

IKV BRIEF

MODERNIZING THE EU-TURKEY CUSTOMS UNION

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Executive Summary

The Customs Union is the backbone of the current economic relations between Turkey and the EU. Although the existing Customs Union has significantly increased the value of bilateral trade in goods between Turkey and the EU and has had a positive impact on the economies of both sides, it is not sufficient to reveal the current trade potential of Turkey and the EU.

Since the Turkey-EU Customs Union covers only industrial and processed agricultural products, its coverage does not reflect the comprehensive trade deals that the EU is pursuing globally now. Apart from that, the asymmetric nature of the Customs Union, that does not involve Turkey in policy-making procedures or the negotiation process for FTAs with third countries, and issues such as visa requirements, limited transport quotas, and an inadequate dispute settlement mechanism are the major problems regarding the functioning of the Customs Union

Turkey and the EU, initially, seemed to be keen on starting the negotiations for modernising the Customs Union. However, following developments stalled the process, and the mandate has never been given to date:

- The Turkish Minister of Economy and The EU Commissioner for Trade decided to set up a Senior Official Working Group (SOWG) to explore what could be done about the current problems of the Customs Union in February 2014.
- The World Bank report proposing that modernising the Customs Union would benefit both parties was revealed in March 2014.
- Impact assessments that analyse modernising the Customs Union's possible effects were carried out by the Commission and the Turkish Ministry of Economy in 2016
- The Commission asked the Council for a mandate to begin negotiations regarding the modernisation of the Customs Union in December 2016.
- The General Affairs Council halted the recommendation of the European Commission in June 2018.
- The European Parliament called on the Council to consider "the suspension of the trade preferences under the agreement on agricultural products and, as a last resort, the suspension of the EU-Turkey Customs Union" in the European Parliament resolution of 24 October 2019.
- The European Council imposed sanctions over Turkey's drilling activities in the Eastern Mediterranean in July 2019.
- The European Council in its conclusions stated that "the European Council had agreed to launch a positive political EU-Turkey agenda with a specific emphasis on the modernisation of the Customs Union" in October 2020.
- European Council President Charles Michel and European Commission President Ursula von der Leyen visited Turkey in April 2021 and highlighted that modernising the Customs Union and addressing challenges on its implementation would be on the EU's agenda.

- Although technical meetings, exchange of letters, and high-level contacts were held with the European Commission officials and positive agenda created a positive atmosphere, concrete steps to realise modernising the Customs Union were not taken by the EU.

In many studies conducted to date, especially in the World Bank report, the Commission's impact assessment, and the Turkish Ministry of Trade's impact assessment, it has been revealed that the modernisation of the Customs Union is the best option that brings the most benefit to both parties. According to the most up-to-date analysis, which was presented to the European Parliament Committee on International Trade in July 2021:

- Including trade in the agricultural and service sectors, a modernised and upgraded Customs Union would benefit Turkey and the EU, and bilateral trade between both parties would significantly increase. Turkish GDP is predicted to rise by 1.84 % in this scenario.
- Suppose Turkey complies with the rules of the Customs Union, adapts its NTBs to EU regulations, and continues to follow EU FTA policy with third parties; in that case, significant growth effects are forecasted for both parties. If Turkey either has a modernised Customs Union or aligns its trade policy with the EU's new FTA partners, both parties' welfare gains would be the largest in this scenario. While additional GDP growth of around 0.7% is estimated for the EU, more than 2% additional growth in its GDP is predicted for Turkey. If Turkey successfully signs equivalent FTAs with the EU's new trading partners, the GDP growth is predicted, even more, reaching 2.5 %.
- As for sectors, mainly in three primary sectors agriculture, manufacturing, and services, Turkish exports to the EU are foreseen to increase by nearly 70%. While exports to the EU for the agricultural sector are expected to grow by 95%, a growth of 430% is envisaged in the service sector. However, a decline in exports is forecast for the manufacturing sector. Furthermore, updating the Customs Union is expected to redistribute resources from the manufacturing industry to the services sector.

Modernizing the EU-Turkey Customs Union

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Ankara Agreement signed in 1963 envisaged three phases: preparation, transition, and final periods for Turkey's association with the European Economic Community, which would later turn into the European Union. Entering into force in 1973, Additional Protocol determined the transition period's terms and obligations, and completing the Customs Union was gradually aimed at the end of this period. The EU-Turkey Customs Union was eventually established by the Decision No. 1/95 of the EC-Turkey Association Council on 6 March 1995 and entered into force on 1 January 1996. Thus, the final period began as foreseen in Ankara Agreement.

The Customs Union is one of the most critical stages on the way to the goal of integrating Turkey into the EU internal market and has given a new dimension to relations between Turkey and the EU. In accordance with article 54 of Decision No. 1/95, far beyond a market access facilitation in bilateral trade, the Customs Union obliges Turkey to align its national legislation with EU's Common Commercial Policy and agreements with third countries, competition and industrial and intellectual property law, legislation on the abolition of technical barriers to trade in industrial products and customs legislation.¹ Also, Turkey needs to adopt changes in these policies. Therefore, the Customs Union has been a driving force in modernising the Turkish economy's structure, standards, and legal framework.

Table 1: Turkey's Imports and Exports to the EU (thousand \$)

| Year | Exports | Imports | The Bilateral Trade Volume | EU's Share in Turkey's Total Exports (%) |
|------|------------|------------|----------------------------|--|
| 1996 | 11 328 579 | 21 838 787 | 33 167 366 | 49.61 |
| 1997 | 11 099 010 | 23 364 341 | 35 323 350 | 47.21 |
| 1998 | 13 095 388 | 22 613 599 | 35 708 986 | 48.99 |
| 1999 | 13 621 355 | 20 347 853 | 33 969 208 | 50.51 |
| 2000 | 13 651 184 | 25 804 530 | 39 455 714 | 47.95 |
| 2001 | 15 400 787 | 17 926 941 | 33 327 728 | 45.82 |
| 2002 | 17 432 965 | 23 259 924 | 40 692 889 | 46.45 |
| 2003 | 23 809 267 | 31 656 820 | 55 466 087 | 47.57 |
| 2004 | 31 154 616 | 43 813 760 | 74 968 375 | 46.65 |
| 2005 | 35 610 069 | 48 085 688 | 83 695 757 | 43.99 |
| 2006 | 41 322 262 | 54 309 920 | 95 632 182 | 42.48 |
| 2007 | 52 119 405 | 62 995 082 | 115 114 487 | 41.51 |
| 2008 | 55 549 563 | 69 254 329 | 124 803 893 | 37.37 |
| 2009 | 41 288 877 | 53 142 848 | 94 431 725 | 38.85 |
| 2010 | 45 697 963 | 67 710 152 | 113 408 115 | 37.87 |
| 2011 | 54 436 524 | 85 598 331 | 140 034 855 | 37.27 |

¹ Decision No 1/95 of the EC-Turkey Association Council, [https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:21996D0213\(01\)](https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:21996D0213(01)). Accessed on 5 March 2021.

| | | | | |
|------|------------|------------|-------------|-------|
| 2012 | 50 700 814 | 82 027 895 | 132 728 709 | 34.12 |
| 2013 | 54 253 068 | 86 176 068 | 140 429 136 | 34.81 |
| 2014 | 58 610 951 | 82 851 274 | 141 462 225 | 35.38 |
| 2015 | 53 441 794 | 73 139 975 | 126 581 768 | 36.06 |
| 2016 | 56 657 040 | 72 180 833 | 128 838 337 | 37.77 |
| 2017 | 64 302 995 | 78 656 466 | 142 959 462 | 36.58 |
| 2018 | 72 847 019 | 73 366 674 | 146 213 693 | 37.40 |
| 2019 | 72 308 293 | 63 943 661 | 136 251 954 | 36.41 |
| 2020 | 70 019 688 | 73 337 528 | 143 357 216 | 36.84 |
| 2021 | 93 082 120 | 85 386 214 | 178 468 334 | 35.93 |

Source: TÜİK

Since its introduction, the Customs Union has been the backbone of economic ties between the EU member states and Turkey. Although the EU's share in Turkey's total exports gradually decrease, bilateral trade in goods between Turkey and the EU has increased significantly. In this respect, the bilateral trade volume increased nearly 5 times and reached from 33 billion 167 million USD to 178 billion 468 million USD from 1996 to 2021. In 2021, Turkey exported 93 billion 82 million USD to the EU, the highest export in its history.

Table 2: Exports by economic activity (ISIC, Rev.3) in 1996

| Economic Activities | Amount (million \$) | Its share in all economic activities (%) |
|----------------------------|--------------------------------|---|
| Manufacturing | 20 525 761 | 88.38 |
| Agriculture and forestry | 2 152 577 | 9.27 |
| Mining and quarrying | 368 625 | 1.59 |
| Wholesale and retail trade | 134 515 | 0.58 |

Source: TÜİK

Table 3: Exports by economic activity (ISIC, Rev.3) in 2019

| Economic Activities | Amount (million \$) | Its share in all economic activities (%) |
|----------------------------|--------------------------------|---|
| Manufacturing | 161 552 342 | 94.2 |
| Agriculture and forestry | 5 515 507 | 3.2 |
| Mining and quarrying | 3 194 715 | 1.9 |
| Wholesale and retail trade | 563 485 | 0.3 |

Source: TÜİK

A large portion of Turkey's exports consists of manufacturing sector products, as seen in tables 2 and 3. As a matter of fact, the share of manufacturing, which accounted for 88.38% of exports in 1996, increased to 94.2% in 2019. Moreover, exports, which amounted to 20

billion 522 million USD in 1996, increased 8 times and reached 161 billion 552 million USD in 2019. As for agriculture and forestry, the share of them, which were 9.27% in 1996, decreased to 3.2% in 2019.

Table 4: Exports by International Standard Industrial Classification (ISIC, Rev.3), (1996, million \$)

| | | |
|-----------|--|-----------|
| 1 | Manufacture of wearing apparel; dressing and dyeing of fur | 4 829 702 |
| 2 | Manufacture of textiles | 3 817 823 |
| 3 | Manufacture of food products and beverages | 2 455 094 |
| 4 | Manufacture of basic metals | 2 233 719 |
| 5 | Manufacture of chemicals and chemical products | 1 244 289 |
| 6 | Manufacture of motor vehicles, trailers, and semi-trailers | 975 877 |
| 7 | Manufacture of machinery and equipment n.e.c. | 828 739 |
| 8 | Manufacture of other non-metallic mineral products | 780 908 |
| 9 | Manufacture of electrical machinery and apparatus n.e.c. | 771 656 |
| 10 | Manufacture of rubber and plastics products | 510 218 |

Source: TÜİK

Table 5: Exports by International Standard Industrial Classification (ISIC, Rev.3), (2005, million \$)

| | | |
|----------|--|------------|
| 1 | Manufacture of motor vehicles, trailers and semi-trailers | 10 226 102 |
| 2 | Manufacture of wearing apparel; dressing and dyeing of fur | 9 924 749 |
| 3 | Manufacture of textiles | 8 742 704 |
| 4 | Manufacture of basic metals | 6 887 671 |
| 5 | Manufacture of machinery and equipment n.e.c. | 4 865 027 |
| 6 | Manufacture of food products and beverages | 4 271 660 |
| 7 | Manufacture of radio, television and communication equipment and apparatus | 3 150 196 |
| 8 | Manufacture of chemicals and chemical products | 2 818 310 |
| 9 | Manufacture of other non-metallic mineral products | 2 686 826 |

| | | |
|-----------|--|-----------|
| 10 | Manufacture of fabricated metal products, except machinery and equipment | 2 684 603 |
|-----------|--|-----------|

Source: TÜİK

Table 6: Exports by International Standard Industrial Classification (ISIC, Rev.3),(2019, million \$)

| | | |
|-----------|--|------------|
| 1 | Manufacture of motor vehicles, trailers and semi-trailers | 27 011 472 |
| 2 | Manufacture of basic metals | 16 748 739 |
| 3 | Manufacture of machinery and equipment n.e.c. | 16 242 432 |
| 4 | Manufacture of textiles | 14 558 381 |
| 5 | Manufacture of wearing apparel; dressing and dyeing of fur | 12 794 220 |
| 6 | Manufacture of food products and beverages | 11 424 931 |
| 7 | Manufacture of chemicals and chemical products | 10 101 338 |
| 8 | Manufacture of furniture; manufacturing n.e.c. | 8 752 108 |
| 9 | Manufacture of fabricated metal products, except machinery and equipment | 7 780 093 |
| 10 | Manufacture of rubber and plastics products | 7 661 709 |

Source: TÜİK

From the mid-1990s to the mid-2000s, there was a decline in exports of labour-intensive, low-tech sectors such as agriculture, food and textiles; instead, Turkey joined the global competition with more capital-intensive sectors and increased its exports in medium-low and medium-high technology sectors² as seen Tables 4,5 and 6.

While the manufacture of wearing apparel and manufacture of textiles ranked first and second in manufacturing in 1996 and accounted for 43% of manufacturing, that figure dropped to 27% in 2005 and to 17% in 2019. On the other hand, the manufacture of motor vehicles, trailers and semi-trailers, which ranked 6th in manufacturing in 1996 and accounted for 5% of manufacturing, rose to first place in 2005 and 2019, reaching 15% and 17%, respectively.

Another indicator of the positive development of foreign trade between the EU and Turkey was the increase in foreign direct investment inflows into Turkey. The amount of foreign direct investment, which was 14.6 billion USD in the 1984-2002 period, reached

² Ministry of Development of the Republic of Turkey, Üretim ve Dış Ticaret İlişkisi, <https://www.sbb.gov.tr/wp-content/uploads/2020/04/Uretim-ve-DisTicaret-IliskisiCalismaGrubuRaporu.pdf>. Accessed on 8 March 2022.

224.9 billion USD cumulatively in 2003-2020.³ European countries' investments in Turkey have accounted for 64.5% of total foreign direct investment in the last 5 years.⁴

Although the existing Customs Union has significantly increased the value of bilateral trade in goods between Turkey and the EU and has been the basis of economic relations for both sides, it is not enough to reveal the current trade potential of Turkey and the EU. There are problems in the functioning of the Customs Union that both sides complain about more and more, and this brings the discussions about modernising the customs union.

Problems Regarding the Functioning of the Customs Union

- **Customs Union's Asymmetric Nature**

One of the main issues about the Customs Union stems from its asymmetric nature. Since Turkey is not an EU member, it cannot get involved in decision-making and policy-making procedures. Thus, Turkey cannot have any chance to influence the EU decisions that directly affect itself. However, Turkey must adopt and implement decisions related to the functioning of the Customs Union such as the common commercial policy and common external tariff of the EU.⁵

Moreover, bilateral trade relations of the EU have significantly increased through numerous extensive FTAs as seen in table 8, since the early 2000s, especially following the new trade policy the European Commission introduced in 2006 in response to a slowdown in the liberalisation of the multilateral trading rules within the World Trade Organisation (WTO).⁶ Turkey is bound to adopt the EU's preferential trade regime with third countries. However, obliging Turkey to negotiate and sign FTAs with those countries, Customs Union does not automatically include Turkey in any negotiation process. Turkey can not negotiate jointly with the EU, conduct parallel negotiations, or have any effective pre-negotiation mechanism. As a result, Turkey can not protect its economic interests when the European Commission conducts bilateral trade negotiations with third countries. While, within the scope of free trade, goods from the third countries having FTA with the EU can have the access to the Turkish market without customs duties or quota restrictions, Turkish goods can not benefit from the same privileges of those third country goods. Having trade agreements with the EU, third countries such as South Africa, Mexico, Algeria, Japan, and Vietnam are unwilling to have an equivalent FTA with Turkey since these countries can asymmetrically access the Turkish market via the EU. However, Turkey cannot reach these countries' markets freely because Turkey does not have an FTA with these countries as the EU does. Therefore, countries having FTAs with the EU do not want to lose this advantage.⁷

³ Ministry of Trade of the Republic of Turkey, <https://ticaret.gov.tr/data/5e18288613b8761dccc355ce/Ekonomik%20G%C3%B6r%C3%BCn%C3%BCm%20Ocak%202022.pdf>. Accessed on 8 March 2022

⁴ AA, Türkiye'ye son 5 yılda en fazla yabancı yatırım Hollanda'dan geldi, <https://www.aa.com.tr/tr/ekonomi/turkiyeye-son-5-yilda-en-fazla-yabanci-yatirim-hollandadan-geldi/2415689>. Accessed on 5 March 2022.

⁵ Çiğdem Nas, Yonca Özer, Turkey and EU Integration Achievements and Obstacles, 2019.

⁶ Yonca Özer, Modernizing The EU-Turkey Customs Union As An Interest-Driven Initiative, 2020.

⁷ Erdal Yalcın And Gabriel Felbermayr, The EU-Turkey Customs Union and trade relations: what options for the future, [https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/653640/EXPO_IDA\(2021\)653640_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/653640/EXPO_IDA(2021)653640_EN.pdf). Accessed on 10 November 2021.

Table 7: FTAs with Third Countries (Turkey and EU)

| TURKEY | | | | | |
|---|---------------------------------------|--|---------------------------------------|---|--|
| E U R O P E A N U N I O N | | In force | Under adoption or ratification | Being negotiated | No FTA |
| | In force | Albania Bosnia-Herzegovina Chile EFTA Countries [1] Egypt Faroe Islands Georgia Israel North Macedonia Moldova Morocco Montenegro Palestinian Republic of Korea Serbia Singapore Tunisia United Kingdom Syria Mauritius (ESA) Kosovo | Lebanon Ukraine | Cameroon Colombia Peru Mexico Japan Ecuador Seychelles (ESA) | Algeria Canada Central America Countries [2] South Africa Andorra [3] Armenia Vietnam CARIFORUM Countries [4] Ivory Coast Eastern and Southern Africa (ESA) [5] Jordan [6] Papua New Guinea (West Africa) Ghana (West Africa) SADC Countries [7] San Marino [3] Pacific Countries [8] |
| | Under adoption or ratification | | | MERCOSUR Countries [9] | Eastern African Community [10] Haiti (CARIFORUM) West Africa [11] |
| | Being negotiated | Malaysia [12] | Sudan [12] Qatar (GCC) [12] | Thailand [12] Chad (Central Africa) [12] Djibouti [12] Congo, D.R (Central Africa) [12] Gulf Cooperation Council (GCC) [12] [14] Indonesia [12] India [4] ESA Countries [15] | Australia Central Africa [12] [13] China New Zealand Philippines USA [12] |
| | No FTA | Venezuela | | Pakistan | |

- [1] Iceland, Liechtenstein, Norway, Switzerland
- [2] Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama
- [3] There is a Customs Union Relationship with the EU
- [4] Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Jamaica, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Suriname, Trinidad, and Tobago
- [5] Comoros, Madagascar, Zimbabwe
- [6] Jordan repealed Turkey-Jordan FTA in 2018.
- [7] Botswana, Eswatini, Lesotho, Mozambique, Namibia
- [8] Fiji, Samoa, Solomon Islands
- [9] Argentina, Brazil, Paraguay, Uruguay
- [10] Rwanda (signed), Kenya (Signed and ratified), Burundi, Tanzania, Uganda (have not signed or ratified the agreement. the agreement will enter into force once all East African countries have signed and ratified it.)
- [11] Benin, Burkina Faso, Cabo Verde, Gambia, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo
- [12] EU negotiations on hold.
- [13] Congo, Central African Republic, Equatorial Guinea, Gabon, São Tomé & Príncipe
- [14] Bahrain, Kuwait, Oman, United Arab Emirates, Saudi Arabia
- [15] Zambia, Ethiopia, Malawi, Somalia, Djibouti

Table 8: Turkey's Compliance with Existing Bilateral Trade Agreements of the EU, Historically

| COUNTRY and COUNTRY GROUP | EUROPEAN UNION | TURKEY |
|---------------------------|---|---|
| EFTA Countries | (Switzerland-1973, Iceland and Norway-1974, Liechtenstein-1975) | 1992 |
| Faroe Islands | 1997 | 2017 |
| Palestinian | 1997 | 2006 |
| Tunisia | 1998 | 2005 |
| Azerbaijan | 1999 | No STA Attempts - Preferential Trade Agreement signed in 2020 |
| Israel | 2000 | 1997 |
| Mexico | 2000 | Negotiations Continue |
| Morocco | 2000 | 2006 |
| Jordan | 2002 | No STA Attempts |
| Chile | 2003 | 2011 |

| | | |
|--|-------------------------|---|
| Egypt | 2004 | 2007 |
| North Macedonia | 2004 | 2000 |
| Algeria | 2005 | Turkey Has Launched Initiatives To Start Negotiations |
| Lebanon | 2006 | Negotiations Completed |
| CARIFORUM Countries | 2008 | Turkey Has Launched Initiatives To Start Negotiations |
| Albania | 2009 | 2008 |
| Montenegro | 2010 | 2010 |
| Iraq | 2012 | No Sta Attempts |
| Serbia | 2013 | 2010 |
| Central America Countries | 2013 | Turkey Has Launched Initiatives To Start Negotiations |
| Colombia | 2013 | Negotiations Continue |
| Ecuador | 2013 | Negotiations Continue |
| Papua New Guinea | 2013 | No STA Attempts |
| Peru | 2013 | Negotiations Continue |
| Cameroon (Central America) | 2014 | Negotiations Continue |
| Fiji (Pacific) | 2014 | No STA Attempts |
| Republic of Korea | 2015 | 2013 |
| Bosnia-Herzegovina | 2015 | 2003 |
| Georgia | 2016 | 2008 |
| Kazakhstan | 2016 | No STA Attempts |
| Kosovo | 2016 | 2019 |
| Moldova | 2016 | 2016 |
| South Africa | 2016 | Turkey Has Launched Initiatives To Start Negotiations |
| Ukraine | 2016 | Negotiations Completed |
| SADC Countries | 2016 | No Sta Attempts |
| Ivory Coast | 2016 | No FTA Attempts – A Trade Agreement Signed In 2005 |
| Ghana | 2016 | No Sta Attempts |
| Canada | 2017 | Turkey Has Launched Initiatives To Start Negotiations |
| Armenia | 2018 | No Sta Attempts |
| Samoa (Pacific) | 2018 | No Sta Attempts |
| Japan | 2019 | Negotiations Continue |
| Singapore | 2019 | 2017 |
| Eastern and Southern Africa (ESA) | 2019 | No Sta Attempts |
| Seychelles (ESA) | 2019 | Negotiations Continue |
| Mauritius (ESA) | 2019 | 2013 |
| Vietnam | 2020 | Turkey Has Launched Initiatives To Start Negotiations |
| Solomon Islands (Pacific) | 2020 | No FTA Initiatives |
| United Kingdom | 2021 | 2021 |
| Malaysia | EU Negotiations on Hold | 2015 |
| Venezuela | No STA | 2020 |

Transatlantic Trade and Investment Partnership (TTIP) negotiations may be one of the best examples of how an FTA could affect Turkey's economy. If TTIP negotiations concluded successfully, Turkey will have to abolish tariffs on US goods because there is a Customs Union between Turkey and the EU, and the USA could reach Turkish market freely. As a result, according to a Working Paper published by Leibniz Institute for Economic Research (IFO) in 2016, it was estimated that export from the USA to Turkey would increase by 4.9%. However, the USA would not have to abolish tariffs on imports of Turkish goods imposed by itself, and the Turkish exporters would be exposed to trade diversion in the USA market. As a result of these, export from Turkey to the USA would decrease nearly by 1.2%.⁸

Similarly, a "No Deal Brexit" between the UK and the EU posed significant risks for the UK and Turkey trade relations. As a matter of fact, Turkey's obligations under the Customs Union required the country to conclude similar agreements only with those actors with whom the EU has preferential trade agreements, as mentioned above. Therefore, before Turkey and the UK could sign an FTA, the UK and the EU had to reach an agreement. As a result of the UK's withdrawal from the EU and the signing of an FTA with the EU, the existing Customs Union between Turkey and the EU as of 1 January 2021 has lost its validity in UK-Turkey relations, and Turkey has come to a position to sign an FTA with the UK. Then, in parallel with the relevant process, the Turkey-United Kingdom Free Trade Agreement was signed on 29 December 2020. The agreement, which started to be implemented on 1 January 2021, entered into force on 20 April 2021. As a result of this agreement, the gains made through the Customs Union have been largely preserved between Turkey and UK in the form of a free trade agreement.⁹

The Narrow Scope of the Custom Union

Despite the fact that a customs union is a deep form of economic integration and requires adaptation of commercial policies and customs procedures, the scope of the Customs Union in terms of sectors covered is considerably limited, and it only includes trade in industrial and processed agricultural products. Given that EU's FTAs with third countries include agriculture, investments, services, regulations on social rights and environment and government procurement, it can be argued that the narrow scope of the EU-Turkey Customs Union is outdated and contrast with the dominant trend in international trade.¹⁰

- **Limited Transportation Quotas**

The Lisbon Treaty has stipulated an international legal personality thereby giving the right to the EU to conclude agreements with third countries, but the authority to conclude road transport agreements is still generally in the exclusive competence of the Member States. In this context, road transport services transactions between the EU Member

⁸ Ifo Institute, Going Deep: The Trade and Welfare Effects of TTIP Revised, <https://www.ifo.de/DocDL/wp-2016-219-aichele-felbemayr-heiland-welfare-ttip.pdf>. Accessed on 10 November 2021.

⁹ Şehnaz Dölen, Oğuz Güngörmez and Ahmet Emre Usta, Brexit'in Bir Yılı: Birleşik Krallık, AB ve Türkiye'ye Etkileri, https://www.ikv.org.tr/images/files/BrexitilkY%C4%B1l_Degerlendirme_Notu.pdf. Accessed on 3 August 2022.

¹⁰ Yonca Özer, Modernizing The EU-Turkey Customs Union As An Interest-Driven Initiative, 2020

States and third countries like Turkey are regulated mainly by bilateral intergovernmental agreements between the Member States and these third countries.¹¹

A study on the economic impact of an agreement between the EU and the Republic of Turkey regarding liberalisation of road freight services reached the conclusion that such an agreement would have a positive impact on trade, output and employment for both parties. Full liberalisation of road transport between Turkey and the EU could increase trade between the parties by more than 3 billion euros per year.

Turkey and the EU have signed several agreements on road transport, often with significant differences. The relevant agreements bring quota and transit permit arrangements to the parties' hauliers. The main problem is that while Turkish exports to the EU has increased significantly, the number of bilateral and transit permits remains stable for Turkey and Turkey is exposed to land transport quotas. When the insufficient stock of free transit permits used by Turkish hauliers run out, some Member States issue transit permits in return for payment of a fee. These problems affect Turkey's export adversely and cause additional costs, waste of time and administrative burden. Consequently, it is estimated that Turkey's exports of 1,66 billion tons are hindered due to the EU quota system, and it leads to a loss of 5,56 billion USD.¹²

While Turkey argues that restrictions on goods transportation are against Customs Union's nature, the EU considers the issue in terms of the free movement of services instead of goods and services are not covered in the current Customs Union's framework as mentioned above.

- **Visa Obligation**

As for the visa issue, the visa requirement that the EU imposes on Turkish citizens even covers Turkish businesspeople and service providers. While an entry visa is required for Turkish economic actors to undertake economic activities in EU countries, their European counterparts can travel to Turkey either without visa obligation or taking a visa at the point of entry. High visa fees and long visa progress disadvantage Turkish economic actors.

Although the visa issue is included in the discussions on the updating of the Customs Union, The Visa Liberalization Dialogue, which was launched on 16 December 2013, in parallel with the signing of the Turkey-EU Readmission Agreement, based on the "Roadmap towards a visa-free regime with Turkey (the roadmap)", has added another dimension to this matter.¹³ The 72 criteria Turkey needs to adopt were listed in the roadmap, and Turkey completed 66 out of 72 of them. Moreover, especially with the EU-Turkey Statement on 18 March, the solution to this problem was closer than ever in 2016. However, in the following periods, the process has stalled.

¹¹ Deniz Servantie, AB ve Türkiye Arasındaki Tařımacılık Kotalarının Kaldırılması Üzerine Senaryolar, [https://www.ikv.org.tr/images/files/AB%20VE%20T%20C3%9CRK%20C4%BOYE%20ARASINDA%20TAC%205%9EIMACILIK%20KOTALARININ%20KALDIRILMASI%20%20\(Pastori%20Raporu\)%20edit%20son%20FINAL%20FINAL\(1\).pdf](https://www.ikv.org.tr/images/files/AB%20VE%20T%20C3%9CRK%20C4%BOYE%20ARASINDA%20TAC%205%9EIMACILIK%20KOTALARININ%20KALDIRILMASI%20%20(Pastori%20Raporu)%20edit%20son%20FINAL%20FINAL(1).pdf), Accessed on 3 March 2022.

¹² Füsun Ülengin, Şule Önsel Ekici, Özay Özaydın, Economic Aspects of Turkey & EU Road Transport Agreement

¹³ Ahmet Ceran, Vize Serbestlięi Diyaloęunda Hasar Kontrolü: Vizesiz Avrupa Neden Hayal Deęil?, https://www.ikv.org.tr/images/files/ikv_degerlendirme%20notu_196_.pdf, Accessed on 4 March 2022

- **Insufficient Dispute Settlement Mechanism**

According to Ankara Agreement, all parties may submit any dispute relating to the application or interpretation of the agreement which concerns the Union, a Member State, or Turkey to the Association Council. The main problem in this issue is that the unanimity of the parties and a political decision are required to determine disputes between the parties and bring the solution to the judiciary, as regulated in Article 25 of the Ankara Agreement.

According to Article 25 of the Ankara Agreement:

"1. The Contracting Parties may submit to the Council of Association any dispute relating to the application or interpretation of this Agreement which concerns the Community, a Member State of the Community, or Turkey.

2. The Council of Association may settle the dispute by the decision; it may also decide to submit the dispute to the Court of Justice of the European Communities or to any existing court or tribunal.

3. Each Party shall be required to take the measures necessary to comply with such decisions.

4. Where the dispute cannot be settled in accordance with paragraphs 2 of this Article, the Council of Association shall determine, in accordance with Article 8 of this Agreement, the detailed rules for arbitration or for any other judicial procedure to which the Contracting Parties may resort during the transitional and final stages of this Agreement."¹⁴

In this framework, in accordance with paragraph 4 of Article 25, a new mechanism has been introduced in Articles 61 and 62 regarding the settlement of disputes in Decision No 1/95 of the EC-Turkey Association Council.¹⁵

According to Article 61 of the Decision No 1/95:

Without prejudice to paragraphs 1 to 3 of Article 25 of the Ankara Agreement, "if the Association Council fails to settle a dispute relating to the scope or duration of protection measures taken in accordance with Article 58 (2), safeguard measures taken in accordance with Article 63 or rebalancing measures taken in accordance with Article 64, within six months of the date on which this procedure was initiated, either Party may refer the dispute to arbitration under the procedures laid down in Article 62. The arbitration award shall be binding on the Parties to the dispute."¹⁶

As to Article 62, how the arbitration process will work is specified in this article. However, both parties have one vote and unanimity is required in the Association Council to resolve a dispute or to take disputes to the judiciary for resolution. Since mutual consent of both parties needs to operate the mechanism and both sides prioritise their interests in the conflict, disputes between parties usually are not solved within the current mechanism. It

¹⁴ Ankara Agreement, <https://www.gif.org.tr/documents/ab/1963%20ankara%20agreement.pdf>. Accessed on 5 March 2022.

¹⁵ ABKAD, Türkiye Ve Avrupa Birliği Arasındaki Gümrük Birliği'nin Güncellenmesi: Tarım, Hizmetler ve Anlaşmazlıkların Halli, <http://abkad.org/wp-content/uploads/2021/01/CSSP-II-062-Projesi-G%C3%BCmr%C3%BCK-BG-Kitab%C4%B1-1-Ocak-2021.pdf>, Accessed on 6 March 2022.

¹⁶ Decision No 1/95 of the EC-Turkey Association Council, [https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:21996D0213\(01\)](https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:21996D0213(01)), Accessed on 5 March 2021.

also contradicts the principle of "no-one is judge in his own cause" if a party causes the dispute and participates in the decision-making process as one of the parties of the Association Council¹⁷. Finally, it should be emphasised that the Association Council has not convened since 2019 due to political problems.

A Closer Look at the Process

Because both parties were affected by Customs Union's problematic features mentioned above, debates on modernising it has existed for a long time. The Turkish Minister of Economy and The EU Commissioner for Trade decided to set up a Senior Official Working Group (SOWG) in February 2014 to explore what could be done about the current problems of the Customs Union. After protracted negotiations, the SOWG announced that three headlines were agreed to work.

1. Better implementation and amendment of the Customs Union Agreement – Decision 1/95,
2. Liberalisation of agricultural products, services, and public procurement,
3. Better institutional structure.¹⁸

Published by the World Bank, a report proposing that modernising the Customs Union would benefit both parties¹⁹ was a critical step at the beginning of the process. Impact assessments which analyse modernising the Customs Union's possible effects carried out by the Commission, the Turkish Ministry of Economy in 2016, and separate studies about the same topic were revealed, following the Word Bank report.

When modernisation of the Customs Union is being discussed, the Syrian refugee crisis brought Turkey and the EU closer since the EU aimed at controlling irregular migration over the Aegean Sea. A joint action plan adopted on 29 November 2015 and the EU-Turkey Statement of 18 March in 2016 mainly focused on the migration issue while also referring to modernising the Customs Union.²⁰ The EU highlighted openly that "The EU and Turkey welcomed the ongoing work on the upgrading of the Customs Union." in the EU-Turkey Statement of 18 March.²¹

In December 2016, the Commission asked the Council for a mandate to begin negotiations regarding the modernisation of the Customs Union. Both parties, initially, seemed to be

¹⁷ ABKAD, Türkiye Ve Avrupa Birliği Arasındaki Gümrük Birliği'nin Güncellenmesi: Tarım, Hizmetler ve Anlaşmazlıkların Halli, <http://abkad.org/wp-content/uploads/2021/01/CSSP-II-062-Projesi-G%C3%BCmr%C3%BCk-BG-Kitab%C4%B1-1-Ocak-2021.pdf>. Accessed on 6 March 2022.

¹⁸ Doruk Arbay, The Modernization of the European Union's Customs Union with Turkey, https://www.swp-berlin.org/publications/products/arbeitspapiere/CATS_Working_Paper_Nr_5_Doruk_Arbay.pdf, Accessed on 11 November 2021

¹⁹ AB-TÜRKİYE Gümrük Birliği Değerlendirmesi, The Word Bank, <https://www.worldbank.org/content/dam/Worldbank/document/eca/turkey/tr-eu-customs-union-tr.pdf>, 28 March 2014. Accessed on 12 November 2021

²⁰ Çiğdem Nas, Turkey-EU Customs Union: Its Modernization and Potential for Turkey-EU Relations, <https://www.insightturkey.com/file/958/turkey-eu-customs-union-its-modernization-and-potential-for-turkey-eu-relations>, 2018.

²¹ The European Council, EU-Turkey Statement of 18 March, <https://www.consilium.europa.eu/en/press/press-releases/2016/03/18/eu-turkey-statement/>. Accessed on 12 November 2021

keen on starting the negotiations for modernising the Customs Union. However, following developments stalled the process, and the mandate has never been given to date.

15 July 2016 was a breaking point for Turkey-EU relations and would affect modernising Customs Union's future. The EU disapproved of the measures Turkey took after the failed coup attempt in 2016 and relations between both parties escalated. Modernising the Customs Union, which is an economic matter, has turned into a political issue.

The General Affairs Council halted the recommendation of the European Commission on 26 June 2018 noting that "Turkey had been moving further away from the European Union," the Council stated that "no further chapters could be considered for opening or closing, and no further work towards the modernisation of the EU-Turkey Customs Union was foreseen," in its conclusions.²²

Following developments further escalated the relations. The European Parliament called on the Council to consider "the suspension of the trade preferences under the agreement on agricultural products and, as a last resort, the suspension of the EU-Turkey Customs Union" in the European Parliament resolution of 24 October 2019 against Turkey's military operation in northeast Syria.²³ Moreover, sanctions imposed by the European Council on 15 July 2019 over Turkey's drilling activities in the Eastern Mediterranean²⁴ signalled that the issue would be associated with modernising Customs Union. This was seen in the European Council's conclusions published on 1 October 2020. In the conclusions, the EU stated that "the European Council had agreed to launch a positive political EU-Turkey agenda with a specific emphasis on the modernisation of the Customs Union." However, it was also conditioned upon ending Turkey's activities in the Eastern Mediterranean, and the Council indicated that Turkey needs to sustain constructive efforts to stop activities vis-à-vis Greece and Cyprus.²⁵ Although, including political conditions, the EU's positive agenda calls was responded to positively by Turkish authorities. President Recep Tayyip Erdoğan's statements of "Turkey sees its future in Europe", "Turkey is ready to set a positive agenda with the EU," and "the Customs Union agreement between Turkey and EU should be updated"²⁶ in January 2021 demonstrated it clearly.

The Union of European Chambers of Commerce and Industry (EUROCHAMBRES) President Christoph Leitzl's statements of "the Customs Union update is in the best interest of both parties" and "EUROCHAMBRES fully supports the updating of the Customs Union" in the Turkey-EU High-Level Economic Dialogue was important to show the European business community's support of modernising the Customs Union.

²² Council of the European Union, Enlargement And Stabilisation And Association Process, <https://www.consilium.europa.eu/media/35863/st10555-en18.pdf>. Accessed on 12 November 2021.

²³ Official Journal of the European Union, The Turkish military operation in northeast Syria and its consequences, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019IP0049&rid=5>. Accessed on 12 November 2021.

²⁴ European Council, European Council meeting (20 June 2019) – Conclusions, <https://www.consilium.europa.eu/media/39922/20-21-euco-final-conclusions-en.pdf>. Accessed on 12 November 2021.

²⁵ European Council, Special meeting of the European Council (1 and 2 October 2020) – Conclusions, <https://www.consilium.europa.eu/media/45910/021020-euco-final-conclusions.pdf>. Accessed on 12 November 2021.

²⁶ Hürriyet Daily News, Turkey, EU ready to work together, <https://www.hurriyetdailynews.com/eu-has-priority-in-turkeys-agenda-president-erdogan-161506>. Accessed on 12 November 2021.

Welcomed by Turkey, the EU Council conclusions released on 25 March also involved statements regarding modernising the Customs Union. Admitting that the de-escalation in the eastern Mediterranean was a positive step, the EU invited "the Commission to intensify talks with Turkey to address current difficulties in the implementation of the Customs Union" and asked "in parallel the Council to work on a mandate for the modernisation of the Customs Union." However, the Council also sustained its political stance and noted that all these depended on Turkey's steps in the Eastern Mediterranean and could be reversed.²⁷

European Council President Charles Michel and European Commission President Ursula von der Leyen's Turkey visit on 6 April 2021 was a crucial development to get EU-Turkey relations back on track. Indicating that the EU was ready to support positive agenda, especially in economic cooperation and migration, European Union leaders highlighted that modernising the Customs Union and addressing challenges in its implementation would be the EU's agenda and evoked the Council's call for starting preparatory work regarding modernising the Customs Union.²⁸

Although technical meetings, exchange of letters, and high-level contacts were held with the European Commission officials and positive agenda created a positive atmosphere, concrete steps to realise modernising the Customs Union were not taken by the EU. It was seen in the European Council conclusions of 24 June once again. Indicating that the EU is ready to "start working at the technical level towards a mandate for the modernisation of the EU-Turkey Customs Union," the Council raised the Cyprus issue, which has been unsolvable for years.²⁹ This drew Turkey's reaction. Stressing that "EU states postpone concrete decisions for the implementation of the positive agenda, the Turkish Ministry of Foreign Affairs indicated that "the Conclusions adopted by the EU Council on 24 June 2021 regarding Turkey are far from the necessary steps expected to be taken."³⁰ Also, criticising the EU's stance, Deputy Minister of Foreign Affairs and Director for EU Affairs Ambassador Faruk Kaymakçı stated that Cyprus and Eastern Mediterranean issues have been conditions of the process of modernising the Customs Union.³¹ Likewise, Minister of Trade Mehmet Muş said that Turkey put a lot of effort into modernising the Customs Union, but the process was not started yet.³²

²⁷ The European Council, Statement of the Members of the European Council, <https://www.consilium.europa.eu/media/48976/250321-vtc-euco-statement-en.pdf>. Accessed on 12 November 2021.

²⁸ Euronews, AB Konseyi ve Komisyonu, Türkiye'deki insan haklarıyla ilgili endişelerini Erdoğan'a anlattı, <https://tr.euronews.com/2021/04/06/ab-komisyonu-ve-konseyi-liderleri-turkiye-de>. Accessed on 12 November 2021.

²⁹ The European Council, European Council meeting (24 and 25 June 2021) – Conclusions, <https://www.consilium.europa.eu/media/50763/2425-06-21-euco-conclusions-en.pdf>. Accessed on 12 November 2021.

³⁰ Republic Of Turkey Ministry Of Foreign Affairs, No: 226, 25 June 2021, Press Release Regarding the Conclusions on "Turkey" Adopted by the EU Council on 24 June 2021. Accessed on 12 November 2021.

³¹ Dünya, AB'nin Türkiye'ye bakış açısını değiştirme zamanı geldi, <https://www.dunya.com/gundem/abnin-turkiyeye-bakis-acisini-degistirme-zamani-geldi-haberi-633763>. Accessed on 12 November 2021.

³² Hürriyet, Gümrük birliği için çok çaba sarf ettik, <https://www.hurriyet.com.tr/ekonomi/gumruk-birligi-icin-cok-caba-sarf-ettilik-41887380>. Accessed on 12 November 2021.

Possible Scenarios regarding the modernisation of the Customs Union

A- The European Commission's Impact Assessment

The European Commission revealed an impact assessment on the modernisation of the Customs Union on 21 December 2016. In the report, 3 scenarios were suggested against the problems and shortcomings of the Customs Union. The option the Commission supported was a CU+FTA formula which means modernising the Customs Union by tackling its structural shortcomings and extending trade preferences to include services, agriculture, and public procurement via a new FTA. The other two options were sustaining the current Customs Union with no substantial change or creating a new deep and comprehensive FTA instead of the current Customs Union.³³

The bilateral liberalisation envisaged under the CU+FTA formula provides huge export gains for both sides. In this context, while an increase of 27.1 billion euros is expected for the EU, this increase is estimated at 5 billion euros for Turkey. As for the increase in real GDP and economic welfare, the increase in real GDP is estimated at 0.01%, which generates 5.4 billion euros in economic welfare for the EU, while the increase in real GDP is estimated at 1.44%, which generates 12.5 billion euros in economic welfare for Turkey.³⁴

Bilateral trade gains in the DCFTA policy option are lower than the CU+FTA option. Turkey faces a decline of about 4.3 billion euros in its exports to the EU as switching from a Customs Union to an FTA necessitates the introduction of rules of origin, leading to an increase in trading costs. Regarding the real GDP and welfare, while the real GDP of the EU is expected to decline by about 0.01%, its welfare is expected to increase by 1.2 billion euros. For Turkey, real GDP is expected to increase by about 0.26%, but Turkish welfare is also expected to decrease by 144 million euros.³⁵

B- Analysis Requested by the INTA Committee

Upon the request of the European Parliament Committee on International Trade, the in-depth analysis carried out by Erdal Yalçın and Gabriel Felbermayr indicated by mainly using the GED Study revealed in 2016 that there were possible options discussed in European Commission and the European Parliament concerning the Customs Union:

- 1- Continuation of the current Customs Union framework,
- 2- Modernisation and upgrading of the Customs Union,
- 3- A transformation of the bilateral trade relations into a deep and comprehensive free trade agreement (DCFTA, similar to the EU-Canada trade agreement),
- 4- Suspension of the Customs Union (in which case WTO rules would apply).³⁶

³³ Yonca Özer, Modernizing The EU-Turkey Customs Union As An Interest-Driven Initiative, 2020.

³⁴ European Commission, Impact Assessment, https://trade.ec.europa.eu/doclib/docs/2017/january/tradoc_155238.pdf. Accessed on 05 March 2022.

³⁵ Ibid.

³⁶ Erdal Yalçın And Gabriel Felbermayr, The EU-Turkey Customs Union and trade relations: what options for the future, [https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/653640/EXPO_IDA\(2021\)653640_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/653640/EXPO_IDA(2021)653640_EN.pdf) Accessed on 12 November 2021

1- Continuation of the Current Customs Union Framework

Keeping the status quo means that the Customs Union still will include only industrial and processed agricultural goods. It is expected that the continuation of the current framework would sustain to create disadvantages for Turkey because of the asymmetric participation of Turkey in the EU's FTAs negotiations. It is presumed that new free trade agreements with third countries the EU conclude would increase, and the EU would eliminate tariffs and non-tariff barriers with countries having new FTAs.³⁷ However, Turkey cannot sign equivalent FTAs due to the asymmetry problem earlier described above.

According to the report, while the EU's welfare increases insufficiently, a marginal decrease in Turkish GDP is expected in this scenario. Expecting to experience a sharp decline in sectoral exports, in the long run, imports and exports between Turkey and the EU are predicted to decrease by around 2.3% due to trade agreements. If the EU concludes FTAs with countries having a strong and competitive industry, such as Japan or the USA, the negative effects would be more extensive.³⁸

2- Modernisation and Upgrading of the Customs Union

According to the report, including trade in the agricultural and service sectors, a modernised and upgraded Customs Union would benefit Turkey and the EU, and bilateral trade between both parties would significantly increase. Turkish GDP is predicted to rise by 1.84 % in this scenario. Suppose Turkey complies with the rules of the Customs Union, adapts its NTBs to EU regulations, and continues to follow EU FTA policy with third parties; in that case, significant growth effects are forecasted for both parties.³⁹

Mainly in three primary sectors agriculture, manufacturing, and services, Turkish exports to the EU are foreseen to increase by nearly 70%. While exports to the EU for the agricultural sector is expected to grow by 95%, a growth of 430% is envisaged in the service sector. However, a decline in exports is forecast for the manufacturing sector. Furthermore, updating the Customs Union is expected to redistribute resources from the manufacturing industry to the services sector.⁴⁰

Liberalising agricultural trade would increase economic gains, improve welfare and real income for both parties. It is estimated that Turkey would be advantageous in sectors such as fresh fruit, vegetables, and oilseeds, while the EU would benefit from liberalisation in sectors such as meat, grain, dairy products, and sugar.⁴¹ However, the level of external trade protection of Turkey and the EU is different, and Turkey's domestic support policies do not quite correspond to the Common Agricultural Policy (CAP). Turkey has a highly protected agricultural market, which is one of the highest tariffs to protect agricultural imports among OECD countries. Therefore, opening the agricultural market to the EU would be challenging for Turkey since it would require full compliance with the EU's *acquis* on agriculture.⁴² In this sense, Turkey would need to comply with the EU's food security and sanitary and phytosanitary standards in the agriculture sector.⁴³ For these

³⁷ Ibid.

³⁸ Ibid.

³⁹ Ibid.

⁴⁰ Ibid.

⁴¹ Çiğdem Nas, Perspektif, <https://www.perspektif.online/gumruk-birligi-neden-guncellenmeli/>, 2020.

⁴² Yonca Özer, Modernizing The EU-Turkey Customs Union As An Interest-Driven Initiative, 2020.

⁴³ Çiğdem Nas, Perspektif, <https://www.perspektif.online/gumruk-birligi-neden-guncellenmeli/>, 2020.

reasons, the Turkish agricultural sector needs a significant transformation even before starting the modernising process.

Since the service sector is one of the key areas for economic development, including services in the Customs Union similarly would create real economic gains for the EU and Turkey. Selected sectors are expected to be included in the mutual liberalisation in services. While Turkey is more competitive in sectors such as tourism, transportation, and construction, the EU is expected to have more benefits in the categories of professional services and consultancy services.⁴⁴ The challenge for Turkey in this area would be to adopt and implement the regulatory framework of the EU for each of the service sectors it intends to liberalise.⁴⁵

Moreover, if Turkey either has a modernised Customs Union or aligns its trade policy with the EU's new FTA partners, both parties' welfare gains would be the largest in this scenario. While additional GDP growth of around 0.7% is estimated for the EU, more than 2% additional growth in its GDP is predicted for Turkey. If Turkey successfully signs equivalent FTAs with the EU's new trading partners, the GDP growth is predicted, even more, reaching 2.5 %.⁴⁶

3- A Transformation of The Bilateral Trade Relations into Deep and Comprehensive Free Trade Agreement

An EU-Turkey free trade agreement as an alternative option to adjust the trade relationship between the EU and Turkey has recently gained importance from the EU side owing to the challenging political developments between Turkey and the EU. According to the report, considering an alternative trade policy may enable Turkey and the EU to stabilise bilateral trade relations.⁴⁷

In this scenario, the asymmetrical challenges Turkey experienced from the EU's FTAs would no longer exist since Turkey would have full sovereignty to apply its tariffs toward third countries. However, complex Rules of Origins arrangements would need to be integrated, and it would be likely to reduce trade between Turkey and the EU.⁴⁸

Regaining control over its external tariff policy, Turkey is likely to increase its trade with the world. However, trade with the EU is expected to decrease more significantly and Turkey would experience a decrease in GDP by 0.8 % while no major changes in the EU's GDP are foreseen.⁴⁹

⁴⁴ Ibid.

⁴⁵ Kamala Dawar; Christopher Hartwell; Subidey Togan, Reforming and Renegotiating the EU-Turkey Customs Union, 2018.

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[https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/653640/EXPO_IDA\(2021\)653640_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/653640/EXPO_IDA(2021)653640_EN.pdf)
. Accessed on 14 November 2021

⁴⁷ Ibid.

⁴⁸ Enc Perspectives, A Modernized EU-Turkey Customs Union, <https://www.tepav.org.tr/upload/files/1491836076-0.A Modernized EU Turkey Customs Union.pdf>. Accessed on 14 November 2021

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[https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/653640/EXPO_IDA\(2021\)653640_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/653640/EXPO_IDA(2021)653640_EN.pdf)
. Accessed on 14 November 2021.

4- Suspension of the Customs Union

Calling for a suspension of the Customs Union, some policymakers in the EU asserted that the EU should react strictly to Turkey against the worsening political developments. However, this scenario has the most extensive adverse effects on trade between Turkey and the EU. According to the empirical estimations revealed by Baier and Larch in 2019, Turkey and the EU are likely to experience similar negative trade effects. In this scenario, while the EU's export to Turkey would be expected to decline by 33%, Turkey would have a decline of 43% in exports.⁵⁰

C- An Alternative Proposal for the Future of the Relations

Arguing that the Ankara Agreement was outdated and was not designed for the twenty-first century, it was stated that revising this document could provide a rules-based relationship in Turkey-EU relations and address democratic regression in Turkey by bringing democratic conditionality to the fore and adding some new instruments such as Turkey's participation in selected EU programs and the use of EU funds, high-level political dialog, people-to-people contacts or visa liberalisation.⁵¹ However, putting the Ankara Agreement up for discussion is an issue that Turkey will not accept, because this document has been the basis of Turkey-EU relations and Turkey's EU membership perspective since 1963, and the issue of revising the Ankara Agreement may involve the risk of proposing a revised agreement that will reflect a consensus on the lowest common denominator and thereby fall short of the scope and breadth of the Ankara Agreement.

Conclusion

Although the existing Customs Union has significantly increased the value of bilateral trade in goods, has positive growth effects on welfare and has improved the quality of production and international competitiveness, 25 years have passed since its creation, and the situation has completely changed. Since then, the global trade and world economy have evolved, become more interlinked and have made the Customs Union outdated.

The Customs Union's problems are mainly derived from its asymmetric nature which does not include Turkey in any policy-making procedures or negotiation process of FTA with third countries, its narrow scope which only covers industrial and processed agricultural products, and issues such as visa obligation, limited transportation quotas, and insufficient dispute settlement mechanism.

Both parties, aware that an update is undoubtedly needed, were initially willing to find a solution to address the Customs Union's problematic features. Including those of Turkey and the EU, various impact assessments and studies revealed that modernising the Customs Union was the most fruitful alternative for Turkey and the EU, among other options.

However, relations between Turkey and the EU suffer from several crises and conflicts, and it has changed the tone of the discussion process. Modernising Customs Union, which

⁵⁰ Baier, Scott, Zylkin and Yoto Yotov, On the widely differing effects of free trade agreements: Lessons from twenty years of integration, *Journal of International Economics*, 2019.

⁵¹ İlke Toygür, A New Way Forward for EU-Turkey Relations, <https://carnegieeurope.eu/2022/01/26/new-way-forward-for-eu-turkey-relations-pub-86264>. Accessed on 5 March 2022.

is an economic matter, has turned into a political issue and has been conditioned upon political developments. Even though European Council's positive agenda call on 1 October 2020 helped to deescalate disrupted relations between Turkey and the EU, the EU did not take a realistic step to realise it. Consequently, the Commission's call to the Council for a mandate to begin negotiations is still waiting to be responded positively since 2016.

While the recovery efforts continue in the EU after the pandemic, essential lessons have been taken from this process. Today, global logistic problems or issues in the supply of some critical products during the pandemic made reorganising supply chains necessary. In this context, desiring to have a climate-neutral, sustainable, resource-efficient and resilient economy by 2050, the EU on 18 February unveiled to the public its renewed trade strategy aimed at recovering more resiliently in the post-pandemic era and implementing a green and digital transformation, defined as twin transformation. Within the framework of this strategy, the EU, which envisages increasing investments in clean energy and promoting circular, responsible and sustainable supply chains, declared that it would make a will to adopt higher standards in areas such as the environment, human rights and the labour market. In addition, the EU emphasised that in its new trade strategy, production and investment can be shifted to countries geographically closer to it to make supply chains more resilient.⁵² Thanks to the Customs Union, Turkey could undertake a vital role in the supply chains, which the EU is reshaping. Turkey has the power and the advantage of making production in the direction of the EU market's needs and supplying these productions rapidly to the EU market. In addition, the EU's aim to diversify its supply chains by moving from China to closer geographies within the scope of its new trade strategy provides an advantage for Turkey. Taking into account and adopting the points emphasised by the EU in its new trade strategy, especially on green and digital transformation, may strengthen Turkey's negotiating position in updating the Customs Union. Starting the modernising process of the customs union will allow further development of the Turkish economy and commercial relations with the EU. In this way, it will be possible to develop the trade in goods and services, which have become more complex, overcome the obstacles encountered in service sectors such as logistics, and increase agricultural trade. It is possible to foresee that these advantages will maximise both parties' gain with accomplishing to modernise the Customs Union.

⁵² Merve Özcan Altan, 10 Soruda AB'nin Yeni Ticaret Stratejisi ve Türkiye'ye Etkileri, [https://www.iky.org.tr/images/files/10_soruda_ABnin_yeni_ticaret_stratejisi_ve_turkiyeye_etikileri_Merve_Ozcan_Altan\(1\).pdf](https://www.iky.org.tr/images/files/10_soruda_ABnin_yeni_ticaret_stratejisi_ve_turkiyeye_etikileri_Merve_Ozcan_Altan(1).pdf). Accessed on 7 March 2022.