

# TURKEY-EU RELATIONS AND THE CUSTOMS UNION: EXPECTATIONS VERSUS THE REALITY

*This article focuses on three interrelated issues of Turkey-EU relations. Initially, an overview of Turkey-EU relations and some reasons that have led to Turkish frustration and disappointment towards the EU are presented. The next section focuses on the Customs Union between Turkey and the EU, the changes it brought to Turkish legislation and regulatory institutions and their impact on Turkey's economy. It is argued that, despite some important benefits to the Turkish economy, the CU has not met –thus far– the original expectations. This argument is followed by highlighting the EU's “unfulfilled obligations” towards Turkey concerning the Customs Union. The Minister points out that the current visa requirements violate the agreements signed between Turkey and the EU, and constitute discrimination against Turkish citizens. Finally, the initiatives of the Ministry of Customs and Trade to increase the trade volume with other neighboring regions are noted.*

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**T**he Ankara Treaty, which was signed in Ankara on 12 September 1963 and entered into force on 1 December 1964, clearly envisioned Turkey's full EU membership. Turkey received candidate status in 1999 and accession negotiations started on 3 October 2005.

However, some important EU member states, such as France and Germany, put forward a new narrative of a “privileged partnership” with Turkey with the intention to prevent the latter's full membership. Although Greece applied for EU membership at the same time with Turkey, it became a full member in 1981; Eastern and Central European countries, which previously had communist regimes and were able to built market-oriented economies only after the mid-1990s became full members in 2004. On the other hand, Turkey is still conducting accession negotiations which have been restrained by the Cyprus issue. Opponents of Turkey's accession claim that the EU will be unable to absorb Turkey's large economy and population and they use this argument in order to negatively affect public opinion in their countries.



One of the most important conditions for EU membership is the principle of good neighborly relations. Despite Turkey's warnings, the Greek Cypriot administration of South Cyprus joined the EU in 2004 (without the resolution of the Cyprus problem first) under the name “Republic of Cyprus”. It seems that geopolitical considerations and Greece's pressures have played a key role for the EU's decision to accept South Cyprus. This decision, however, made apparent the EU's double standards towards Turkey concerning the principle of friendly neighborly relations.

Another disillusionment has arisen from the EU's insufficient support on Turkey's battle against terrorism. Incidents that occurred in the process of capturing the leader of a major terrorist organization (PKK) and the continuing financial support that this organization has been receiving by some EU member states has led to a significantly decreased Turkish trust.

## ***Turkey's Legislative and Structural Reforms Related to the Customs Union***

The Customs Union (CU) between Turkey and the European Union, which came into effect on 1 January 1996, has brought changes to the jurisdiction of the Ministry of Customs and Trade.

The CU was something more than just a typical customs union since it has imposed the obligation to align national legislation (concerning trade, competition, intellectual and industrial property rights, patent and customs) with that of the EU.

With the enforcement of the CU in 1996, the Customs Administration has considerably improved its structure, quality of service, implementation of legislation and dissemination of customer-focused service approach. In this context, the following points deserve special attention:

The Association Council Decision 1/95 has enjoined the approximation of regulations, directives and their implementation besides the legislation on the customs duties. With the entry into force of the Law 4458, Turkey fulfilled its obligations on this issue and aligned its legislation (regarding issues such as the origin of goods, customs value, entering to and leaving the customs territory and Customs operations) with the Community Customs Code. Turkey's Customs Legislation was harmonized with that of the EU, thus it became mandatory to maintain the same harmonized tariff schedule and, apart from some exceptions, same tariff rates in trade.

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With the Association Council Decision 1/95, Turkey has been undergoing an important process in order to harmonize its foreign trade policies with the EU. Within this framework, Turkey has signed and will continue signing agreements in compliance with the existing free trade agreements between the EU and third countries. These agreements will undoubtedly create trade opportunities. Projects are carried out to bring the Turkish administrative capacity to the EU's level of customs administration. This process also involved the development of the capacity of the relevant human resources to implement the new legislation.

The CU's personnel responsible for provincial outlets have been trained in accordance with the EU norms while considerable progress has been also achieved in the quality of service provision.

With the aim to combat smuggling and to protect the EU's eastern frontier, investment for physical infrastructure has been rapidly enhanced in cooperation with the European Commission. As a result, a new institution has been created which has been supported by enhanced infrastructural capacity and the use of new equipment.

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The implementation of e-customs, which aims to create a unitary understanding of the EU Customs, has been almost completed with the help of the EU.

Turkey's Customs Administration computer infrastructure that is responsible for facilitating the on-line processing will soon be connected to that of the European Commission and of the member states.

All the preparations concerning the harmonization with the Convention on Common Transit have been completed and the formal process for signing the Convention has almost come to an end. It is expected that problems which occur in the transit zones will be solved and that the Turkish carriers will be transporting goods in Europe and in the European Free Trade Association (EFTA) countries through the same electronic processes.

Turkey has made significant reforms in its customs laboratories (which are highly significant in all the EU countries in order to appropriately classify the goods and combat smuggling), and has adopted the EU practices by modernizing its infrastructure, improving personnel's training and through information sharing.

The Modernized Customs Code (which has not yet been implemented by the European Commission) that enables all customs procedures to be realized electronically has been prepared in order to be included in the Turkish Customs Legislation.

In a nutshell, the Customs Union accelerated our Customs Administration's regulatory harmonization with the EU *acquis* and the adoption of modern techniques. Administrative capabilities have been considerably improved with the EU's financial support, which amounted to 82 million euros.

Turkey's Customs legislation and practices have also been in compliance with the standards set by other international organizations such as the WTO and the World Customs Organization.

Progress achieved in relation to Turkey's obligations in the framework of the Customs Union also contributes to Turkey's accession process to the EU and quickens the pace of negotiations. In fact, the EU's Annual Progress Reports state that Turkey's progress in harmonizing custom legislation contributes to its accession negotiations with the EU.

### ***Impacts of the Customs Union on the Turkish Economy***

The Customs Union theory suggests that a CU will bring significant economic benefits to its member states. In order to accept this conclusion we need to examine first whether it can be supported by empirical evidence.

The various studies conducted about the economic consequences of the CU between Turkey and the EU do not examine all dimensions sufficiently and thus the existing theoretical assumptions have not all been backed up with empirical evidence. This depicts that the fact that not all of the theoretically established positive consequences are covered. Moreover, the methods and models used in these studies vary significantly. Therefore it is important to take into consideration all the work that assesses the effects of the Turkey-EU Customs Union.

CU's impacts are basically observed on the allocation of resources. The effect on the allocation of resources can be divided into two categories: static impacts and dynamic impacts. With the term "static impacts", we mean CU's one-time impact on national income. Dynamic impacts, on the other hand, can be observed in the growth rates of national income over the years. Moreover, in the recent years, economic mergers are viewed in terms of their additional benefits for developing countries.

There are two different approaches concerning CU's static impacts on the Turkish economy. The first one focuses on the trade diversion and trade creation-effects. Most of the studies that have adopted this approach come to the conclusion that the CU creates trade more than it diverts it. The CU increases the trade volume and has an overall positive net effect on welfare.

The second approach incorporates variables which can potentially be affected by the CU such as imports, exports, and custom duty loses. The main argument here

is that if the trade creation-effect displaces resources from expensive production to productive areas, then this change must have a reflection on exports.

However the studies that examine exports and imports separately have come to the conclusion that although the CU increases imports, it does not lead to a substantial increase of exports. Studies of the second approach suggest that the contribution of CU's static impacts to economic growth is either insignificant or even negative. When we also add the losses in tariff revenues CU appears to have had a detrimental effect on the Turkish economy. In conclusion, the literature on the CU's static impacts suggests that there is indeed a trade creation-effect, but not in Turkey's favor.

After the establishment of the CU, the free movement of industrial and processed agricultural products increased the trade volume between the two parties. Since the CU agreement requires Turkey to adopt the same tariff rates as the EU does *vis-à-vis* third countries, Turkey's trade relations with other countries have also been influenced.

When we compare Turkey's exports to and imports from the EU (15) in 1995 and in 2008 (in order to assess the difference between the situation before and after the CU agreement), we can see that the increase in exports is larger than the increase in imports.

This fact, however, does not mean that Turkey is in a favorable position concerning its balance of trade. On the contrary, the foreign trade deficit between Turkey and the EU approximately doubled between the years 1995 and 2010. Furthermore, the foreign trade deficit between Turkey and the non-EU countries has increased by six times during the same period. Therefore, we can conclude that the actual impact of the CU has been observed on Turkey's trade with non-EU countries.

When we examine the export to import ratio over the years, we can observe that the ratio has been increasing substantially and has gone beyond 80 percent compared to the pre-CU era. Export to import ratio, in terms of trade with the EU (27), was 88 percent in 2009 and 85 percent in 2010. Contrary to the anti-CU arguments, these results demonstrate Turkey's increasing ability to withstand the competitive pressures resulting from the removal of tariffs.

Before the CU, consumer goods had the biggest share of Turkey's exports to the EU (15). After the CU agreement, however, the share of consumer goods has decreased while the share of investment and intermediate goods has increased. On the other

hand, the largest share of imports belongs to intermediate and investment goods. If we consider that this situation reflects the general tendency in terms of Turkey's imports, we may claim that Turkey depends on foreign countries for raw material needs; therefore, a considerable amount of the revenues gained from exports is spent on the inputs which are necessary for the production of our export goods. Manufactured goods constitute 95 percent of the trade volume between Turkey and the EU (15). Additionally, the share of agricultural products has decreased while the share of industrial goods has increased.

Empirical analysis reveals that the CU has significantly increased Turkey's exports to the EU-countries (15) as well as intra-EU trade. However, in the period under examination, the increase of trade between the EU-countries has been bigger compared with the increase of Turkey's exports to the EU (15). This is why the CU's impacts should be examined in a broader scope because those impacts are not limited just to the EU-countries.

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Although the existing literature gives more focus to CU's dynamic effects, these effects have in fact been less studied than the static effects. This is probably due to the fact that the dynamic effects will become obvious only in the long term.

Studies on the CU's impact on Turkey's economic growth reveal positive results but they do not meet the expectations that had been originally set. Nevertheless, it is expected that the CU's impact on growth will be more important in the upcoming years. However, we need to pay more attention to the CU's effect on competition because most of the positive effects of CU are directly or indirectly related with it.

The research regarding the CU's impact on Turkey's competitiveness reveals different results. This can be partially attributed to the reliability and accuracy of the competition indicators. In other words, we need to examine the indexes that measure competitiveness more carefully. For example, whether the comparative advantage index or any other indexes are actually capable of measuring competitiveness in exports remains an important question.

Studies examining the CU's role in attracting foreign direct investment (FDI) give consistent results. They have concluded that the CU plays an important role in attracting FDI, but it is not a sufficient factor on its own. Another area that has been examined is the CU's impact on the agricultural sector, which is not included in the CU agreement. The conclusion is that the agricultural sector is in fact influenced by CU through external economies.

More research needs to be done on the CU's impact on technology. The existing literature mostly focuses on the CU's effects on technology governance but it is not sufficient. Additionally, the CU's effects on trade and its unconventional effects have not been yet satisfactorily examined. Concerning the unconventional effects, some research has been conducted only on the CU's effects on the security (which comes from the obligation of not increasing customs tariffs in the future) however the results do not meet the theoretical expectations.

### ***EU's Unfulfilled Obligations Related to the Customs Union***

#### *Free Movement of Labor*

Besides the free movement of goods, the Ankara Agreement, also envisioned the free movement of labor. With the Additional Protocol, signed on 23 November 1970 and entered into force on 1 January 1973, the free movement of labor between Turkey and the EU was supposed to mutually take place until 1 December 1986; however this did not happen. The global financial crisis and the oil shock diminished Europe's demand for labor thus making the EU unwilling to fulfill its obligations toward Turkey. The EU-Turkey Association Council made some reforms in 1976 and 1980 concerning Turkish citizens who immigrated to Europe, however the free movement has not been materialized.

#### *Systemic Control of Country of Origin for Color Televisions and Anti-Dumping Investigation*

Since Turkey has harmonized its legislation with the EU, there was no point to conduct anti-dumping investigations on Turkish goods. However, our exporters were significantly affected when the EU conducted anti-dumping investigations on Turkish color televisions, despite the fact that they were exported with the A.TR Certificate of Circulation.

After being under investigation for 15 months, Vestel enterprise was finally absolved. Additionally, although the Customs Union Decision 1/95 bans the systemic control



of the country of origin on industrial and processed agricultural products, the EU carried out a control on all color televisions that were imported from Turkey in 2002 which considerably damaged Turkish producers.

### *Financial Support*

From the beginning of their partnership until the completion of the CU (1994-96), the Financial Cooperation between Turkey and the EU has been carried out/regulated through financial protocols. Three financial protocols and one supplementary protocol have been signed aiming at Turkey's social and economic development. After 1981, another financial protocol, which amounted to 600 million euros, was prepared, but did not enter into force because of Greece's veto. These protocols mostly consist of grants from the European Investment Bank and credits from the Union. Despite the fact that Turkey was expected to receive a financial support of 1433 million euros within 32 years, it has only received 830 million euros.

The CU also envisioned that Turkey received credits and grants from the EU budget and from resources that were previously given to Mediterranean countries. Between 1996 and 1999, grants were gathered under the EU Budgetary Assistance, MEDA and Administrative Cooperation Fund and a grant of 768 million euros was put forward. However, due to the rejection of Greece, this grant was reduced to 52 million euros.

### *Non-inclusion of Turkey to the EU's Free Trade Agreements (FTA) vis-à-vis the Third Parties*

The Article 16 of the Association Council Decision 1/95 stipulates Turkey's concordance with the preferential regimes, including EU's Free Trade Agreements. While goods are exported to the EU from third countries with reduced tariffs or no tariff in accordance with the FTA and afterwards can be exported to our country without facing any significant obstacle pursuant to free movement principle of CU, since Turkey is still not a member of the EU and hence does not take part in the making of aforementioned agreements and is not incorporated into the processes of negotiation, remarkable contradiction emerges. This has had a negative impact on Turkey's trade interests.

Due to the fact that the EU has signed FTA with particular third countries, which remain reluctant to sign same agreements with Turkey, tariffs on imports from those countries are either reduced or removed while Turkey continues to collect customs duties. Consequently, they came up with the solution of exporting goods

to Turkey and then to the EU rather than exporting directly. This has led to losses in tariff revenues and trade deviation.

Additionally, concessions given by the third parties to the EU do not apply for Turkey because it is not a member state. Therefore, these countries are able to maintain high tariff rates when they are importing from Turkey. This leads to a unilaterally beneficial outcome for the EU mechanism, which makes it even more difficult to persuade third countries, which are part of FTA with the EU, to enter into FTA with Turkey.

### *Non-inclusion of Agricultural Products to the Customs Union*

The CU agreement focuses only on industrial goods and processed agricultural products (areas in which the EU has a clear advantage) without including agricultural products. So, while European farmers can enjoy the benefits from the EU Common Agricultural Policy (CAP), Turkey can neither receive subsidies nor export its agricultural products to the EU.

### *Transport Quotas*

In order to meet the CU's goal concerning the free movement of goods, all trade obstacles need to be removed. Turkey has demanded the removal of all restrictions which are the result of the transit permit quotas that have been imposed on our land transport sector. Quotas and transit documents constitute barriers against the free movement of goods.

### *Schengen Visa Requirements for Turkish Nationals and the Issue of Freedom of Provision of Services*

The Article 14 of the Association Agreement notes, about the free movement of services, that: "The Contracting Parties agree to be guided by the Articles 55, 56, 58 and 65 of the Treaty establishing the Community in order to abolish the restrictions against the freedom of establishment between them."

The Additional Protocol, which was signed on 23 November 1970 and entered into force on 1 January 1973, states in Article 41 (1) that: "The Contracting Parties shall refrain from establishing any new restrictions against the freedom of establishment and the freedom to provide services."

Among the most important prerequisites for the free movement of services is the free movement of people (workers) and the freedom of settlement.

According to an EU Council Directive, Turkey is among the countries whose citizens are required to apply for a visa in order to enter the EU. The fact that Turkish citizens asked to present a large amount of documents, including an invitation letter, to the consulates (where they are often mistreated), have to wait a long time while receiving only short term visas, has been causing significant problems.

These facts have led many people to believe that Turkey has been treated with discrimination in comparison to other countries. Unfair visa requirements have a negative impact on Turkish citizens and businesses.

Turkish businessmen, for example, cannot move freely in the EU while their European counterparts are exempt from visa requirements or are able to get a visa in a short period of time by paying only a small amount of money. Therefore, Turkish businessmen face problems with their day-to-day business operations, not to mention the lost opportunities for new business connections. Consequently, this situation triggers unfair competition, since it poses obstacles to free trade.

### ***Increasing Trade with Other Neighboring Regions***

The Ministry of Customs and Trade has been taking several initiatives with regard to Turkey's customs policy in order to increase its trade volume with neighboring regions besides Europe.

We have been conducting bilateral negotiations with our neighbors in order to simplify our land border check/entry points, as required by the Caravanserai Project initiated within the scope of Silk Road Customs Cooperation Initiative.

The establishment of common check/entry points and the exchange of data between the neighboring officials will effectively address duplication in cross-border customs operations. This new system will especially help the transit traders save time and money. Agreements on this issue have been already reached with Azerbaijan, Georgia, Iran, and Syria while the implementation protocols and the necessary technical measures have been almost completed.

A necessary prerequisite for increased trade relations is to make the legislation and practices in the sphere of customs and the immediate resolution of problems uniform. Finally, open channels of communication are much needed.

To this end, we have been conducting meetings (at the under-secretary level) with the heads of Customs Administrations of all the neighboring countries with which

Turkey has diplomatic relations as well as with our significant trade partners such as the U.S., Germany, South Korea, Italy, the Russian Federation, and Ukraine. These meetings aim to address day-to-day problems, remove the impediments against legal trade and prevent illegal operations. During the past few years, we have been making great progress on this front, and we have witnessed a substantial increase in the number of reciprocal technical visits with the aim to observe customs practices on the ground.

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Another goal of our Ministry is to appoint customs counselors and attachés to the Turkish embassies and consulates which operate in our neighboring countries, in our major trade partner countries, and in countries where a significant number of Turkish citizens live. Thus far our customs attachés have been operating in seven countries while soon they will be operating in a total of 20 countries.

These delegations help us solve problems directly and immediately, establish close contact with representatives of customs administrations and tradesmen of each country and to inform our citizens and tradesmen engaged in trade with Turkey, timely and correctly.

### **Conclusion**

Despite Turkey’s close cooperation with the EU, some issues have led to an increased frustration on the former’s side. Turkey is still conducting accession negotiations with the EU which have been further complicated by the unresolved Cyprus problem. Turkish frustration has been also caused by the EU’s insufficient support for Turkey’s battle against domestic terrorism (e.g. PKK).

Since the establishment of a Customs Union between the EU and Turkey in 1996, the latter went through radical changes in its Customs legislation and administration in order to meet the EU standards. Turkish economy improved, however its trade deficit with the EU and third parties has increased. Additionally, the EU has failed -thus far- to fulfill certain important obligations which were envisioned in the CU Agreement concerning, among others, the free movement of Turkish citizens in the EU and the removal of trade barriers.

There are steps that the EU can take which Turkey merits and which can help reduce the distrust. For example, the imposition of visa requirements for Turkish nationals openly violates the principle of free movement of goods as it is declared in the Association Council Decision 1/95 as well as the Article 41 of the Additional Protocol underlining that no new restriction shall be introduced in the field of freedom of establishment and freedom to provide services between the Parties. As a country involved in a process defined to target full membership, Turkey's invitation to EU summits where priorities and fundamental policies of the EU are decided, is important.

Turkey has intensified its efforts to open up economically to regions besides Europe. To this end, we have made further changes to our Customs policy in order to increase trade relations with our neighbors. High-level meetings, the simplification of our entry check points and the deployment of Customs Cancellors and Attachés in other countries are only some of the measures that will help us to achieve this goal.