 1959-2009," in *On the Road to EU Membership: The Economic Transformation of Turkey*, Selen Sarısoy Guerin, Yannis A. Stivachtis (eds.), (Brussels: Brussels University Press, 2011), pp.17-33, p.22.

paved the way for the introduction of an export-oriented economic model based on neoliberal policies. In 1989, foreign exchange transactions and capital movements were also liberalized with decree 32.⁷ Hence, the economic aspect of Turkey's international relations became more significant, and diversifying export markets and employing growing economic power were the basis of a more active and effective foreign policy. Turkey's need for the inflow of foreign direct investment (FDI), combined with the relocation of European industries to nearby regions, also laid the basis for an interdependent economic and trade relationship.

With the desire to compensate for lost time, improve Turkey's international standing, and step up Turkey-EC relations, the ANAP⁸ government under Turgut Özal (on April 14, 1987), has filed the application to join the EC. After lengthy deliberation, in 1989, the EC Commission rejected the application, even though it did accept Turkey's eligibility for membership. The Commission noted that the EC was undergoing tremendous change and that it was incapable of opening accession negotiations with any state, but that the political and economic situation in Turkey did not warrant full membership status.⁹ The Commission stressed further cooperation with Turkey and recommended the completion of the customs union. The Matutes package of 1990 proposed a new path to keep Turkey-EC relations on track. The report advised the completion of the customs union by finalizing the gradual custom duties reductions and by abolishing quantitative restrictions and other related measures.¹⁰ However, the package was not adopted by the Council.¹¹ Nevertheless, the first half of the 1990's witnessed Turkey's efforts to complete the commitments embodied in the additional protocol, with a goal to reach to the final stage of the association.

⁷ Saygın, Hasan and Çimen, M. *Turkish Economic Policies and External Dependency*, (Newcastle upon Tyne: Cambridge Scholars Publishing, 2013), p.2.

⁸ Motherland Party (Anavatan Partisi) of Turkey.

⁹ EC Commission. "Commission Opinion on Turkey's Request for Accession to the Community," SEC (8) 2290 final/2, Brussels, December 20, 1989. <http://aei.pitt.edu/4475/1/4475.pdf>.

¹⁰ Arıkan, Harun. *Turkey and the EU: An Awkward Candidate for Membership*, 2nd ed., (Aldershot, Hampshire: Ashgate, 2006), pp.72-73.

¹¹ European Commission. "Regular Report from the Commission on Turkey's Progress Towards Accession," Brussels, 1998. http://www.ab.gov.tr/files/AB_Iliskileri/Tur_En_Realitons/Progress/Turkey_Progress_Report_1998.pdf.

Establishing a Customs Union

The Turkey-EU customs union, (based on decision no: 1/95 of the Association Council), entered into force at the end of 1995, abolishing all trade barriers on industrial goods and the industrial components of processed agricultural goods.¹² Turkish external trade policy was expected to be harmonized in line with EU commercial policy and common external tariffs. Turkey was also expected to approximate its legislation according to the EU *acquis* in areas such as competition policy, intellectual property rights, consumer policy, and state aids policy. Decision 1/95 established the main principles and mechanisms of the customs union, integrating Turkey further to the EU economy. At the same time, however, it laid the basis for an asymmetric relationship, as Turkey had to implement trade policy measures it had not been involved in creating. While the decision also stipulated consultation and notification mechanisms, these did not work effectively in practice and did not have any role in integrating Turkey in the EU's trade policymaking. In addition, the inevitable rule of unanimity in the Association Council rendered any dispute settlement avenues useless.¹³

The customs union became the principal mechanism by which Turkey and EU established a close trade relationship, leading to a fourfold increase in bilateral trade in the period between 1996 and 2014.¹⁴ Despite its deficiencies (and the fact that it was the second-best option to full membership), the customs union served Turkish industrial sectors by fostering its competitiveness, facilitating the industrial base restructuring, improving of the regulatory environment, transferring of technology and know-how, adapting to EU norms and standards, and integrating into EU production and supply chains.¹⁵ According to the results of a synthetic control method analysis, if Turkey-EU customs union was not established, Turkey's exports

¹² For an account of the customs union decision, see: Nas, Çiğdem and Özer, Yonca. *Turkey and EU Integration: Achievement and Obstacles*, (London: Routledge, 2017), pp. 33-38.

¹³ For an account of the structural weaknesses of Decision 1/95, see: Kabaalioglu, Haluk. "Turkey's Relations with the EU: Customs Union and Accession Negotiations," in Peter-Christian Müller-Graf, H. Kabaalioglu eds., *Turkey and the European Union: Different Dimensions*, (Baden Baden: Nomos, 2012).

¹⁴ Gillson, Ian et al., "Evaluation of the EU-Turkey Customs Union," World Bank, Report no. 85830-TR, March 28, 2014. <http://documents.worldbank.org/curated/en/298151468308967367/pdf/858300ESW0P1440disclosed090260140TR.pdf>.

¹⁵ Nas, Çiğdem and Özer, Yonca. *opt. cit.*, p.39.

to the EU would be lower by 38 percent, and Turkish GDP per capita would be lower by 13 percent.¹⁶

At the time of its entry into force, Turkish political leaders had proclaimed that the customs union would be the final step before Turkey's final integration into the EU family, foreseen to happen in 3-4 years' time.¹⁷ Despite Turkey's candidacy to the EU in 1999 and the opening of accession negotiations in 2005, membership did not occur due to political and cultural reasons. In the meantime, EU's trade policies changed in parallel with the evolving global trade regime. The Doha Round stalemate in multilateral trade negotiations led prominent trade actors (such as the EU) to seek new bilateral trade deals with third countries.¹⁸ The new generation of trade agreements included not only trade in goods, but also trade in services, agriculture, and sanitary and phytosanitary standards (SPS) measures, opening of public procurement markets, regulation of technical standards, intellectual property rights, environment, energy and labor issues, among others.¹⁹ The Turkey-EU customs union became outdated and Turkey's advantages in the EU market eroded as a result of third countries gaining privileged access to the EU market through bilateral FTAs.

The problems in the functioning of the customs union, combined with changes in international trade and Turkey's failure to accede to the EU, necessitated a revision and update to EU-Turkey trade relations. The Association Agreement already embodied the principles of extensive integration to the EU market in goods, services, agriculture, and capital. However, the Association Council could only make decisions based on unanimous approval of both parties.²⁰ Soon, both Turkey and the EU

¹⁶ Aytug, Hüseyin et al., "Twenty Years of the EU-Turkey Customs Union: A Synthetic Control Method Analysis", *Journal of Common Market Studies*, Vol.55, No.3, May 2017, pp.419-431, p.429.

¹⁷ "En Geç 98'de Avrupa Birliği'ne Tam Üyeyiz [We will be Full Member of the EU in 1998 the Latest]", *Hürriyet*, July 5, 1995. <http://www.gecmisgazete.com/haber/en-gec-98-de-avrupa-birligi-ne-tam-uyeyiz>.

¹⁸ Akman, M. Sait. "Dynamics of the European Union's Trade Strategy and Its Imperatives on Turkish Trade Policy," in Belgin Akcay, Bahri Yilmaz eds., *Turkey's Accession to the European Union: Political and Economic Challenges*, (Boulder: Lexington, 2013), pp.127-160.

¹⁹ Dawar, Kamala and Togan, Subidey. "Workshop: Bringing EU-Turkey Trade and Investment Relations up to Date?" (Belgium: European Parliament, Directorate-General for External Policies, Policy Department, May 2016), p.29-30. http://www.europarl.europa.eu/RegData/etudes/STUD/2016/535014/EXPO_STU%282016%29535014_EN.pdf

²⁰ Peers, Steve. "Living in Sin: Legal Integration Under the EC-Turkey Customs Union," *European Journal of International Law*, (Vol. 7, Issue:3, January 1996): pp.411-430, p.421.

began to voice their complaints about the functioning of the customs union. It was Turkey that showed greater interest in an improvement and betterment of the customs union to resolve issues that emanated from the asymmetric nature of the customs union relationship.²¹

Issues with the EU-Turkey Customs Union

The problems in the functioning of the customs union can be summarized as follows: 1) problems associated with FTAs signed by the EU, 2) consultation and decision-making procedures, 3) dispute settlement procedures, 4) transport quotas, 5) nontariff barriers, and 6) visa requirement for Turkish citizens.

Problems Related to FTAs with Third Countries

Firstly, FTAs that the EU negotiated and signed with third countries became a major problem in the custom union relationship. While these new trade partners gained tariff-free access to the Turkish market (due to custom union agreement), Turkey could not gain reciprocal advantages as it was not part of these bilateral agreements. Turkey approached these countries to sign FTAs but as the EU and Turkey negotiation processes were not conducted in parallel, time delays and losses involved in trade flows occurred. Some of these countries (that had signed FTAs with the EU) did not agree to negotiate a separate deal with Turkey. Hence, the increasing number of FTAs signed by the EU placed Turkey in a disadvantageous position. The so-called “Turkey clause” added to the EU’s FTAs did not have a binding force over the third countries.²²

Consultation and Decision-Making Mechanisms

In addition, a lack of effective consultation mechanisms regarding trade policies in the EU became apparent. This problem laid at the foundation of the asymmetric relationship between Turkey and the EU. Turkey was committed to implementing and adapting to the EU’s external trade regime, however, it did not have any say in the making of trade policy since it was not a member of the EU. The customs union decision stipu-

²¹ See, among others: Yazıcı, Hayati. “Turkey-EU Relations and the Customs Union: Expectations versus the Reality,” *Turkish Policy Quarterly*, (Vol.11, No:1, Spring 2012): pp.25-37.

²² Dawar, Kamala and Togan, Subidey. *opt.cit*, p.25.

lated that the EU consulted and informed Turkey about any changes to its trade policy. However, this mechanism was not sufficient to ensure that Turkey's interests were taken into account in the EU's trade policy. The improvement of these instruments was needed in order to resolve problems stemming from the asymmetric nature of the relationship.

Dispute Settlements

The issue of dispute settlement emerged as one of the weaker arrangements of the customs union. Despite the existence of such institutions (Association Council and the Customs Union Joint Committee), the trade problems between Turkey and the EU could not be effectively resolved in the 21 years since the inception of the customs union. The dispute settlement mechanism foreseen in the customs union decision²³ was not extensive and was restricted to disagreements on the duration of safeguard measures.²⁴ Thus, a dispute settlement mechanism applicable in a more extensive array of trade disagreements would be desirable for a fully-functioning customs union.

Transport Quotas and Permits

Transport quotas and permits implemented by several EU member states to trucks carrying goods from Turkey into the EU represented an import hurdle for the functioning of the customs union. Countries along the route towards Western Europe implemented quotas and levied fees that impeded the transit of goods. While this certainly constituted a non-tariff barrier to trade in the customs union, it could not be dealt with within the confines of the trade relationship, since the carriage of goods was regarded as a service. Services were not within the remit of the customs union. Turkey's International Transporters Association as well as business organizations (TOBB²⁵ and IKV)²⁶ successfully argued that these transport quotas were limiting the amount of trade between Turkey and the

²³ The Association Agreement stipulated a comprehensive dispute settlement mechanism including "any dispute relating to the application or interpretation of this Agreement" (Article 25). This could involve the submission of the matter to the Court of Justice of the European Communities. However, since unanimity was required in the Association Council, the triggering of this mechanism proved to be quite difficult in practice.

²⁴ Gillson, Ian et al., "Evaluation of the EU-Turkey Customs Union." World Bank Report no. 85830-TR, March 28, 2014, p.iii. <http://documents.worldbank.org/curated/en/298151468308967367/pdf/858300ESW0P1440disclosed090260140TR.pdf>.

²⁵ Union of Chambers and Commodity Exchanges of Turkey.

²⁶ Economic Development Foundation.

EU and most importantly, the trade of goods produced by EU companies that invested in Turkey.²⁷

Non-Tariff Barriers

The implementation of non-tariff barriers was especially a cause of concern, expressed several times by EU officials. Bureaucratic delays at customs points, delays in adaptation to technical standards, practices violating the customs union (e.g., the introduction of customs duties and import surveillance measures on goods such as textiles, clothing, and footwear, disproportionate testing obligations),²⁸ and any other measures which had the intention or impact to deter trade between the parties, harmed the customs union relationship.

Visas

Lastly, the visa regime presented a barrier for businesspeople between Turkey and the EU. Turkish citizens involved in the production and trading of goods to be exported to the EU experienced problems with visa applications when and if they wanted to travel to the EU. The delays, the burden of providing multiple documents, and the disclosure of bank statements and other required commercial documents created a burden that discouraged travelling to the EU for business purposes. Complaints about the visa procedure were compiled by the Economic Development Foundation in a project conducted in liaison with European Citizen Action Service.²⁹

After 2010, the two parties began discussing the modernization of the customs union. Zafer Çağlayan, a former Minister of Economy in Turkey, argued that the customs union in its present form was to Turkey's disadvantage and that if it was not rectified, it should be turned into a free trade agreement.³⁰ Similarly, Turkey's current Minister of Economy, Nihat Zey-

²⁷ Servantie, Deniz. "The Quota Issue of the Turkish Road Transport Sector in the EU." *IKV Brief*, (Istanbul: Economic Development Foundation, June 2017). [http://www.ikv.org.tr/images/files/brief\(1\).pdf](http://www.ikv.org.tr/images/files/brief(1).pdf).

²⁸ Foreign Trade Association. "The EU-Turkey Customs Union: Is It Working?" *Position Paper*, March 9, 2015. Accessed: May 15, 2017. http://redirect.ftave.org/doc/unp/opinion/en/FTA-Position-The_EU-Turkey_Customs_Union.pdf.

²⁹ Ozler, Zeynep and Ozsoz, Melih. "Visa Hotline Project: Final Report." *Economic Development Foundation Publications* no.231, (Istanbul: Economic Development Foundation, 2010).

³⁰ "Gümrük Birliği Türkiye'nin Aleyhine [The Customs Union is to Turkey's Detriment]." *Bloomberg*, September 24, 2013. <http://www.bloomberght.com/haberler/haber/1430671-caglayan-gumruk-birligi-turkiyenin-aleyhine>.

bekçi, noted the need for upgrading the customs union, especially in view of the urgency created by the TTIP process. Zeybekçi warned that if Turkey was not included in TTIP, Turkey would come under a “commercial siege” as the U.S. would gain tariff-free access to Turkey (through the customs union agreement) but Turkey would not be able to gain reciprocal access to the U.S. market. He added that if that were the case, it would be impossible to preserve the customs union.³¹

The “Positive Agenda,” launched in 2012 by Stefan Füle, the EU Enlargement Commissioner, was aimed to moving the stagnant Turkey-EU relations forward, including improvements in trade and the customs union.³² Even though the “Positive Agenda” could not fully accomplish the intended aims, it drew attention to the customs union, both in need of its reform and as a ground for further integration between Turkey and the EU.

Since the parties were not in agreement on some of the above-mentioned issues, the assessment of a third party was seen as necessary. Commissioned by the European Commission, the World Bank prepared a report titled “Evaluation of the EU-Turkey Customs Union,” diagnosing the problems in the customs union, offering solutions, and proposing ways for its reform. The report, finalized on 28 March 2014, was publicized in Turkey and Brussels consecutively and was favorably received in both quarters. It pointed to structural problems in the customs union, which hindered its efficient functioning offering agreeable solutions.³³ The findings of the report created a suitable base for the upgrading of the customs union to proceed.

Before the World Bank report was published, Turkey and the EU decided to set up a “Senior Official Working Group” with goal to reach initial agreement on how to revise the customs union. The final report was released on April 27, 2015, with a set of joint recommendations regarding the revision and upgrading of the customs union and enhancement of

³¹ “Zeybekçi: Gümrük Birliği Güncellenmeli [Zeybekçi: The Customs Union Should be Updated].” *CNN Türk*, <https://www.cnnturk.com/haber/ekonomi/genel/zeybekci-gumruk-birligi-guncellenmeli>

³² Delegation of the EU to Turkey. “EU-Turkey: Commissioner Š.Füle to launch positive agenda.” May 16, 2012. <http://www.avrupa.info.tr/tr/node/2229>.

³³ Gillson, Ian et al., *opt.cit.*

trade relations.³⁴ The common understanding reached (as a result of this process) contributed to the consolidation of political will on both sides.

Nihat Zeybekçi, Turkey's Minister of Economy, and Cecilia Malmström, the European Commissioner responsible for Trade, reached an agreement on May 12, 2015 to proceed with the modernization of the customs union. In the press release marking the political consensus to go forward with the process, Malmström said, "We need to modernize our Custom Union with Turkey and bring it into the 21st century. This initiative will boost EU-Turkey commercial relations."³⁵ Minister Zeybekçi also noted the significance of this event and underlined the benefits of a customs union for Turkey. "Turkey's participation into the EU's consultation and decision-making mechanism as an equal partner of the customs union," "finding a permanent solution to problems associated with the adaptation to free trade agreements," and "road transport quotas." Zeybekçi stressed Turkey's two-fold aim of finding solutions to these "systemic" problems and the deepening of trade relations with the EU in the areas of agriculture, services, and public procurement. The minister also added that Turkey's aim was to be included in the TTIP process.³⁶

Both Turkey and the EU commissioned multiple economic impact analyses to predict the probable effects of the modernized customs union. In December 2016, the European Commission asked for the Council's mandate in order to conduct formal negotiations with Turkey. At the time of the writing of this chapter, the Council has not yet given its mandate. The latest crisis between Turkey and Germany sparked controversy over this issue, leading Germany's Minister for Foreign Affairs, Sigmar Gabriel, to speak of the possibility of economic sanctions against Turkey. Some EU member states believe that the modernization process of the customs union should start only if Turkey fulfills certain political criteria. The European Parliament in its report on Turkey advocated the imposition of political conditions before the start of formal negotiations.

³⁴ "Report of the Senior Officials Working Group (SOWG) on the Update of the EU-Turkey Customs Union and Trade Relations," April 27, 2015. http://trade.ec.europa.eu/doclib/docs/2016/march/tradoc_154367.pdf.

³⁵ European Commission. "EU and Turkey announce modernization of customs union," May 12, 2015, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1307>.

³⁶ Cumhuriyet. "AB ile Türkiye Arasında 20 Yıl sonra Önemli Adım [Important Step Between the EU and Turkey After 20 Years]." May 12, 2015. http://www.cumhuriyet.com.tr/haber/dunya/274845/AB_ile_Turkiye_arasinda_20_yil_sonra_onemli_adim.html.

The Modernization of the Turkey-EU Customs Union: Expectations and Obstacles

Despite the interdependence of Turkey and the EU, bilateral relations are currently going through a particularly difficult period, especially following the coup attempt of July 15. In December 2016, the Council of the EU announced that while negotiations with Turkey are not frozen, no new chapters could be opened, resulting in a *de facto* suspension of Turkey's accession process. The visa liberalization process, based on Turkey's fulfillment of 72 conditions embodied in a roadmap, was expected to be completed as of October 2016. However, the seven remaining criteria, (and above all the requirement regarding revision of Turkey's anti-terror legislation), created a stumbling block, that has not yet been overcome. The refugee issue is grudgingly being implemented by the parties but is based on a transactional approach. The deterioration of political relations with the EU and certain member states in particular, created an atmosphere of mistrust and animosity, spilling over to other issues. The loss of credibility in Turkey's EU membership perspective and the disappointment regarding the EU's handling of relations left Turkey with a bitter aftertaste.

At the moment, the modernization of the customs union seems to be the only concrete mechanism to elevate and sustain Turkey-EU relations. It promises benefits for both Turkey and the EU as attested by the economic impact analyses prepared for both parties. As Minister Zeybekçi put forward in the above-mentioned statement, the modernization of the customs union is expected to resolve outstanding issues in the functioning of the customs union and to enlarge the trade relationship between Turkey and the EU to new areas (i.e., agriculture, services, and public procurement). Hence, if negotiations are started and completed successfully, the modernized customs union is expected to boost the economic and trade component of Turkey-EU relations and integrate Turkey further into the EU Single Market.

According to the impact analyses, the modernization of the customs union is expected to result in a 1.44 -1.9 percent increase in Turkey's GDP and 0.01 percent increase in the EU's GDP. The EU's impact analysis report studies the probable effects of 3 different scenarios on the Parties, the first one being the case of no policy change. According to the second scenario, the Turkey-EU trade relationship revisions involve trade in industrial products only, along with the signing of an additional FTA covering trade in agriculture and fishery products, services and establishment,

non-tariff barriers, and public procurement. According to the third scenario, a “Deep and Comprehensive Free Trade Agreement” (DCFTA) would replace the current customs union and include all trade, including agriculture, services and establishment, non-tariff barriers, and public procurement. According to the conclusions of the report, the second scenario is beneficial for both parties, while the third shows mixed results. With an enhanced trade framework, the EU is expected to experience a 0.01 percent increase in GDP, while with a DCFTA, the GDP is expected to decrease by 0.005 percent. For Turkey, an enhanced trade framework is expected to increase GDP by 1.44 percent, and the DCFTA is expected to show increase of 0.26 percent. The enhanced trade framework would increase EU exports to Turkey by 27 million euros, and Turkey’s exports by nearly 5 million euros. In the case of the DCFTA, Turkey is set to lose more than 4 million euros in exports to the EU, while the EU’s increase would be 8 million euros.³⁷

The Ministry of Economy’s impact study was based on four different scenarios. The first scenario was based on an agreement that would resolve structural problems in the customs union, achieve 50 percent liberalization in agricultural products, and open up service and public procurement markets. The second scenario was similar as it also included an agreement to resolve the structural custom union problems through its upgrading, but instead offered 100 percent liberalization in agricultural products and an increased number of FTAs with Canada and the U.S. While the first scenario was expected to increase Turkey’s GDP by 1 percent, the second scenario produced the best results, including a 1.9 percent increase in GDP, a 24 percent increase in exports to the EU, a 15 percent increase in Turkey’s overall trade, a 1.5 percent decrease in consumer prices, and a 1.6 percent increase in household consumption. The third and fourth scenarios held poorer expectations. In the third scenario, the customs union was to be replaced by an FTA to include only trade in industrial products. In this scenario, the expected effect was calculated as a 0.4 percent decrease in GDP and a 16 percent decrease in exports to the EU. The fourth scenario was based on the replacement of the customs union by a DCFTA including industrial products, agriculture, services and pub-

³⁷ European Commission. “Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of Its Possible Enhancement: Final Report.” October 26, 2016, pp.15-16. http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2016/turkey_anx6_en.pdf.

lic procurement. The expected benefit in terms of GDP increase was limited to 0.16 percent.³⁸

The impact analysis studies reassured the parties to proceed with the opening of formal negotiations on the modernization of the customs union, expected during 2017. On December 21, 2016, the European Commission asked the Council for a mandate to start talks with Turkey to modernize the customs union.³⁹ At the time of the writing of this chapter, the Council has still not given this mandate to the Commission. The political problems between Turkey and the EU, several disputes with EU member states, and consecutive elections in EU member states may be linked to this delay. In the 2016 EP's Commission report on Turkey, the European Parliament recommends the opening of talks on the modernization of the customs union, calling to the European Commission to include a political condition for Turkey to comply with before the start of these negotiations. The EP "calls on the Commission to include a clause on human rights and fundamental freedoms in the upgraded customs union between Turkey and the EU, making human rights and fundamental freedoms a key conditionality."⁴⁰

Following renewed tension in Turkish-German relations (after the arrest of a German human rights activist in Turkey), both the German Minister of Foreign Affairs and the Minister of Economy also referred to the suspension or indefinite postponement of customs union talks. The Minister of Economy, Brigitte Zypries, said that she would "discuss with our European partners how to proceed. This applies to questions of economic aid for Turkey or the further development of the customs union." Sigmar Gabriel, German Minister of Foreign Affairs, also talked of "redefining Germany's policy on Turkey" following the arrest of the human rights activist and noted that additional measures could be taken such as "suspension of credit guarantees for businesses that invest in Turkey, and a possible cutting of EU pre-accession aid promised to Turkey as part of its accession process to the EU." Gabriel said that he also supported the Social Democratic Party leader Martin Schulz's idea to freeze the customs

³⁸ Republic of Turkey Ministry of Economy. "Gümrük Birliği Güncellenmesi Etki Analizi Basın Bildirisi [Press Release on the Impact Analysis Regarding the Updating of the Customs Union]." January 18, 2017. <http://bit.ly/2gaGoLJ>.

³⁹ European Commission. "Commission proposes to modernize the Customs Union with Turkey." December 21, 2016. <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1609>.

⁴⁰ European Parliament resolution of July 7, 2017 on the 2016 Commission Report on Turkey (2016/2308(INI)), July 7, 2017. <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P8-TA-2017-0306&language=EN&ring=A8-2017-0234>.

union modernization talks until the improvement of the political situation in Turkey.⁴¹

The Cyprus issue could be the other obstacle that may endanger the modernization talks. The latest international Conference on the Cyprus question held in Crans-Montana was adjourned on July 7, 2017, without a resolution. Apparently, issues regarding the continuation of the status of guarantor powers, the presence of Turkish soldiers on the island and rotating presidency proved to be stumbling blocks leading to the intransigence of the parties.⁴² The Council of the EU had decided not to open eight chapters in Turkey's EU accession negotiations, found to be linked to the customs union. This was a punitive measure against Turkey on grounds that Turkey did not implement the customs union fully and in a non-discriminatory manner to all the member states, including the Greek Cypriots. This issue still has the potential to cause an impediment to the modernization of the customs union.

Impact on Transatlantic Relations

Initially, the TTIP negotiations created a push factor for the modernization of the EU-Turkey customs union. The Turkish side in particular was anxious to start and complete customs union negotiations by the end of the TTIP process so that Turkey would also be able to become a part of the to-be-established free trade area (FTA). Since Turkey's exclusion from the EU's FTAs would be handled within the customs union modernization talks, inclusion into the TTIP process by a docking mechanism⁴³ or a separate FTA between Turkey and the U.S. would be a plausible alternative.⁴⁴ With the suspension of TTIP talks, this sense of urgency for the start and completion of the customs union modernization negotiations is

⁴¹ Hanke, Jakob. "Relations with Turkey 'can't go on as before,' says Germany." *Politico*, July 20, 2017, <http://www.politico.eu/article/sigmar-gabriel-peter-steudtner-erdogan-relations-with-turkey-cant-go-on-as-before-says-germany/>.

⁴² Miles, Tom. "Cyprus reunification talks collapse, U.N. chief 'very sorry.'" *Reuters*, July 7, 2017, <http://www.reuters.com/article/us-cyprus-conflict-idUSKBN19S02I>.

⁴³ Kirişçi, Kemal. "Turkey and the Transatlantic Trade and Investment Partnership." *Brookings Turkey Project Policy Paper*, No.2, September 2013, p.17, <https://www.brookings.edu/wp-content/uploads/2016/06/Turkey-and-the-Transatlantic-Trade-and-Investment-Partnership.pdf>.

⁴⁴ Long, Catherine. "The Opportunity Space of Overlapping Trade Regimes: Turkey, the Customs Union, and TTIP." *Global Policy*, (Volume 7, Issue 3, September 2016): pp. 360-369.

no longer present. However, there are signs that the U.S. and EU may be about to start a new process regarding a free trade agreement in the near future as implied during a meeting between U.S. Secretary of Commerce, Wilbur Ross, and European Commissioner for Trade, Cecilia Malmström.⁴⁵ In such a case, the swift opening and completion of the customs union modernization negotiations will be beneficial for Turkey's inclusion into the process minimizing any costs associated with the exclusion from the new economic area that is supposed to result from the agreement.

It is often contended that trade and investment relations between Turkey and the U.S. are limited and should be improved. When former U.S. President Barack Obama visited Turkey in 2009, strengthening the economic relationship was among the priorities. In 2010, an economic commission was established between Turkey and the United States, together with a Turkey-U.S. Business Council. Turkey and the U.S. could develop the economic aspect of trade and economic relations by strengthening the 1990 Bilateral Investment Treaty and the 1999 Turkey-U.S. Trade and Investment Framework Agreement. The conclusion of an FTA between the two could expand the trade potential, increase a mutual presence in each other's markets and draw U.S. investments to Turkey.⁴⁶ However, this option was dependent on the resurgence of the TTIP process due to Turkey's commitments under the customs union. It should also be noted that political tension between the parties, especially over the situation in Syria and Iraq, environmental, food security, intellectual property rights, and social concerns may prove to be an impediment for a far-reaching deal.

Policy Recommendations

The customs union between Turkey and the EU is a defining feature of Turkey's international trade relationships. After 21 years, the customs union is in need of a revision. Therefore, the first priority should be to start negotiations as early as possible. Updating the current problems in the functioning of the customs union should be a priority. These include the resolution of the FTA issue where Turkey would be able to negotiate and conclude FTAs in parallel with the EU. The respective agreements

⁴⁵ Gardner, Anthony. "How to Revive TTIP." *Politico*, July 9, 2017. <http://www.politico.eu/article/opinion-how-to-revive-ttip/>.

⁴⁶ Council on Foreign Relations. "US-Turkey Relations: A New Partnership." *Independent Task Force Report*, No.69, May 2012, p.11. https://www.cfr.org/sites/default/files/pdf/2012/05/TFR69_Turkey.pdf.

(i.e., those the EU negotiates with a third party and those it directly negotiates with Turkey) should enter into force at roughly the same time.

In a modernized customs union, Turkey should be involved in the shaping of the EU's trade policy by participating in relevant committee and working group meetings and engaging in extensive consultation with EU Commission authorities.

The dispute settlement mechanism between the customs union partners should be enhanced and disagreements on trade issues should be rapidly resolved through broader and more effective dispute settlement procedures.

Road transport quotas and transit permits for trucks carrying goods from Turkey to the EU should be liberalized, as they act as a non-tariff barriers and are stifling trade. In addition, the visa barriers for Turkish citizens should be lifted when the visa liberalization roadmap is completed. The visa application process is an impediment to business contacts and civil society dialogue between Turkey and the EU.

The trade relationship between Turkey and the EU should be expanded to include services, agriculture, and public procurement. This could be achieved through the Turkey-EU Association Council or through separate protocols. Agriculture is a vital sector of the Turkish economy and an important source of employment, and considering that Turkey is not a beneficiary of the EU's Agricultural Policy, technical and financial assistance for an effective preparation on Turkey's part should be included.

Since Turkey is also an EU candidate country, its ultimate aim is EU membership. Hence, both sides should strive to resolve political differences and make strides in Turkey's EU accession process.

Lastly, Turkey's relationship with the U.S. is of the utmost importance. In recent years, we have witnessed differences and disputes more than reconciliation and cooperation in this relationship. Turkey has displayed a pattern of seemingly looking for alternatives to its Western ties, such as the Shanghai Cooperation Organization (SCO). Strengthening economic and commercial relations could be a very effective way of recalibrating the Turkey-U.S. relationship.

