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Prepared by: Selen Akses (sakses@ikv.org.tr)

Outlook to Turkey's trade relations and the Turkey-EU Customs Union

Over the last years, the diversity of market destination has increased in Turkey's external trade policy. Within this framework, the share of trade relations with the European Union has slightly decreased while the share of non-EU trade relations is still gradually rising. In 2007, 40,8 percent of Turkey's imports came from the European Union whereas in 2010 this share decreased to 39,3 %. In the same timeframe, the share of Turkey's exports directed to the European Union decreased from 56,8% to 46,3 %. On the other hand, trade activities with Middle East and North African countries increased during these last years; this has been reinforced with some of the countries in this region through visa liberalization regimes. However the increase of trade relations with Middle Eastern and North African countries has been often interpreted as a shift in the axis of Turkey. Nevertheless in the aftermath of the global financial crisis, it became crucial for Turkey to seek new market opportunities other than the European Union in order to become more resilient to the economic crisis and avoid a huge decrease of its exports caused by the reduction of the demand-side on the part of the European Union. Therefore Turkey's new trade structure is only the result of its adaptation to the globalization and to the new economic environment. Besides, the European Union remains Turkey's main trading partner. The establishment of the Customs Union between Turkey and the European Union in 1996 has significantly increased the volume of trade between Turkey and EU Member States. Even though its share of trade relations has decreased, the European Union remains Turkey's first trade partner. Furthermore, Turkey constitutes also an important trade partner for the European Union since Turkey ranks as seventh in its import and fifth as its export partner.

The establishment of the Customs Union between Turkey and the European Union not only enabled trade relations between Turkey and the European Union to increase but also it has constituted an important stimulus for Turkey to harmonize its legislation to the *acquis communautaire* in various areas of internal market (technical legislation, intellectual and industry property rights, competition laws). Most of all, the establishment of the Customs Union has enabled Turkish industries to open up to new markets and to keep up with the fierce competition. Since the Common Market opened to Turkish market, Turkish companies find themselves in competition with European companies which force them to keep up with the competition by increasing their productivity. This overall increased also the competitiveness of the Turkish economy.

Despite all these benefits withdrawn from the establishment of the Customs Union, there is a rising concern on the current way of functioning of the Customs Union especially within the context of the Free Trade Agreements signed by the European Union with third countries.

Since the trade liberalization within the framework of the World Trade Organization is coming to a halt due to the slowing down of multilateral trade negotiations and to some extent to the failure of the Doha Round, the European Union has shifted its focus to strengthening its network of bilateral trade agreements. The European Commission presented its new trade policy strategy on the 9th November 2010 as the core component of the Europe 2020 Strategy aiming to generate smart, sustainable and inclusive growth. The strategy focuses on the negotiations and conclusions of a new wave of free trade agreements¹ with third countries especially in Asia and Latin America. But at the stage of negotiation, the European Union does not take into account Turkey's interest although this agreement could have an important impact on Turkey's trade relations since the European Union is negotiating on behalf of the Customs Union (and not only on behalf of the Union) which is made up currently of 27 Member States of the European Union plus Turkey. Turkey is absent in the decision making and negotiations processes of the Free Trade Agreements conducted by the European Union with third countries. Turkey suffers economic and interest losses because it has not yet become a member of the European Union and is being put aside of the decision making bodies. As a result, when the European Union signs a trade agreement with a third country and once the goods of this country in question enters into the European market, they can enter into the Turkish market without paying any customs duties to Turkey since they benefit from the Customs Union between Turkey and the European Union. But on the other hand, when Turkey exports to this third country in question, Turkey still has to face high tariffs and non tariff barriers. This creates a situation of trade diversion against Turkey.

In addition to this loss in trade, according to article 16 of the Decision 1/95 of the Association Council Turkey has to align its trade policy with the European Union's Preferential Trade Regime, including the Free Trade Agreements. Therefore, as soon as a trade agreement is signed by the European Union, Turkey also has to sign an agreement with the third country in question. But in general, this third country shows some reluctance in signing another trade agreement with Turkey since it already benefits from free access to Turkish market without having to make any additional concession to Turkey. Within the framework of its new trade strategy, the European Union aims to increase free trade agreements with Asian and Latin America countries but this makes it more difficult for Turkey to build stronger economic and trade relations with the emerging countries in the international arena. Moreover, this situation forces Turkey to reinforce its export competitiveness in order not to lose market opportunities.

So far, in order to overcome this situation, the European authorities have introduced the "Turkish Clause" in the Free Trade Agreements signed with third countries. The "Turkish Clause" was for instance included in the free Trade Agreement signed with South Korea, inviting the latter to negotiate a free trade agreement with Turkey. But this clause was far from being legally binding. The Free Trade Agreement between the European Union and South Korea has entered into force on the 1st July 2011 whereas Turkey is still undergoing negotiations for the Free Trade Agreement with South Korea. With the entry into force of the trade agreement before Turkey has managed to conclude its negotiation process with South Korea, Turkish industries are worried that Turkish companies especially in the automotive sector will loss competitiveness against its Korean counterparts.

The Economic Development Foundation has stated in various platforms that the ideal alternative to overcome this situation would be that the European Union and Turkey conduct

¹European Commission. Trade Growth and World Affairs. Trade Policy as a Core Component of the EU's 2020 Strategy. COM (2010) 612. http://trade.ec.europa.eu/doclib/docs/2010/november/tradoc_146955.pdf

and conclude similar trade agreements with third countries and that both agreements enter into force at the same. However considering that the European authorities have only contented themselves by introducing a non-binding clause, Turkey may need to find alternative solution to overcome the unwillingness from the European Union to protect Turkish interests within the Customs Union. This alternative solution could be sought within the framework of article 24/5 of the General Agreement on Tariffs and Trade.² There is a need to carry a comprehensive analysis to better assess the trade diversion faced by Turkey from the Free Trade Agreements signed by the European Union with third countries. The customs union, which is in general beneficial for both parties, could be reinforced by the adoption of more effective joint consultation and decision-making mechanisms. Such mechanisms are necessary in view of the quite extensive economic integration envisaged by the customs union, which stipulates Turkey's adoption of the common commercial code of the European Union and its external commercial policy instruments.

² “Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided that:*

- (a) with respect to a customs union, or an interim agreement leading to a formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;
- (b) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement as the case may be; and
- (c) any interim agreement referred to in subparagraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.”