

# THE MODERNISATION OF THE EU-TURKEY CUSTOMS UNION

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## Abstract

The European Union is a sui generis, supra-nation organization. After the World War II, step by step, the European Union has turned from a regional trade collaboration into a political integration and become successful during the rise of globalization. The historical signification and geographical location of Turkey and its relationship with Europe gained an economical dimension with the Ankara Agreement of 1963 and the final step of this agreement, the Customs Union of 1995, Turkey tried to integrate into the Western Market Economy. In this study, we will analyze relations between Turkey and EU within the context of Customs Union, internal dynamics and external agents of Turkey that executes full membership process to EU. In addition to this, advantages and disadvantages of Customs Union, reviews and suggestions of the modernization in Customs Union will be presented.

**Keywords:** *Relations Between the European Union and Turkey within the context of Customs Union, Advantages and Disadvantages of Customs Union, Reviews and Suggestions of the Modernization in Customs Union*

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## INTRODUCTION

International economics focuses on international trade, international finance, international monetary economics and international macroeconomics, international political economy and its sub-categories of international relations, especially the international trade studies, international factor movements, policy variables, movements of goods and services, international economic balance, international economic improvements and economic integration.

The actors of international economic integration are the states. Economic integration is a unification aiming to raise mutual interests. In the globalization process, the main purpose is to destroy tariffs, restrictions and trade quotas. International economic integration is a product of liberalization. Instead of protectionist policies, encouragement of higher volumes of import, export and trade transformed the relations among states. Core, semi-periphery and periphery countries, as classified by Wallerstein's (Wallerstein, 1978: 91-103) world-system analysis, follow different aims in this environment. A core country needs new markets. In this way, technological progress, competition, extensive sales opportunities reduce costs. Periphery and semi-periphery countries want to industrialize their countries so they need new technologies (Dura & Atik, 2007:2).

For the common target of liberalization of international trade, firstly, the General Agreement on Tariffs and Trade (GATT) abolished trade restrictions with 83 countries in 1947. Secondly, economic integrations occurred and after the Second World War, the European Economic Community, the European Community, the European Common Market or briefly the EU, which is one of the most successful regional economic integration movements formed after the Treaty of Rome of 1957.

The *raison d'être* of the EU is to establish an economic, political, cultural, social integration in the European continent. Historically, the struggle to maximize interest has been the *casus belli* among states and European Countries dealt with two world wars due to this reason. Therefore, presence of the EU is crucial not only for the stability of Europe but also for a peaceful world order. In this context, border countries of Europe want to become a part of welfare of Europe. This attractiveness has led to the European enlargement process and the emergence of some benchmarks.

Amid this process, the direction of Turkish foreign policy that follows westernization and modernization shifted European market. When Turkey began to negotiate with the EU in 1959, the policy of Turkey mainly aimed at economic aid. Turkey took economic aid from the US Marshall Plan in 1948, which provided financial grants and technical military aid to democratic countries in the Western Europe against the Soviet threat, Turkey entered the orbit of the US and had to move in the direction the US requested. Therefore, as Turkey had tried to break American dependency and the solution was the EU in line with Turkey's multipolar foreign policy. In the short-term process, Turkey justified itself because in the crisis of Cyprus, US oriented foreign policy led to the Johnson Letter in 1964. Turkey was shocked as NATO, which is a guardian or insurance of territorial integrity and the future of Turkey, could not assist in the case of invasion of the Soviet Union. This event became a milestone in Turkish foreign policy and Turkey gave up pro-American foreign policy. State mechanism has to analyze social dynamics to protect status quo and order. National awareness in Turkey caused huge demonstrations about Cyprus and Turkey tried to empower alliance with Europe. In this way, necessity of establishing ties with the EU emerged once again.

Since the establishment of the Republic of Turkey, Turkey has become a member of some economic and political organizations and with the Ankara Agreement in 1963. Turkey began to integrate with the countries of the European Community. On March 6th, 1995, Turkey signed the agreement creating an association between the Republic of Turkey and the European Economic Community or the Ankara Agreement and the customs union between Turkey and the EU was established. Political actors have calculated that the relations with the EU would support the Turkish trade capacity and economy but in the long run, estimates have become a total fiasco.

This study discusses the origins and the progress of the relationship between Turkey and the EU within the context of Customs Union. In addition to this, advantages and disadvantages of Customs Union with economical results, reviews and suggestions of the modernization in Customs Union will be presented.

## **HISTORICAL PROCESS**

The historical background of the ties between Turkey and the EU are based on the 1920s when Western countries were considered to be representing the most civilized and the most developed countries in the world. Mustafa Kemal Atatürk, the founder of the Turkish Republic, said in the 1923

İzmir Economic Congress “All of the victories and failures that fill our history are closely related to our economic situation. We have to give importance to this issue by keeping our economy first, whatever it takes to reach the "Civilization Level" that is worthy of our new Turkey.” (Afet İnan, 1982) He advocated that, Turkey should reach the level of welfare of Western countries in order to not be defeated by Western countries that were the failure of The Turkish War of Independence militarily and politically. Moreover, Turkey should establish good relations with Western countries for economic and political independence and equality.

During World War II, Turkey remained neutral until February 1945 when it joined the Allies. The country took part in the Marshall Plan of 1947, became a member of the Council of Europe in 1949, and a member of NATO in 1952. During the Cold War, Turkey allied itself with the United States and Western Europe.

In the Menderes government period, 19 months after The Treaty of Rome, the official treaty establishing the European Economic Community (EEC) which was signed on 25th March 1957 by Belgium, France, Italy, Luxembourg, the Netherlands and West Germany; Turkey applied to the European Economic Community (EEC) for associate membership. Turkey became the second country to apply for associate membership after Greece. The main agent for this application can be seen in the discourse of Fatin Rüştü ZORLU who was the Foreign Minister of Turkey during this period: “If Greece skips to an empty pool, we need to follow it immediately.” (Özgöker, 2010: 146).

On March 1st, 1960 the negotiation process began for Greece but the EEC executed the balance of power policy against Athens and Ankara, and accordingly Turkey's negotiation process began in April 1960. However on 27th may, 1960 a coup d'état took place in Turkey which became the first barrier in the negotiation process. After the coup, Prime Minister Menderes, the Minister of Foreign Affairs Fatin Rüştü Zorlu and the Minister of Finance Hasan Polatkan were executed and Charles de Gaulle the President of France demanded that all ties with Turkey be frozen. . The protection of a democratic regime is one of the conditions of Western countries. On October 14th, 1960, negotiations started once again but due to the political instability in Turkey an associate agreement could not be made until 1963. Eventually, on 12th September, 1963, The Agreement Creating an Association Between The Republic of Turkey and the European Economic Community (commonly known as the Ankara Agreement), was signed by Turkey and the EEC.

According to the decision-makers in Turkey at this period of time,

Turkey wanted to join the EEC because of two reasons;

Firstly, in the long-term, Turkey should not be kept out of the political unitary of Europe and secondly, Turkey should be excluded from commercial concession of the Customs Union like Greece.

The Agreement envisioned three phases for Turkey's gradual accession to the EU Common Market through the establishment of a Customs Union:

1. Preparatory Period (1964 – 1970)
2. Transition Period (1973 – 1995)
3. Final Period (1996 to full economic integration)

In 1973, at the end of the preparatory phase, an Additional Protocol entered into force, which aimed to remove customs duties between the two sides. While the EU completely removed customs duties on industrial goods of Turkish origin from the very beginning of the transition period, Turkey's removal of customs duties on EU industrial goods was set to be more gradual. The transitional phase was not fulfilled due to the 1973 oil crises followed by the global recession of the mid-1970s (Balkır and Kuştepelı, 2012: 163). Amid these challenges, Turkey could only decrease tariffs in 1973 and 1976. Because of trade deficit with the EC under Article 60 of the Additional Protocol, a 22-year transition period was foreseen for Turkey to complete the implementation of the Customs Union. During the 1980 Turkish coup d'état, the same year Greece was granted full EC membership, economic relations among EC and Turkey deteriorated (Balkır and Kuştepelı, 2012: 164). A normalization process began after the restoration of democracy in 1986. On April 14th, 1987, Turkey applied for full membership the EC rejected this application due to the majority of Muslim identity and the large population potential (Manısalı, 1988: 14) and noted that it would not be able to accept Turkey as a new member until it had completed its economical harmonization and advised a Customs Union under the reactivation of the Ankara Agreement. Customs Union negotiations restarted in 1993 and were completed with the Association Council Decision 1/95, which took effect on January 1st, 1996 (Balkır and Kuştepelı, 2012: 164).

The Customs Union between Turkey and the EU was the EU's first substantial functioning Customs Union with a non-member state and was one of the earliest attempts by the EU to share some of its legal system with another country (World Bank, 2014: i). Under the Customs Union, Turkey has accepted the EU's Common External Tariff (CET) for most industrial products and industrial components of agricultural products. The parties

have also destroyed all customs duties, quantitative restrictions and charges on their bilateral trade. Since its implementation, the Customs Union has encouraged the growth of EU-Turkey trade and investment, supported Turkish productivity gains, and furthered Turkey's alignment with the *acquis*.

According to Articles 16, 52, 57, 64 of the Agreement, Turkey has to accept the following trade policy of the EU: "With a view to harmonizing its commercial policy with that of the EC, Turkey shall align itself progressively with the preferential customs regime of the EC. This alignment will concern both the autonomous regimes and preferential agreements with third countries. To this end, Turkey will take the necessary measures and negotiate agreements on mutually advantageous basis with the countries concerned. The Association Council shall periodically review the progress made."

According to Turkey, the Customs Union is a step towards full membership, based on Article 28. The EU, on the other hand, viewed the Customs Union as a potential alternative to full membership. As the EU's ex-Ambassador to Turkey, Michael Lake put it,

*"The Customs Union created misconceptions on both sides. The European side felt that Turkey would be preoccupied with making it work and not press for full membership for the time being, while Turkey had the misconception that the Customs Union was a stepping stone towards full membership in the next year or two"* (Balkır and Kuştepe, 2012: 166).

## ADVANTAGES AND DISADVANTAGES

Advantages and disadvantages of customs unions can be analyzed according to static effects and dynamic effects:

Under the habitual assumption of the status qua of structures of technology and economy, the static effects of the customs union examines new effects that will occur at the end of distribution of production factors. Static effects are one-time effects because economic and technologic structures cannot remain constant. Static effects can be classified into two; trade creation and trade diversion effects of customs union creation, which were firstly introduced by Jacob Viner (1950) in his classical work "*The Customs Union Issue*" staying a corner stone in classic theory of international economic integration up-to-date (Jošić, H., & Jošić, M. (2013): 2). According to Viner, a customs union is a step towards the liberalization of territorial commercial. On the other hand, it reduces trade rate with countries that are

not within the union. Therefore, a customs union cannot always increase the world's welfare because liberalization and protectionism occur and they lead to trade creation and trade diversion. In trade creation, cheap import that comes from union countries replaces expensive domestic production. This effect is considered as a positive effect of customs union. In trade diversion, expensive domestic production replaces cheap import that comes from union countries. This effect replaces is seen as a negative effect of customs union. If the trade creation is more than the trade diversion, customs union effects the world's welfare in a positive way.

The dynamic effects of customs union can be classified into two; dynamic advantages and dynamic disadvantages. The main aim is to expect dynamic advantages. Significant dynamic effects of customs union include the increase of external competition and of economies of scale, rising foreign currency reserves, encouragement of investments and the industrialization speeding up.

The dynamic disadvantages of customs union can be classified into four;

1. Development differences between member countries of customs union can lead to movements of production factors from relatively less developed countries to developed countries. The most important reason for this is that marginal returns of production factors are higher than developed countries.

2. Customs union can increase the oligopoly market. Cooperation among companies of developed countries can produce the oligopoly structure and high prices to consumers.

3. Customs union can grow the scale of companies and in this way, huge scale production companies lead to extreme bureaucratic and inactive structures.

4. Administrative costs of a customs union can be high (Özgöker, 2008.).

Advantages of the Customs Union were classified into five by the European Commission (European Commission, 2016: 14-15) in the Study of the EU-Turkey Bilateral Preferential Trade Framework (BPTF), Including the Customs Union (CU), and an Assessment of Its Possible Enhancement Final Report 26 October 2016:

“While the BPTF generated significant benefits for both the EU and



Turkey, it could have still been more beneficial:

- Firstly, the commercial policy that Turkey adopted during the BPTF period because of the CU requirements was not tailored to its needs and, thus, was sub-optimal from its perspective. While unilateral liberalization vis-à-vis the EU's Free Trade Agreement (FTA) partners (in those cases where the EU has an agreement with a third country but Turkey has not) is analyzed as a positive factor for Turkey's overall development and its economic welfare, obtaining reciprocal concessions and recognition of goods originating in Turkey for diagonal cumulation in the EU's FTAs would have been better still. This was incorporated in the EU's FTAs with the European Free Trade Association (EFTA), Euro-med and Western Balkans for example, but is not a general EU practice. From a political economy perspective, although Turkey is informed by the Commission in the context of the EU's FTA negotiations with third countries, formal mechanisms to take Turkey's sensitivities into account in the EU's commercial policy formulation would also have smoothed commercial relations.

- Secondly, the exclusion of services from the BPTF meant that the bilateral relationship was governed by the World Trade Organisation (WTO) General Agreement on Tariffs and Trade (GATS) commitments. In services sectors where Turkey made significant commitments under the GATS, it performed well during the BPTF period; in largely closed sectors, such as business and professional services, Turkey's export performance lagged. The deep liberalization of goods sectors under the BPTF and the exclusion of services sectors does not appear to have been a factor in this underperformance, as the ex post analysis shows. However, the BPTF's failure to build on GATS commitments and open up Turkey's closed services sectors was an opportunity foregone.

- Thirdly, Turkey's retention of higher and more extensive protection of primary agriculture under the BPTF resulted in commensurately reduced structural adjustment towards a more efficient economy and, thus, smaller gains that otherwise would have been possible.

- Fourthly, a range of frictions that militated against the full realization of the potential benefits of the CU emerged or were laid bare by the expansion of bilateral trade during the BPTF period, including new NTBs erected by Turkey that frustrated EU goods sector export interests and the lack of a services component to the BPTF to facilitate the functioning of the cross-border value chains and production networks that emerged under the BPTF.

• Finally, the BPTF's institutional framework was revealed to be inadequate to satisfactorily address the frictions that emerged under the deep integration fostered by the CU, including as regards dispute settlement and ensuring coordination in the development of commercial regulations.”

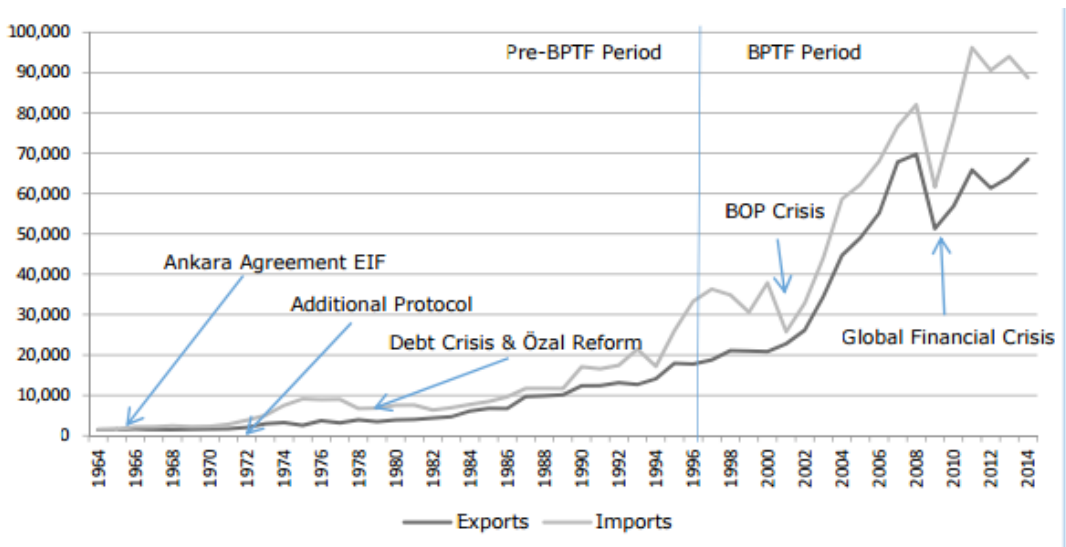
In this study Table 1.1 and Figure 1.1 shows that, the Customs Union among Turkey and the EU maintained some benefits but in the crises, the effects of the Customs Union reduced.

Table 1. Main effects of BPTF on the EU and Turkey

	EU	Turkey
Real GDP (%)	0.008	0.722
Household Income (EUR billions at 2016 prices)	1.6	7.5
Bilateral Exports (EUR billions at 2016 prices)	8.7	6.0
Real Growth in Total Exports (%)	0.029	1.28
Real Growth in Total Imports (%)	0.029	2.60

Source: Study of the EU-Turkey Bilateral Preferential Trade Framework Including the Customs Union and an Assessment of Its Possible Enhancement Final Report of 26th October 2016

Figure 1. Turkey's Bilateral Trade with the EU since the Ankara Agreement, 1964-2014, USD Millions at 2014 Prices



Source: Study of the EU-Turkey Bilateral Preferential Trade Framework Including the Customs Union and an Assessment of Its Possible Enhancement Final Report of 26th October

2016

On the other hand, criticism and dissatisfaction are emerging from Turkey. The increase in trade deficit with the EU, insufficient economical aids, crises in production industries, dependency of the EU about external trade feed Euroscepticism in particular. Application of Customs Union works against the interests of Turkey because this agreement does not recognize equal status and interests. This asymmetric agreement is not win-win situation. On the other hand, EU executes like zero-sum perception that its gain is the Turkey's lose.

Results of Customs Union showed that, Turkey confused tools and aims. The aim is to improve economical relations with EU but the tool should not be dependency of one-sided decisions of EU. Shortcomings of the Customs Union were classified by Manisalı (Manisalı, 1988: 67):

1. Without veto authority, Turkey has to apply EU decisions of whole external economic relations of Customs Union.

2. Under the full membership responsibilities, Turkey is not in the decision mechanism.

3. If the EU does not fulfill its obligations in the agreement, Turkey cannot apply sanction over the EU. For instance; in 1996, the EU did not give economic aid to Turkey and Turkey could not do anything about it.

4. Turkey's position is like a third country or a country outside of the EU. For instance, in 1996, the EU began the application of anti-dumping against Egypt, India, China, Indonesia and Pakistan.

5. Member countries of the EU are applying restrictions, taxes, and establishing barriers but Turkey inside the Customs Union has to apply these decisions without initiative. Consequently, Turkey's external trade and relations with world countries were effected in a negative way.

## REVIEWS AND SUGGESTIONS OF THE MODERNIZATION IN THE CUSTOMS UNION

The modernization of EU-Turkey trade relations forms an essential part of the efforts made by the EU and Turkey to deepen their relations in key areas of joint interest identified at the EU-Turkey Summit of 29 November 2015 and in the EU-Turkey statement of 18 March 2016.

Especially, according to survey of Economic Development Foundation (Vakfi, İ. K., & Akses S., 2016: 27) in Turkey; in services and industry sectors,

Turkish companies faced four obstacles that are transparency, barriers to competition, barriers to free movement of persons and recognition of professional qualification, barriers to entrance of market. In this context, problems of customs union should be fixed in a win-win strategy. Modernizing the Customs Union to reflect current EU-Turkey trade relations would bring substantial economic benefits to both partners.

With the evolution of the economic environment and the significant growth of EU-Turkey trade, the Customs Union that entered into force in 1996 is becoming less and less equipped to deal with the modern day challenges of trade integration. The first EU-Turkey High Level Economic Dialogue last April underlined the potential of its modernization. The modernization and extension of the Customs Union could unlock further opportunities for EU companies in the agri-food and services sectors and the public procurement market (Commission, 2016).

The modernization process in the Customs Union occurred amid the EU-Turkey readmission agreement and the EU-Turkey Visa liberalization. The Syrian Refugee Crises became a powerful trump to Turkey to take visa liberalization but caused some disruptions and disagreements among Turkey and the EU. The Tension of this process can be fixed with a Customs Union. The EU and Turkey should establish a Customs Union while protecting their interest. Especially, current situation disrupt Turkey's balance of economy, external trade and relations with third countries.

*“Accordingly, confirming previous analyses of the BPTF, this study’s evaluation of the BPTF on an ex post basis suggests that the commercial policy governing EU-Turkey relationship should be modernized and upgraded, with particular emphasis on the following: removing the imbalances in terms of sectorial coverage (services and primary agriculture) and of the negotiation of commercial treaties with third parties; addressing a range of NTBs to goods trade that emerged or became important as integration deepened under the CU; and improving the institutional framework for managing bilateral commercial relations.” (European Commission, 2016: 15).*

In addition to this, Turkey should participate in decision the mechanisms of the Customs Union and the EU should protect not only its own interests but also Turkey's interests in order to establish a good relationship.

## RESULTS

Since the 1963 Ankara Agreement of, Turkey has tried to respectively integrate into the EEC, the EC and the EU. The axis of Turkey is western oriented and this periphery country of the EU wants to become a part of the European market economy under a Customs Union. However, political instability and bad decisions regarding the Turkey's direction shadowed not only the negotiations but also the dignity of Turkey. Western countries' welfare is an attractive power to other countries and political ambitions of Turkey that has crucial geostrategic position is to construct integration with European Union.

After 1995, a Customs Union was established but there were more shortcomings in this agreement than there were benefits. Turkey took economical aids and the rate of import and export increased. However, in course of time, agreements diminished profit of Turkey in the face of third countries. According to some Turkish intellectuals and decision-makers, the Customs Union was a mistake. Turkey should become full member of the EU. Without full membership, a Customs Union is a one-side obligation to Turkey and one-side maximized interest to the EU. The Customs Union should be updated by Turkey and the EU.

Unfortunately, amid the Syrian civil war and the Syrian refugee crises, the EU and Turkey bargained the EU-Turkey readmission agreement and the EU-Turkey Visa liberalization and this process effected the future of ties between the EU and Turkey. Furthermore, rising populism and nationalism led to Brexit and right parties are one of the threats against the future of the EU. Also, rising tension between Berlin and Ankara because of arrested 22 German citizens and right activists in Turkey and general election campaigns in Germany shifts the modernization process of the Customs Union. Germany will veto the update of the Customs Union but different kind of discourses of member countries of the EU are not in the same thought with Germany. AKP, the party that has been ruling Turkey since 2011, has tried to execute an axis shift in Turkey. Because of anti-democratic policies, human rights violations, central-Asian style autocratic government system, threats over freedom of speech and neutrality of judiciary, Turkey cannot become a part of the EU. Furthermore, the Cyprus problem, postponed economic reforms, political handicaps and social discriminations with Islamophobia and Turcophobia feed this vicious circle.

As a result, the EU is an important supra-nation organization and is a lebensraum for the national interests of Turkey. Moreover, if Customs Union is revised and amended as Turkey being an as an associate member,

the economic improvement of Turkey would rise. Negotiations for a Customs Union should start immediately and the lack of current agreements should be eliminated by the EU and Turkey.

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