

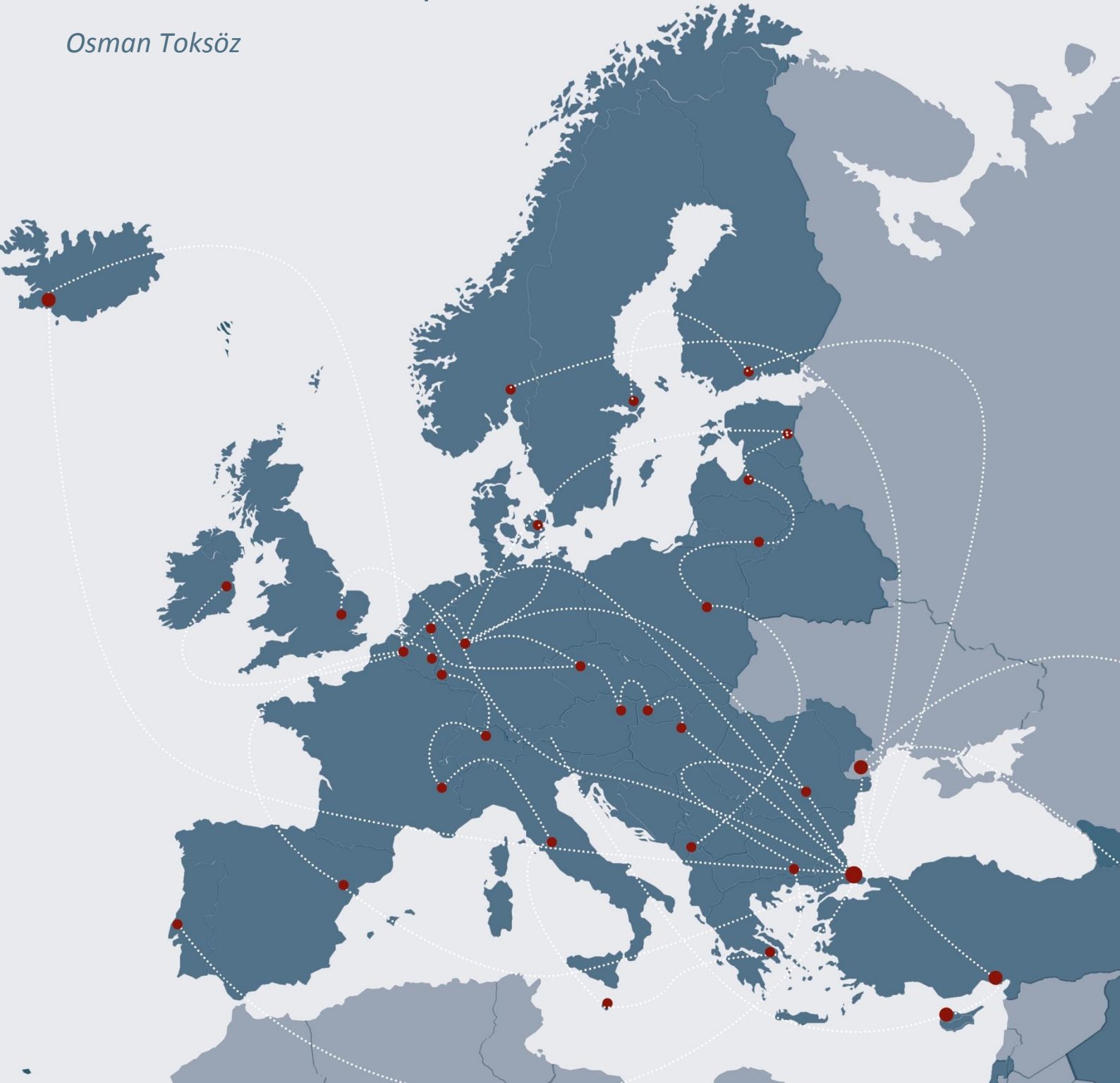
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# VIADUCT Student Paper



## The Modernisation of the EU-Turkey Customs Union: Between Indispensable and Deadlocked.

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## Introduction

Trade agreements have been essential for the European Union (EU)-Turkey relations since the latter's application for associate membership of the European Economic Community (EEC) in 1959. With the signature of the Association Agreement in 1963, the framework for bilateral preferential market access for goods was determined and further development of the Customs Union (CU) was foreseen for Turkey's full membership to ECC. The Additional Protocol, signed in 1970, resulted in the abolishment of tariffs and quotas on industrial goods for a defined timetable and the final phase of the CU was established on 1 January 1996 by Decision No 1/95 of the EC-Turkey Association Council<sup>1</sup>, which remains in force.<sup>2</sup>

The CU has benefited both sides since it has taken effect. 23 years after its entry into force, Turkey has become the EU's 5th largest trading partner: it ranks 5<sup>th</sup> in exports and 6<sup>th</sup> in imports. Moreover, "the EU is by far Turkey's number one import and export partner, as well as the source of foreign direct investment."<sup>3</sup> However, since the application of the CU, multiple issues emerged due to the content and implementation of it and the need arose to modernise the CU with an up-to-date approach. Which factors have been influential for the need of modernisation of the CU? This essay will use Putnam's 'two-level game framework'<sup>4</sup> to analyse the progress of the EU-Turkey CU and the extent to which it needs to be

upgraded. A brief investigation of the CU will be provided drawing on the recent developments, such as the migration crisis and the trade negotiations between the EU and third countries, that create huge reverberation effects and high costs of no-agreement. Addressing the possible overlaps of win-sets, the essay will argue that the modernisation of the CU is crucial for both sides.

Through the definition of the win-set as "all the possible negotiating outcomes that are acceptable to the domestic constituencies", it is crucial to underscore that the EU's win-set is determined by the EU institutions and member states together.<sup>5</sup> Despite the idea that the EU decision making is a "linked process",<sup>6</sup> an adapted version of Putnam's model is needed to draw a three-level game reflecting EU level and EU member state level separately.

## Huge Reverberation Effect

In some instances of the trade negotiations, international developments "reverberate" within domestic politics of the two sides, influencing the outcome of the negotiations.<sup>7</sup> The talks between the EU and Turkey to address the migration crisis following the civil war in Syria created an impact of reverberation over the discussions for a CU modernisation. The respective leaders "took note of the launching of preparatory steps for

<sup>1</sup> EU-Turkey Association Council, "Decision 1/95 of 22 December 1995 on Implementing the Final Phase of the Customs Union (96/142/EC)", *Official Journal of the European Union*, L35/1, 13 February 1996.

<sup>2</sup> K. Binder, *Reinvigorating EU-Turkey bilateral trade: Upgrading the customs union*, Briefing, European Parliamentary Research Service (EPRS), PE 599.319, Brussels, March 2017, p. 2.

<sup>3</sup> European Commission DG Trade, "European Union, Trade in goods with Turkey", Brussels, 3 June 2019, pp. 8-9.

<sup>4</sup> R. Putnam, "Diplomacy and Domestic Politics: The Logic of Two-level Games", *International Organization*, vol. 42, no. 3, 1988, pp. 427-460.

<sup>5</sup> M. Larsén Frennhoff, "Principal-Agent Analysis with One Agent and Two Principals: European Union Trade Negotiations with South Africa", *Politics & Policy*, vol. 35, no. 3, 2007, p. 859.

<sup>6</sup> A. Young and J. Peterson, *Parochial Global Europe: 21st Century Trade Politics*, New York, Oxford University Press, 2014, p. 39.

<sup>7</sup> Putnam, *op.cit.*, p. 454.

upgrading the Customs Union”<sup>8</sup> in 2015 and “welcomed the ongoing work on the upgrading of the Customs Union”<sup>9</sup> in 2016. The migration deal served as an opportunity for Turkey to cement its call for an immediate CU renewal as well as for the launch of visa liberalisation process and reinforcement of the accession talks. By doing so, Turkey tried to maximize the EU’s win-set through non-trade issues and raise its cost of no-agreement.

Turkey faces constraints to conclude FTAs with the countries that do not have FTA with the EU. For instance, to conclude a FTA with concessions beyond the EU’s Generalized System of Preferences (GSP) with then North Macedonia in 1999, “Turkey had to ask for permission from the EU”.<sup>10</sup> It is challenging for Turkey to conclude similar agreements with other third countries, including the US, without the EU concluding a FTA first. Considering that Turkey’s concerns on the CU upgrade increased after the Transatlantic Trade and Investment Partnership (TTIP) talks between the EU and the US, we can say that the TTIP negotiations created another reverberation effect on the need of modernisation of the CU, thus widening the win-set of Turkey.

### A costly game for both sides

Putnam states that: “the lower the cost of no-agreement to constituents, the smaller the win-

set.”<sup>11</sup> From Turkey’s perspective, one of the main problems stemming from the application of the CU is the “unfair competition due to the reluctance of some of EU’s FTA partner countries to conclude similar agreements with Turkey while using the advantage of entering into Turkish market through the EU”<sup>12</sup>. The lack of legal means to convince the EU’s FTA partners to conclude same FTAs with Turkey constitutes difficulties in accessing the markets of some EU FTA partner countries. This expands Turkey’s win-set due to high cost of no-agreement. For cases such as EU-Mexico Trade Agreement where a comparable arrangement is not secured, “Turkey loses from increased competition for its exports and may lose trade tax revenues.”<sup>13</sup> At the same time, the Turkish government has been expressing its discontent over its limited influence on the EU’s trade policy in particular with regard to the FTAs that the EU concludes with third countries. Turkey’s main concern is that the Turkish economic interests are ignored when the EU negotiates FTAs with third countries. Indeed, the European Commission is concerned with promoting advantages for the member states.<sup>14</sup>

Compared to the recently concluded FTAs of the EU, the scope of the EU-Turkey Bilateral Preferential Trade Framework is limited<sup>15</sup> in terms of access for EU agricultural products to the

<sup>8</sup> EU-Turkey Statement, Brussels, 29 November 2015, par. 10.

<sup>9</sup> EU-Turkey Statement, Brussels, 18 March 2016, par. 7.

<sup>10</sup> O. Karakaş, “Türkiye ile ABD Arasında Olası Bir Serbest Ticaret Anlaşmasının, Dünya Ticaret Örgütü ve Avrupa Birliği Çerçevesindeki Yükümlülüklerimiz Açısından İncelenmesi”, Ministry of Foreign Affairs of Republic of Turkey, retrieved 16 October 2019, [http://www.mfa.gov.tr/turkiye-ile-abd-arasında-olası-bir-serbest-ticaret-anlaşmasının\\_-dunya-ticaret-orgutu-ve-avrupa-birliği-çerçevesindeki-yükümlülüklerimiz-acısından-incelemesi.tr.mfa](http://www.mfa.gov.tr/turkiye-ile-abd-arasinda-olası-bir-serbest-ticaret-anlaşmasının_-dunya-ticaret-orgutu-ve-avrupa-birliği-çerçevesindeki-yükümlülüklerimiz-acısından-incelemesi.tr.mfa).

<sup>11</sup> Putnam, *op.cit.*, p. 442.

<sup>12</sup> Republic of Turkey, Ministry of Foreign Affairs, Directorate for EU Affairs, “Customs Union”, retrieved 19 October 2019, [https://www.ab.gov.tr/customs-union\\_46234\\_en.html](https://www.ab.gov.tr/customs-union_46234_en.html).

<sup>13</sup> World Bank, *Evaluation of the EU-Turkey Customs Union*, Report no. 85830, 28 March 2014, p. 3.

<sup>14</sup> F. Hakura, Briefing “EU–Turkey Customs Union Prospects for Modernization and Lessons for Brexit”, *Chatham House*, December 2018, p. 13.

<sup>15</sup> European Commission DG Trade, “Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of Its Possible Enhancement”, Brussels, October 2016.

Turkish market.<sup>16</sup> The parties reaffirmed their common objective to move towards the free movement of agricultural products in the decision 1/95.<sup>17</sup> Yet, the trade of agricultural products is a sensitive subject for Turkey as the export of agricultural products counted for 11 % of its total exports in 2018.<sup>18</sup> Turkey's agricultural import tariffs averaged 42.7 % in 2015 compared to an average of 10.7 percent for the EU.<sup>19</sup> Moreover, Turkey exported agricultural goods worth €5.11 billion to the EU in 2018 whereas imported €4.03 billion worth agricultural goods.<sup>20</sup> Assuming the EU's common external tariff in agriculture could "significantly harm Turkey's import protection."<sup>21</sup> Efforts for a more liberalized agricultural agreement narrows Turkey's win-set as such a change could be hardly absorbed by its agricultural sector without considerable reforms. The same applies for fishery products; constricting Turkey's win-set vis-à-vis the EU.

Inclusion of the agricultural policy complicates the ratification of the upgraded CU for the EU as a unanimous decision by the Council of the EU and the consent of the European Parliament may be required. In this case, the preferences of the European Parliament should be monitored during the negotiations.<sup>22</sup> Potential veto players include agriculturally oriented EU member states such as France and Poland as well as Cyprus "who could

want to use the modernisation as a political leverage vis-à-vis Turkey."<sup>23</sup> Through Thomas Schelling's 'paradox of weakness'<sup>24</sup>, this could make the EU's win-set narrow yet bargaining power greater as the EU could state that an agreed proposal could fail ratification process due to internal division.

Last but not least, the current Dispute Settlement Mechanism (DSM) in the CU is not effective because it is "limited to disagreements on the duration of safeguard measures. Shifting to a DSM where one party can bring a case on a broader range of issues would be more effective in resolving trade irritants."<sup>25</sup>

## Recent Developments and Future Implications

The establishment of a joint Senior Officials Working Group in 2014 to study the options for the modernisation of the trade relationship between the EU and Turkey has been a milestone for the modernisation process of the CU. The European Commission's request from the World Bank to conduct a study on the evaluation and current situation of the CU in 2014 shows the EU's awareness of the need for an upgrade to the agreement.<sup>26</sup> Indeed, the European Commission adopted a recommendation for opening of negotiations with Turkey on the modernisation of

<sup>16</sup> The CU covers only partial liberalisation for processed agricultural products: EU-Turkey Association Council, *op.cit.*, Art.19.

<sup>17</sup> *Ibid.*, art. 25.

<sup>18</sup> Ministry of Trade of the Republic of Turkey, "Foreign trade and Main Economic Indicators Bulletin (2018-annually)" from *Turkish Statistical Institute (TÜİK)*, retrieved 19 October 2019, <https://ticaret.gov.tr/istatistikler/dis-ticaret-istatistikleri>.

<sup>19</sup> K. Dawar, C. Hartwell, and S. Togan, "Reforming and Renegotiating The EU- Turkey Customs Union", *Turkish Policy Quarterly*, vol. 17, no.1, 2018, p. 132.

<sup>20</sup> Ministry of Trade of the Republic of Turkey, "Dış Ticaret ve Başlıca Ekonomik Göstergeler Bülteni (2018

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<sup>21</sup> World Bank, *op.cit.*, p.ii.

<sup>22</sup> S. Gstöhl, & D. De Bièvre, *The Trade Policy of the European Union*, London, Palgrave, 2018, p. 63.

<sup>23</sup> U. Alkan, *The Modernization of Turkey's Customs Union with the European Union: Reasons and Possible Outcomes*, EU Diplomacy Paper, Department of IRD, College of Europe, 2017, p. 20.

<sup>24</sup> T. Schelling, *The Strategy of Conflict*, Cambridge, MA: Harvard University Press, 1960.

<sup>25</sup> World Bank, *op.cit.*, p. 86.

<sup>26</sup> Study of World Bank: World Bank, *op.cit.*

the Customs Union on 21 December 2016. Huge overlap of win-sets of both sides has become clearer with this decision. However, in June 2018, “the General Affairs Council concluded that, under the prevailing circumstances, no further work towards the modernisation of the EU-Turkey Customs Union could be foreseen.”<sup>27</sup> The changing atmosphere in the relationship between the EU and Turkey proved the need for a “new strategy that is more gradual and open-ended to bypass the existing logjam. Progress can be made by focusing negotiations on a narrow set of core areas and separately setting longer-term ambitions and goals.”<sup>28</sup>

## Conclusion

This essay tried to explain the main factors that lead to the idea of modernisation of the CU between the EU and Turkey. By applying the two and three-level game approaches, it is shown that both sides’ overall win-sets are large yet bargaining power relatively weak due to various obstacles related to the structure and implementation of the CU. The slow progress in the modernisation process reflects the small overlap of the win-sets due to asymmetries on the trade of agricultural products and decision-making processes which raise the costs of no-agreement for both sides. Considering the strained relations in the recent past, bringing accession talks and CU modernisation works to a standstill,<sup>29</sup> “if EU membership will no longer be the agreed medium-term goal, building a ‘customs union 2.0’ comes more important for both sides.”<sup>30</sup>

<sup>27</sup> European Commission, “Turkey 2019 Report”, Brussels, 29 May 2019, p., 105.

<sup>28</sup> Hakura, *op.cit.*, p. 15.

<sup>29</sup> Council of the European Union, “Council conclusions on enlargement and stabilisation and association process”, Brussels, 18 June 2019.

<sup>30</sup> S. Gstöhl, “Mapping the European Union’s neighbourhood relations” in S. Gstöhl (eds.) *The European Neighbourhood Policy in a Comparative Perspective: models, challenges, lessons*, New York, Routledge, 2016, p. 22.

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