

EU–Turkey Customs Union Prospects for Modernization and Lessons for Brexit

Fadi Hakura

Summary

- Turkey and the EU have been in a customs union since 1995. Both sides recognize that this arrangement requires updating to rectify design deficiencies that are undermining its operational effectiveness and to keep pace with the new generation of trade agreements that the EU has signed.
- Turkey wants a stronger voice in EU trade policy formulation, and to ensure that it is included in future EU free trade agreements. It also wants to simplify procedures for Turkish goods vehicles at the borders with Bulgaria and Greece and when transiting between EU states.
- The European Commission has proposed expanding the scope of the customs union to include liberalizing services, rights of establishment, public procurement and agriculture.
- Ukraine’s Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU, part of an association agreement that entered into full force in 2017, provides a template for an upgraded EU–Turkey trade relationship in some areas. It suggests that the EU will tie further liberalization to Turkey’s full incorporation of relevant EU rules and regulations (the *acquis communautaire*) and acceptance of the jurisdiction of the Court of Justice of the European Union on matters of EU law.
- Turkey’s bilateral political disputes with individual EU member states have so far hindered prospects for updating the customs union. An alternative, more gradual and open-ended strategy is therefore required to move the process forward.
- Turkey’s experience shows the challenges facing a non-member state in a formal customs arrangement with the EU. Post-Brexit UK should seek a more intimate arrangement with the EU than a Turkey-style customs union.



Introduction

Turkey’s nearly 23-year-old customs union (CU) with the European Union has defined its bilateral economic and trading relationships. Implementation of the CU was supposed to pave the way for the country’s eventual accession to the EU, but this process has become politically stalled and Turkish membership now appears unattainable at any point in the near future.

Although the customs arrangement has benefited both Turkey and the EU, both sides recognize that it needs to be modernized to improve its operational efficiency and widen its scope and coverage. Over the last decade, the EU’s introduction of a new generation of trade agreements has spurred a desire to upgrade the CU beyond its narrow focus on the removal of tariffs on industrial goods, to include provisions on services, investment, intellectual property rights, public procurement, digital innovation and sustainable development.

This paper details the operation of the EU–Turkey CU in its current form and highlights its design flaws. It then lays out the contours of the potential EU offer on an upgrade and analyses the prospects for its implementation. Finally, it proposes an alternative approach to negotiations that could minimize the impediments to a successful outcome, and outlines some salutary lessons for Brexit.

Origins of the EU–Turkey CU

In September 1963, after four years of negotiations, the then European Economic Community (EEC) and Turkey concluded an Association Agreement, also known as the Ankara Agreement (AA). This provided a framework for bilateral preferential market access for goods and called for the establishment of a CU as a stepping stone towards Turkey’s eventual EEC membership. In November 1970, the two countries signed an ‘Additional Protocol’, which progressively abolished tariffs and quotas on industrial goods according to a defined timetable. This protocol entered into force in 1973 and was followed by the CU, which became operational on 31 December 1995.¹

Operation of the CU

The CU means that for industrial goods, Turkey and the EU form a single customs space. Turkey imposes the EU’s Common External Tariff, the same external tariff applied by all states within the CU to goods imported from outside these territories. This eliminates the need for ‘rules of origin’ – complex rules to identify the economic ‘nationality’ of a product and its components in order to determine the correct tariff – which are normally found in free trade agreements (FTAs). Proving the proper origin of a product to customs authorities at the point of entry to a country can be time-consuming and costly. The existing agreement therefore ensures the free circulation of industrial goods between the EU and Turkey.

¹ European Parliamentary Research Service (2017), *Reinvigorating EU-Turkey bilateral trade: Upgrading the customs union*, Briefing, Brussels: EPRS, p. 2, [http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/599319/EPRS_BRI\(2017\)599319_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/599319/EPRS_BRI(2017)599319_EN.pdf) (accessed 23 Mar. 2018).

As part of the CU, Turkey has aligned its domestic legislation with the EU’s internal market rules on product standards.² In addition, to guarantee a level playing field, Turkey is required to implement EU rules on intellectual property rights and on merger control, and enforce EU rules on collusive and monopolistic practices and behaviour. Turkey was also obliged to create a State Aid Monitoring and Supervision Board to align the control of state aid with the EU framework (though at present the law is only partially enforced).³ State aid refers to any advantage granted by the EU and/or Turkish public authorities through state resources on a selective basis that could distort competition and trade between the EU and Turkey.

Ten design flaws in the CU

The CU was created to support the frictionless flow of industrial goods between Turkey and the EU. This arrangement has seen the volume of bilateral trade grow sevenfold during the last two decades. However, it has significant shortcomings that have become increasingly apparent over time:

1. **Limited scope:** The CU excludes services, right of establishment, public procurement and agriculture (except processed agricultural products). Its primary function is to remove tariffs on goods, but it does little to reduce or abolish non-tariff barriers (NTBs), which impede trade in services in particular.
2. **Limited influence:** Turkey is not involved in determining the EU’s Common External Tariff or its Common Commercial Policy – the EU’s trade policy with non-member countries and territories. All these decisions are made by the EU with little or no consideration of Turkey’s concerns and strategic interests.
3. **External asymmetry:** The EU’s FTAs with third countries do not automatically cover Turkey. Countries such as Algeria, Mexico and South Africa, which all have trade agreements with the EU, do not have the same incentive to negotiate an FTA with Turkey since the CU affords tariff-free access to the Turkish market via the EU. This asymmetrical relationship exposes Turkish manufacturers to external competition without the ability to compete on a reciprocal basis in third-country markets. In retaliation, Turkey has implemented origin controls on imports from the EU, particularly in sensitive sectors, to determine whether they originate from countries that have an FTA with the EU. Turkey has, for instance, introduced protection measures against Mexican cars.⁴
4. **Regulatory exclusion:** Given that the CU is not a ‘regulatory union’, Turkey remains outside the EU’s single market and its regulatory, institutional and judicial framework. The CU does not therefore abolish all technical barriers to trade, and many indirect costs remain for Turkish exporters. For example, the EU refused to accept Turkish conformity assessments – certificates issued by the manufacturer or an authorized body confirming that a product placed

² ‘Internal market’ and ‘single market’ are used interchangeably to denote the legal framework enabling the free movement of goods, services, capital and people across the EU, through harmonization of rules and the elimination of technical, legal and regulatory barriers to trade, also known as ‘non-tariff barriers’.

³ European Commission (2018), *Turkey 2018 Report*, SWD(2018) 153 final, Commission Staff Working Document, Strasbourg: European Commission, pp. 70–71, <https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-turkey-report.pdf> (accessed 24 Apr. 2018).

⁴ Çigdem, N. and Özer, Y. (2017), *Turkey and EU Integration: Achievements and Obstacles*, New York and Oxford: Routledge, p. 42.

The CU has seen the volume of bilateral trade grow sevenfold during the last two decades

Particular challenges emerge for products for which there is an EU-wide regulatory body, such as the European Medicines Agency and the European Chemicals Agency

on the market complies with all EU regulations. This meant that many goods from Turkey were subject to inspection as they crossed the border with Bulgaria and Greece. Over time, the EU has negotiated mutual recognition agreements with Turkey, enabling more Turkish goods to enter the EU market without inspection. However, the EU was empowered to reach such agreements only in areas where it has fully harmonized regulations across member states. Where rules are still set at the national level (covering 20 per cent of industrial products⁵), national customs authorities are still entitled to inspect Turkish goods.⁶ Turkey has responded by imposing customs and ‘rules of origin’ controls on woven fabrics and apparel that are ‘freely circulating in the EU contrary to the terms and spirit of the CU’.⁷

5. **Regulatory challenges:** Particular challenges emerge for products for which there is an EU-wide regulatory body, such as the European Medicines Agency and the European Chemicals Agency. Turkey faces NTBs, while EU member states transpose EU regulations for these two sectors into domestic law according to differential rules applying to each party. In addition, Turkish legislation does not permit mutual recognition – the principle of EU law under which a product legally sold in one member state can be sold in another member state – in the field of pharmaceutical products. There is no reciprocal recognition of ‘good manufacturing practice’ (GMP) certificates for the registration of pharmaceuticals to be sold in their respective markets.⁸ GMP prescribes the minimum standards that a pharmaceuticals manufacturer must satisfy in the production process.
6. **Transport problems:** While the free movement of goods is a cornerstone of the CU, the transport underpinning that movement is not. Consequently, the 60,000 Turkish-registered goods vehicles that enter the EU each year at the Greek and Bulgarian borders face administrative hurdles. They must submit a range of documents to relevant authorities, from product invoices and export declarations to insurance certificates and transport permits for each member state through which they transit.⁹ This means that truck queues can be up to 17 kilometres long at the Bulgarian–Turkish border, and crossing can take up to 30 hours.¹⁰

In many cases there are also quota limits on the number of transport permits that may be issued to Turkish trucks and lorries by an EU member state, with demand exceeding the number of permits available. Turkish exporters had to bear

⁵ World Bank (2014), *Evaluation of the EU-Turkey Customs Union*, Report No. 85830-TR, Washington DC: World Bank, p. 37, <http://documents.worldbank.org/curated/en/298151468308967367/pdf/858300ESWOP1440disclosed090260140TR.pdf> (accessed 22 Mar. 2018).

⁶ House of Lords European Union Committee (2016), *5th Report of session 2016-17: Brexit: the options for trade*, London: House of Lords, <https://publications.parliament.uk/pa/ld201617/ldselect/ldeucom/72/72.pdf> (accessed 14 Mar. 2018).

⁷ Ibid.

⁸ World Bank (2014), *Evaluation of the EU-Turkey Customs Union*, p. 36.

⁹ Bogdanor, V. (2018), ‘A customs union won’t help: there is no such thing as a “soft” Brexit’, *Guardian*, 27 February 2018, <https://www.theguardian.com/commentisfree/2018/feb/27/customs-union-brexit-european-union-eu-turkey> (accessed 22 Mar. 2018).

¹⁰ Srivastava, M. and Barker, A. (2017), ‘Turkey border gridlock hints at pain to come to Brexit Britain’, *Financial Times*, <https://www.ft.com/content/b4458652-f42d-11e6-8758-6876151821a6>, 16 February 2017 (accessed 22 Mar. 2018).

transportation costs of \$10.6 billion between 2005 and 2012. It is estimated that liberalization of transportation could add €3.5 billion in bilateral trade volumes.¹¹

However, thus far the EU has reserved open-access road transport deals exclusively for countries that accept free movement of people. Since the EU will not extend free movement to Turkish citizens, Turkish hauliers will continue to face restrictions on their entry into and mobility within the EU.

7. **Lingering disputes:** Bilateral trade disputes between the EU and Turkey tend to fester, in large part owing to the absence of an effective dispute settlement mechanism (DSM) to resolve them. While the CU's DSM is limited to 'safeguard measures' – a policy to restrict an import temporarily to protect a specific industry – the AA's DSM is much wider in scope, but it can only be triggered by mutual consent.
8. **Partial implementation:** Under the terms of the CU, Turkey is not required to transpose the relevant parts of the EU's *acquis communautaire* (its body of rules and regulations) into domestic law. For example, it has not adopted all EU legislation pertaining to motor vehicles. In addition, the Turkish government does not cooperate fully with the European Commission in the monitoring of its compliance with the relevant part of the *acquis*. This is partly due to the ineffective notification obligations to inform Turkey on draft technical legislation.¹²
9. **Trading blows:** Turkey and the EU have resorted frequently to 'trade defence instruments' (TDIs), such as anti-dumping measures, thereby threatening trade between them.¹³ Anti-dumping regulation is a protectionist tariff imposed on foreign imports that allegedly sell below the 'normal' value (usually the sales price) in their own domestic market. TDIs undermine the rules-based trading regime between the EU and Turkey even though the CU requires the latter's alignment with the EU's procedures for safeguard measures, countervailing duties and anti-dumping, surveillance, as well as for managing numerical quotas and officially supported export credits.¹⁴
10. **Visa barriers:** The ability of Turkish businesses to promote commercial activities in the EU is hindered by restrictive visa policies. Turkish hauliers face the same challenge of acquiring the necessary visas before entering and crossing the EU.

¹¹ Karataş, I. (2016), *The EU-Turkey Customs Union: Towards a Revision of the Legal and Institutional Framework?*, Ghent University, p. 52, <https://lib.ugent.be/en/catalog/rug01:002304294> (accessed 17 Jul. 2018).

¹² World Bank (2014), *Evaluation of the EU-Turkey Customs Union*, pp. 36–37.

¹³ Directorate-General for External Policies (2016), 'Bringing EU-Turkey trade and investment up to date?', Workshop, Brussels: European Parliament, p. 18, <http://www.europarl.europa.eu/committees/en/inta/events-workshops.html?id=20160317CHE00051> (accessed 23 Mar. 2018).

¹⁴ *Ibid.* p. 18.

Contours of the EU offer on CU revision

Given these shortcomings, the Turkish government and the European Commission recognize the need to modernize the CU, and they have considered two options to achieve this purpose:

- **Replacing the CU for industrial goods with a new Deep and Comprehensive Free Trade Area (DCFTA).** This would replace the CU with full liberalization of trade in industrial goods and preferential access in non-goods areas; or
- **Modernizing and improving the current CU,** extending it to cover services, right of establishment, public procurement and agriculture (i.e. CU plus non-goods FTA).

On 12 May 2015, EU Trade Commissioner Cecilia Malmström and then Turkish Economy Minister Nihat Zeybekçi committed themselves to the second approach, focusing on upgrading the current CU.¹⁵

It is unclear to what extent the EU is willing to liberalize services, right of establishment, public procurement and agriculture, and under what conditions. Nevertheless, there are strong hints that the eventual EU offer on further liberalization will be partial and measured. The European Commission’s roadmap for updating the CU states that the upgrade will be ‘in line with current ambitious liberalization efforts of the EU with third countries, such as on services, public procurement, agricultural trade and SPS (sanitary and phytosanitary) measures, and other economic areas’.¹⁶ However, in the view of French President Emmanuel Macron, this will ‘not allow full access to the EU single market’.¹⁷

Thus far, the EU has granted the most ambitious terms on services and public procurement to the European Economic Area (EEA) countries – Norway, Iceland and Liechtenstein – and to Ukraine as part of its Association Agreement. The EEA agreement guarantees the free movement of goods, services, capital and, crucially, people, and therefore cannot be a model for the EU’s relations with Turkey. That leaves the Association Agreement with Ukraine, which entered into full force in 2017, as the most relevant model. It includes the most far-reaching provisions outside the EU and EEA. Although outside of the EU CU, it provides a useful guide on the possible future EU proposition to Turkey, in three areas in particular: services, access to public procurement markets, and the right of establishment.

Opening up services: the Ukraine DCFTA

In theory, the EU–Ukraine DCFTA offers internal market treatment in four key service sectors only – postal and courier services, electronic communications (e.g. telecommunications and digital), financial services and international maritime transport – subject to two conditions.

¹⁵ European Parliamentary Research Service (2017), *Reinvigorating EU-Turkey bilateral trade*, pp. 7–8.

¹⁶ European Commission (2015), *Enhancement of the EU-Turkey bilateral trade relations and the modernisation of the EU-Turkey Customs Union*, Inception Impact Assessment, Brussels: European Commission, pp. 2–3, http://ec.europa.eu/smart-regulation/roadmaps/docs/2015_trade_035_turkey_en.pdf (accessed 3 Apr. 2018).

¹⁷ Reuters (2018), ‘Macron says that UK–EU customs union would not offer full access to the EU single market’, 2 February 2018, <https://www.reuters.com/article/uk-britain-eu-macron/macron-says-uk-eu-customs-union-would-not-offer-full-access-to-single-market-idUSKCN1GB17Q> (accessed 3 Apr. 2018).

First, Ukraine must ‘dynamically’ incorporate the relevant parts of the current and future EU *acquis* into domestic law, a process that must be certified by the EU–Ukraine Trade Committee, which is composed of senior officials from both parties.

Second, where there is a dispute on alignment (known as ‘approximation’ in EU parlance) with European regulations, or on an interpretation of EU law, the arbitration panel that oversees the agreement must request adjudication by the Court of Justice of the European Union (CJEU), whose rulings are legally binding (a process known as a ‘preliminary reference’).

Despite the onerous obligations on Ukraine, the level of access to these four liberalized services markets is precarious. For example, the EU and some member states have put in place 46 restrictions on Ukrainian access to EU financial markets because the joint Trade Committee has not certified sufficient progress on regulatory harmonization. Moreover, the EU can unilaterally withdraw market access if it is deemed to threaten the ‘integrity and stability’ of its system.¹⁸

Access to public procurement markets

Ukraine and the EU will enjoy full participation in each other’s public procurement markets – referring to the acquisition of goods, services and infrastructure by a state authority – once Ukraine implements the relevant parts of the EU *acquis* in the future and subject to the jurisprudence of the CJEU in the event of a dispute being brought before the arbitration panel.¹⁹

Right of establishment

Establishment refers to the legal entitlement for either enterprises (‘legal persons’) or individuals (‘natural persons’) to pursue commercial activities in another country. An enterprise can exercise this right by setting up or acquiring branches or representative offices, while an individual can do so as a sole proprietor or via a partnership or company.²⁰

The EU views liberalizing the right of establishment as a necessary component of unshackling the trade in services, particularly in sectors in which trade and investment are increasingly inseparable.

Again, the Ukraine agreement presents a useful example. It provides for ‘national treatment’ and ‘most favoured nation’ (MFN) treatment for establishment. This means that one party must accord the other party’s ‘established’ enterprises treatment no less favourable than that accorded to its own ‘established’ enterprises or to any third-country ‘established’ enterprises, whichever is the better.²¹

¹⁸ Oppenheim, B. (2018), *The Ukraine model for Brexit: is dissociation just like association?*, London: Centre for European Reform, <https://www.cer.eu/insights/ukraine-model-brexite-dissociation-just-association/> (accessed 9 Apr. 2018).

¹⁹ Szyszczak, E. (2017), *A UK Brexit Transition: To the Ukraine Model?*, Briefing Paper 11 (Falmer, Sussex and London: University of Sussex Trade Policy Observatory and Chatham House), p. 6, <http://blogs.sussex.ac.uk/uktpo/files/2017/11/Briefing-Paper-11.pdf> (accessed 20 Apr. 2018).

²⁰ Emerson, M. and Movchan, V. (eds) (2016), *Deepening EU-Ukrainian Relations: What, why and how?*, Centre for European Policy Studies (CEPS), Brussels and Institute for Economic Research and Policy Consulting (IER), Kyiv, London: Rowman & Littlefield International, p. 78, <https://www.ceps.eu/system/files/Ukraine%20e-version%20with%20covers.pdf> (accessed 16 Apr. 2018).

²¹ *Ibid.* p. 78.

In theory, the EU–Ukraine DCFTA offers internal market treatment in four key service sectors only – postal and courier services, electronic communications, financial services and international maritime transport

Ukraine and the EU have circumscribed the applicability of the twin principles by creating a ‘negative’ list of reservations. As a result, any service sectors not ‘reserved’ by either party will be open to external competition. Ukraine identified 24 service-sector reservations; the EU opted for 105 reservations Union-wide and at member-state level.²²

Negotiating an upgrade to the CU

Negotiating an upgrade to the CU presents a number of challenges. Seven areas are worth highlighting in particular: compliance and implementation, trade policy influence, FTA asymmetry, transportation, agriculture, dispute settlement and visa liberalization.

1. **Compliance and implementation:** The EU will demand the introduction of mechanisms and procedures to improve the European Commission’s screening of Turkish legislative compliance with the EU *acquis*, and require Turkey to implement changes in the relevant EU rules and regulations. It will push for deadlines on the notification of Turkish legislative measures to the Commission, the requirement to translate from Turkish, and the creation of a committee composed of Turkish and Commission officials to check its compatibility with the *acquis*.
2. **Trade policy influence:** The Commission has noted Turkey’s dissatisfaction with its lack of influence in EU trade policy formulation, although it has suggested only modest proposals to address this, including ‘better consideration [of Turkey] ... in consultative mechanisms, and participation in the work of some of the committees/groups related to the CU functioning’. For its part, it firmly demands that a DSM ‘should’ as opposed to ‘could’ be established, a key EU objective.²³
3. **Rebalancing FTA asymmetry:** The Commission understands the importance of ending the asymmetrical application of its FTAs to Turkey.²⁴ A potential solution is for the EU to insist that the third country grant equivalent access to Turkish products until an FTA is negotiated with that country. Alternatively, the EU could calibrate implementation with the entry into force of a parallel FTA with Turkey.
4. **Transportation and transit:** The EU will not eliminate the bureaucratic procedures faced by Turkish hauliers at the border with Bulgaria and Greece, since this privilege is linked to the free movement of people. The EU is not ready to grant Turkish citizens the right to free movement, which means Turkish drivers will continue to face border delays. However, the EU may consider mechanisms and procedures to improve dialogue and coordination with the Commission and member states’ customs officials to facilitate the transportation of goods at the border and throughout the EU. Concerning internal restrictions in the form of motor vehicle taxes and transportation quotas/transit permits, the CJEU’s groundbreaking ruling in the 2017 ‘Istanbul Logisitk Limited vs. Hungarian Administrative Authorities’ case may lead to their eventual elimination.

²² Ibid. p. 81.

²³ European Commission (2015), *Enhancement of the EU-Turkey bilateral trade relations and the modernisation of the EU-Turkey Customs Union*, pp. 2–3, <https://www.avrupa.info.tr/en/customs-union-modernisation-54> (accessed 3 Apr. 2018).

²⁴ European Parliamentary Research Service (2017), *Reinvigorating EU-Turkey bilateral trade*, p. 7.

In that case, the CJEU confirmed that:

[T]he interpretation of the provisions of the TFEU [i.e. Treaty on the Functioning of the European Union] in respect of the free movement of goods within the European Union may be transposed to the provisions concerning the free movement of goods within the Customs Union stemming from the EEC–Turkey Agreement.

Accordingly, it ruled that a tax or pecuniary charge on motor vehicles, which must be paid by operators of Turkish-registered heavy goods vehicles in transit through Hungarian territory, constitutes a charge having the equivalent effect of a customs duty. It rejected the argument that this tax concerned the cross-border road haulage services, which are under the jurisdiction of the member states, by observing that the service is linked to the product.²⁵

This judgment established that the principle of the free movement of goods laid out in the CU must be interpreted in accordance with the CJEU's precedents and jurisprudence related to free movement of goods in the EU treaties, which prohibits measures that undermine the movement of goods in transit. It lays the foundation for a legal challenge against EU member states for imposing transit permits on Turkish hauliers for breaching the prohibition on quantitative restrictions and equivalent measures. While this judgment is supportive of the Turkish position, it also shows the difficulties and legal steps Turkey needs to take in order to prevent restrictive practices.

There is recognition in Turkey that agriculture will be the most challenging sector in the CU upgrade negotiations

5. **Agriculture:** There is recognition in Turkey that agriculture will be the most challenging sector in the CU upgrade negotiations.²⁶ Through the Common Agricultural Policy (CAP), the EU provides extensive agriculture subsidies to producers, and has been historically unwilling to open up domestic agriculture markets. Unsurprisingly, it imposes strict time limits and quotas on tariff-free access as well as tariff quotas on fruit, vegetables and dairy produce from Turkey.²⁷

However, the bigger obstacle is Turkey's own protectionist stance on agricultural trade, which will limit the scope for liberalization. As the European Commission asserts, the extension of the CU:

to all goods including agricultural products ... would mean that, in addition to abolition of tariffs in bilateral trade in agriculture, Turkey would also have to assume the EU's common external tariffs in this sector. This would entail a significant fall in Turkey's import protection: Turkey's average customs tariff for agricultural products is 41.7%, while that of the EU is 13.9%. World Bank evaluation concluded that this could be hardly absorbed by Turkey's agricultural sector without a reform of its agricultural policy.²⁸

²⁵ CJEU (2017), *Case C-65/16: Istanbul Lojistik Ltd v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatóság*, Judgment of the Court of Justice of the European Union (Second Chamber) of 17 October 2017, para. 44, <http://curia.europa.eu/juris/liste.jsf?language=en&jur=C,T,F&num=C%20-%2065%20/16&td=ALL> (accessed 11 Apr. 2018).

²⁶ *Hurriyet Daily News* (2016), 'Update in customs union deal to transform Turkey's agricultural sector: Minister', 15 January 2017, <http://www.hurriyetdailynews.com/update-in-customs-union-deal-to-transform-turkeys-agricultural-sector-minister-108548> (accessed 24 Apr. 2018).

²⁷ Turkey and the EU enjoy some limited reciprocal preferential arrangements on agricultural products under Decision 1/98 of the EC-Turkey Association Council 1998. See, European Union (1998), Decision No 1/98 of the EC-Turkey Association Council of 25 February 1998 on the trade regime for agricultural products, <https://publications.europa.eu/en/publication-detail/-/publication/ce879541-5055-43da-b1d8-e885e9c8104a> (accessed 11 Dec. 2018).

²⁸ European Commission (2016), *Impact Assessment: Recommendation for a Council Decision authorizing the opening of negotiations with Turkey on an Agreement on the extension of the scope of the bilateral trade relationship and on the modernization of the Custom Union*, SWD(2016) 476 final, Brussels: European Commission, http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2016/swd_2016_0475_en.pdf (accessed 10 Apr. 2018).

Beyond agricultural tariffs lies the contentious matter of SPS measures to protect humans, animals and plants from diseases, pests or contaminants and ensure consumer safety. Agreeing the SPS measures will be difficult, particularly on the Turkish side, though it will also be critical to boosting the bilateral trade in agricultural products and to limiting health and plant inspections by customs authorities at borders and ports of entry.

6. **Dispute settlement mechanism:** It is reasonable to assume that the EU will also insist on a DSM modelled on the DCFTA with Ukraine, which is a streamlined version of the WTO’s ‘dispute settlement understanding’. If consultation between the parties does not end the dispute, a three-person expert arbitration panel selected by the parties or by lot from an agreed list will issue a ruling within four months. It will be binding on the party in breach and, in the event of partial or non-compliance, the complainant is allowed to impose proportionate sanctions.

This panel must refer an ambiguity pertaining to EU law to the CJEU in the field of trade in services and public procurement, SPS measures, technical barriers to trade, customs and trade facilitation, right of establishment, competition policy or any provision in the agreement that imposes upon a party an obligation defined by EU rules and regulations. The EU is also likely to propose that the CJEU preliminary reference procedure should include the EU *acquis* on the CU, competition law and state aid.

7. **Visa liberalization for Turkish citizens:** Turkey and the EU have isolated visa liberalization for Turkish citizens to the Schengen borderless zone into a separate track from the CU revamp. On 16 March 2016, as part of the deal to curb migration into mainland Europe, the EU and Turkey agreed that:

the fulfilment of the visa liberalization roadmap will be accelerated vis-à-vis all participating member states with a view to lifting the visa requirements for Turkish citizens at the latest by the end of June 2016, provided that all [72] benchmarks have been met.²⁹

Turkey has, according to the European Commission, fulfilled 65 out of the 72 criteria to qualify for visa-free travel to the EU. Seven still await fulfillment: anti-corruption measures, cooperation in criminal matters with EU member states, a cooperation agreement with the EU law enforcement agency Europol, further efforts on data protection and an overhaul of Turkish anti-terror laws.³⁰ Turkey’s failure to meet the last condition is proving the most intractable. President Erdoğan is unwilling to fundamentally reform anti-terror laws, particularly after the 15 July 2016 botched coup attempt.³¹

Yet the unresolved issue of visa-free travel does not preclude the EU agreeing to discuss streamlining visa procedures for Turkish businessmen and hauliers, and

²⁹ European Council of the European Union (2016), ‘EU-Turkey Statement’, <http://www.consilium.europa.eu/en/press/press-releases/2016/03/18/eu-turkey-statement/> (accessed 10 Apr. 2018).

³⁰ European Commission (2016), *Turkey’s Progress on Visa Liberalisation Roadmap*, Brussels: European Commission, https://ec.europa.eu/home-affairs/sites/homeaffairs/files/what-we-do/policies/european-agenda-migration/background-information/docs/20160504/turkey_progress_visa_liberalisation_roadmap_en.pdf (accessed 10 Apr. 2018).

³¹ Gotev, G. (2018), ‘Turkey to press for visa-free travel at Varna summit’, EURACTIV, 9 February 2018, <https://www.euractiv.com/section/global-europe/news/turkey-to-press-for-visa-free-travel-at-varna-summit/> (accessed 10 Apr. 2018).

perhaps for academics and students, and easing the movement of Turkish citizens who supply a service within the EU or who work for a service supplier present in an EU member state.³²

The politics of CU modernization

Both the EU and Turkey have recognized the value of modernizing the CU. To that end, the European Commission asked the European Council for a mandate to launch talks with Turkey on 23 December 2016. However, the litany of recent political disputes has undermined the bilateral relationship. The Turkish government was surprised and frustrated by the EU's hesitant response to the failed coup on 15 July 2016 and its perceived dismissal of Turkey's claim that the movement led by Fethullah Gülen – the Pennsylvania-based reclusive Islamic cleric – played a significant role in that plot. In turn, the EU has criticized the post-coup clampdown that has seen thousands of arrests and further restrictions on Turkey's media. Many leaders in the EU countries are also concerned about constitutional change in Turkey, with the introduction of a powerful executive presidency enabling President Erdoğan to promulgate laws by presidential decree. It is in this context that Germany has blocked the opening of talks on the CU, with little opposition from other member states, and has also opposed the criminal prosecution of German citizens on alleged terror charges in Turkey.

The Turkish government was surprised and frustrated by the EU's hesitant response to the failed coup on 15 July 2016

More broadly, the political climate in both the EU and Turkey is not conducive to the CU agenda. In Europe, the growth of radical right-wing populist parties that are hostile to immigration is encouraging anti-Turkey sentiment among traditional centre-left and centre-right parties. German Chancellor Angela Merkel has blocked the CU upgrade, in part, because of domestic opposition and in response to the rise of the far-right party Alternative for Germany (AfD).

At the same time, the requirements that CU modernization would place on the Turkish government clash with aspects of its domestic agenda. Erdoğan is prioritizing short-term economic growth and consolidation of domestic political power. The Turkish government therefore has little desire to liberalize its public procurement markets, where the practice of awarding infrastructure and construction projects to politically favoured companies is widespread.³³

For instance, Turkey will not want its Housing Development Administration (TOKI), which undertakes or supports urban regeneration and social housing projects, to be subject to strict EU rules on transparency and competition. This agency's revenue-sharing model between its commercial arm, Emlak Konut, and private Turkish contactors lacks transparency and is shielded from scrutiny.³⁴

³² Alan, U. (2017), *The Modernization of Turkey's Customs Union with the European Union: Reasons and Possible Outcomes*, Brugge and Natolin: College of Europe, p. 16, https://www.coleurope.eu/system/files_force/research-paper/edp-9-2017_alkan.pdf?download=1 (accessed 11 Apr. 2018).

³³ Gürakar, E. and Meyersson, E. (2016), *State Discretion, Political Connections and Public Procurement: Evidence from Turkey*, <https://drive.google.com/file/d/0BxGIkxI0T-q7SzRLSDNaVjZhYk0/view> (accessed 26 Mar. 2018).

³⁴ Dombey, D. (2014), 'Turkey probe underlines links between construction and politics', *Financial Times*, 1 January 2014, <https://www.ft.com/content/ef8b4e0e-72d5-11e3-b05b-00144feabdc0> (accessed 10 Apr. 2018).

Alternative approach to CU modernization

Considering the fractious EU–Turkey relationship, the two partners should consider a different negotiating strategy to bypass the current stalemate over the upgrade of the CU.

A new strategy would replace the existing comprehensive approach to amending the CU with a three-pronged process, as proposed below. In the first instance, the EU and Turkey should begin negotiations by concentrating on a limited number of key objectives to improve the operation of the CU, in order to focus energy and prioritize, rather than attempting to deal with all aspects simultaneously.

A new negotiating strategy would replace the existing comprehensive approach to amending the CU with a three-pronged process

The EU's key objective is the creation of a robust DSM, which can press Turkey to implement the relevant new *acquis* conditions and boost cooperation on European Commission screening of Turkish legislation. Turkey's priorities are guaranteeing the applicability of EU FTAs, enhancing its consultative role in setting EU trade policy, and better coordination between EU and Turkish customs officials at the borders with Bulgaria and Greece. These issues should form the basis of the initial phase of negotiations.

Second, both parties should agree in the legal text of the CU agreement the objectives of progressively liberalizing services, right of establishment, public procurement and agriculture to create the framework for agreeing sectoral deals over the course of time.

Third, the two stages should be decoupled from each other to differentiate this method from the present comprehensive approach to reforming the CU.

As part of this new strategy, the EU should consider bolder and more ambitious end-goals on services, right of establishment, public procurement and agriculture than those in the DCFTA with Ukraine or any other FTA. This would entail, for instance, going beyond the selective approach in extending the CU to services; liberalization should not only cover certain services regulated by EU legislative instruments.³⁵ In practice, the EU should include those governed primarily by domestic law, such as legal and accounting services, where EU law permits the mutual recognition of professional qualifications between the EU member states. This would serve to raise ambitions for the long term, but not create insurmountable challenges in the short term.

Such an alternative strategy, although more gradual and open-ended, has the potential to overcome the current deadlock in negotiations. It could also enable sector-by-sector arrangements to be reached as more favourable circumstances develop in the future. At the same time, it indirectly improves Turkey's long-term EU accession prospects by integrating Turkey more tightly into the EU single market and forcing the country to implement the bulk of the EU *acquis*.

Turkey is not a typical third country. After all, it is officially a candidate for EU accession, however remote the prospects may be at present; it has been in a one-sided CU for longer than two decades; it has been a NATO member since 1952; it remains central to managing the flow of migrants and refugees to Europe; and it acts as

³⁵ Alkan U. (2017), *The Modernization of Turkey's Customs Union with the European Union: Reasons and Possible Outcomes*, p. 16.

a strategic buffer between Europe and the Middle East, the Caucasus and Central Asia. Also, there are significant Turkish diasporas residing in several European countries, notably in Austria, Germany and the Netherlands.

Importantly, Turkey’s cooperation is critical to European stability and security, as was vividly demonstrated by the 2015 Syrian migration crisis. Given that the EU is not currently able to offer a credible accession perspective, anchoring Turkey’s economy in Europe is the best tool available to influence the country towards greater democracy, human rights and a rule-based liberal market economy.

Salutary lessons for Brexit

There has been an active debate in the UK about its customs relationship with the European Union after Brexit. This has become particularly acute given the commitments made by the UK and EU to avoid a hard border in Ireland, the UK government’s insistence on avoiding any trade barriers within the UK, and the ambitious hopes for an independent UK trade policy in the future. The draft withdrawal agreement reached between UK and EU negotiators maintains the UK’s position inside the EU customs union during transition, and, in the Northern Ireland backstop protocol (the arrangements which will come into effect at the expiry of the transition period if a further agreement has not been reached), commits the UK to maintaining a single customs territory with the EU indefinitely, until an alternative arrangement is found. To square this circle, the UK has proposed a complex ‘facilitated customs partnership’ in which the UK would collect EU tariffs on goods that pass through the UK but are intended for the EU, while potentially operating different tariff rates on goods destined for the UK market, with any difference claimed back by UK importers – although the EU has rejected this proposal. The UK Labour Party, meanwhile, supports a new CU between the UK and the EU.

Turkey’s experience with the CU and its stalled modernization provides some important lessons for the UK’s departure from the EU.

First, the Turkish experience has demonstrated how the EU actively guards its institutional and legislative sovereignty, as well as its decision-making autonomy. Turkey has had to endure asymmetries regarding the non-application of some EU FTAs. The UK could face similar difficulties.

The Turkish government is frustrated by its limited influence over the EU’s trade policy. The perception in Ankara is that, in spite of the CU, Turkish economic interests are ignored when the EU negotiates FTAs with third countries. The European Commission is concerned with promoting advantages for the member states. If Britain remains in a CU after Brexit, it would fall into the same category as Turkey: an ‘associated state’. There may be space for creating new consultative mechanisms to give the UK a greater voice, but its direct influence will remain limited. The EU Commission will recognize that privileges or concessions made to the UK in any future relationship would create a demand for comparative treatment of Turkey in any upgraded CU. Furthermore, this makes it less likely that the EU will offer the UK mechanisms to influence the direction of EU trade policy as a non-member.

Turkey’s experience with the CU and its stalled modernization provides some important lessons for the UK’s departure from the EU

Second, the benefits of a CU alone in resolving border challenges are sometimes overstated. The EU–Turkey CU does not eliminate all requirements for border checks and non-tariff barriers, and a UK–EU CU would similarly not obviate the need for border checks on the island of Ireland. While the CU eliminates the need for rules of origin, regulatory barriers would remain. Turkish hauliers, as noted above, face long queues and onerous procedures at the Greek and Bulgarian borders. By comparison, the current UK rail and port crossings to France and Belgium are seamless for people and goods, a situation that could not be maintained if the UK exits the EU single market while remaining within the EU’s CU.

Third, Turkey’s experience illustrates that the UK government’s rejection of any form of CJEU jurisdiction may be a mistake. Turkey has found that the European Court has been an ally in knocking down barriers to trade, as shown by the Hungarian case described above: by interpreting the CU objective as seeking free movement of goods, it essentially treated Turkey as an EU member state for the purpose of trade in goods and struck down the motor vehicle tax levied by Hungary.

Fourth, this Hungarian case, although a positive development for Turkey, also indicates the limitation of relying on the CJEU to knock down trade barriers erected by the EU and/or member states. It is a piecemeal approach requiring legal action in a domestic court of the relevant member state; litigation could take several years while not preventing any member state from imposing similar obstacles to trade in the future. For example, an EU member state could, foreseeably, impose a tax on Turkish trucks crossing its territory on the grounds of environmental protection. Any attempt to challenge this measure would necessitate launching legal action in that member state’s courts, which will be expensive and time-consuming.

Fifth, if the UK government negotiates a simple FTA with the EU, or the limited UK–EU CU stipulated by the Irish backstop in the Withdrawal Agreement takes effect, the Hungarian case demonstrates that EU member states will be at liberty to impose all kinds of restrictions on UK road haulage services transporting UK exports to the EU. Given that neither free trade nor the limited UK–EU CU in the Withdrawal Agreement mean the free circulation of goods, the CJEU will likely view motor vehicle taxes, transit permits and any other pecuniary charge or quantitative measure imposed by an EU member state on UK lorries and trucks as lawful under the FTA and limited CU.

Sixth, politics and bureaucracy can get in the way of reform. The Turkish government is frustrated at the slow pace of the process to upgrade the CU and the ability of any EU member state to block the process. The UK is discovering, like Turkey, that the EU bureaucratic machinery moves methodically and laboriously and is rarely insulated from politics and diplomatic pressures.

The UK would be well-advised to avoid replicating the Turkey model, and if it is to pursue a CU in some form, to aim for a closer and more intimate economic relationship with the EU than that offered by even an upgraded Turkey-style CU.

Conclusion

The EU–Turkey CU needs modernization but, despite recognition of this on both sides, political disputes have stunted progress and brought it to a standstill. Neither party seems willing to broaden and deepen the bilateral economic relationship by bringing the current CU arrangement up to date.

The stalemate suggests the need for a new strategy that is more gradual and open-ended to bypass the existing logjam

The stalemate suggests the need for a new strategy that is more gradual and open-ended to bypass the existing logjam. It is possible to make progress by focusing negotiations on a narrow set of core areas and separately setting longer-term ambitions and goals.

For the UK, the Turkish experience with the EU shows the shortcomings of a CU. While it would eliminate the need for complex rules of origin, it would still mean long queues for trucks and lorries at the border, no say in EU trade deals with non-EU countries, obligation to adopt EU rules and regulations, asymmetrical market access, and the inability to adequately challenge unlawful restrictions introduced by EU member states on UK exports.

About the author

Fadi Hakura is a consulting fellow in the Europe Programme at Chatham House where he manages the Turkey Project. Before joining Chatham House in 2005, he qualified as a solicitor in the City of London. Prior to this he completed an internship at the European Commission and worked in the World Bank's office in Brussels.

He regularly comments on Turkish affairs and has given interviews to several international media organizations, including Al-Jazeera, BBC, Bloomberg, CNBC, CNN, *Daily Telegraph*, *Financial Times*, *Guardian* and Reuters.

Chatham House, the Royal Institute of International Affairs, is a world-leading policy institute based in London. Our mission is to help governments and societies build a sustainably secure, prosperous and just world.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical including photocopying, recording or any information storage or retrieval system, without the prior written permission of the copyright holder. Please direct all enquiries to the publishers.

Chatham House does not express opinions of its own. The opinions expressed in this publication are the responsibility of the author(s).

Copyright © The Royal Institute of International Affairs, 2018

Cover image: A container ship passes under the Fatih Sultan Mehmet Bridge while navigating the Bosphorus Straits. Istanbul, Turkey, 8 August 2018.

Copyright © Diego Cupolo/NurPhoto/Getty Images

ISBN 978 1 78413 305 4

Typeset by Soapbox, www.soapbox.co.uk

This publication is printed on recycled paper.