

The Customs Union Between Turkey and the European Union: An Alternative to EU Membership?

By Selim Kunalp

Turkey applied to join the European Economic Community on 31 July 1959, barely a year after the Treaty of Rome creating the Community had entered into force. The decision to apply was taken exclusively for political reasons. Relations with Greece had deteriorated sharply after the first of many crises erupted in the Crown Colony of Cyprus when the UK made it clear that it was going to vacate the island as part of the gradual demise of the British Empire. Greece had applied to join the Community in June 1959. It was therefore important for the then leaders of the Turkish Republic to do the same so as not to be left behind.

The response of the Community to both countries was that they were not ready for membership because their economies were at a much lower level of development than that of the six original members of the Community. They each signed Association Agreements with the Community, Greece in June 1961 in Athens, Turkey on 12 September 1963 in Ankara.

Both agreements followed a similar pattern. Each country was offered a process of gradual economic integration which would prepare it for a customs union that would be completed at an originally unspecified date and that would serve as a stepping stone to full membership of the Community.

One cannot stress too emphatically that economic integration and a customs union were not ends in themselves but merely instruments to prepare the two countries for full membership of the Community. This objective was in the case of Turkey recognized in the Preamble to the Association Agreement which states as follows:

“Recognizing that the support given by the European Economic Community.... will facilitate the accession of Turkey to the Community at a later date;¹

Article 28 of the same Agreement states further as follows:

“As soon as s the operation of this Agreement has advanced far enough to justify envisaging full acceptance by Turkey of the obligations arising out of the Treaty

¹ Underlining by the author

establishing the Community, the Contracting Parties shall examine the possibility of the accession of Turkey to the Community.²

The Association Agreement was essentially a non-binding declaration of intention which called on the parties to do some unspecified ground work to prepare Turkey for the establishment of a customs union. The agreement was accompanied by financial assistance protocols under which grant aid was allocated to Turkey to help raise its level of development.

This process of preparation was expected to be followed at the end of a five-year period by the next phase, called the transitional stage, during which Turkey and the Community were to establish a Customs Union between them.

It is important to note that as a non-member, Turkey was not expected to join the Customs Union that the member states of the Community were gradually establishing among themselves at the same time but instead to create with the Community a separate one whose basic principles, such as a common external tariff and the elimination of tariffs and non-tariff measures were identical in theory but somewhat different in practice.

Soon after the end of the preparatory phase, an Additional Protocol to the Association Agreement was concluded on 23 November 1970. The Additional Protocol set out a detailed programme of work which would have to be followed throughout the transitional period that would follow the preparatory phase and culminate in the final phase of the Association, namely the completion of the Customs Union between Turkey and the European Communities. It contained detailed provisions for the gradual elimination of tariffs between the two parties and the adoption by Turkey of the Common Customs Tariff of the Communities. Because of the continued disparity in the levels of development between the two sides, the transitional period was envisaged to last twenty-two years from the date of the entry into force of the Protocol, that is after it had been ratified by both parties. This occurred on 1 January 1973 which meant that the two sides had until 1 January 1995 to complete the Customs Union. However, because of the asymmetric nature of the association, the Communities undertook to fulfil their side of the deal almost immediately, that is on 1 January 1971 and eliminate import tariffs on products covered by the Protocol, namely industrial products.

As the Customs Union was not an end in itself but a means of preparing Turkey for full membership of the Communities, the Protocol also contained provisions dealing with agriculture, movement of persons and services, right of establishment, alignment of economic policies, particularly competition, taxation and commercial policy. Generally speaking these provisions envisaged a standstill in policies which meant that

² Underlining by the author

neither side would in its relations with the other raise obstacles that had not existed at the time of the entry into force of the Protocol. There were also provisions for coordinating efforts to align Turkish legislation and practice in the areas covered, with those of the Communities. The main idea was that for the Customs Union to function properly, it had to be accompanied by measures that would ensure a level playing field between the two sides.

The Protocol was accompanied by commitments to continue providing regular material assistance in the form of financial protocols of which there were four in the end

The standstill commitment on movement of persons and the right of establishment was particularly valuable for Turkey which at that time was supplying large numbers of workers to member states of the Communities, chiefly Germany but also France, Belgium and the Netherlands. This particular provision has proved to be a serious bone of contention between Turkey and its Community partners as soon after the entry into force of the Protocol, Germany followed by other member states rapidly started to introduce restrictions on movements of labour, as a result of the economic recession that followed the oil shock of 1973.

The Additional Protocol with its concrete schedule aimed at gradually laying the ground for the establishment of a customs union between the two parties was a highly contentious issue in Turkey, right from the beginning. The conventional wisdom at the time was that Turkey's industrialization could only take place behind very high protective barriers and that Turkish industry should aim at meeting the needs of the domestic market without being too concerned about exports. In other words, the economic development strategy was based on import substitution.

The result of this approach was that on the eve of the signature of the Protocol, the government substantially raised the level of the Turkish tariff which meant that the threshold from which the gradual reductions would take place would be much higher than had been envisaged when the Protocol was being negotiated. Only a few months after the signature of the Protocol and even before it had been ratified, the government that had replaced the one that had signed the Protocol sent its Foreign minister to the Community capitals to ask for a revision of the Protocol.

Despite the profound unpopularity of the Protocol and the Customs Union that was its ultimate objective, the first few tariff reductions were implemented. However, they were soon frozen allegedly as a result of the oil crisis of 1973 which badly affected Turkey, a country that relies almost entirely on imports for its consumption of oil. Soon afterwards, the reductions were reversed so that by 1975 the Turkish tariff was back at the level that it had at the time of the signature of the Protocol. No serious effort was made to align Turkish legislation in any of the areas covered by the Protocol.

There followed in Turkey a long period of political and economic instability which precluded the country from taking any steps to liberalize the economy, let alone prepare itself for a Customs Union that would pave the way for its accession to the Communities. The military coup that occurred in September 1980 froze political relations with the Communities. The accession of Greece to the Communities in January 1981 complicated matters further as the country followed for many years a policy of blocking any kind of dialogue with Turkey.

Meanwhile, the Communities continued to implement its zero-tariff policy on imports of industrial products from Turkey. As one of the world's major cotton producers Turkey's textile industry was naturally very competitive and it met a large part of the Communities' need for cotton yarn at a cheap price.

The accession of the UK to the Communities in 1973 changed this situation. The UK's cotton yarn industry that had spearheaded industrialization in the 19th century was by then outdated and uncompetitive. However, British governments were not ready to allow the cotton yarn industry to go under. At the same time, the Additional Protocol's standstill clause prevented the introduction of new non-tariff barriers to imports of industrial products from Turkey.

At first anti-dumping duties were imposed but soon enough, a somewhat ingenious solution was found, namely the negotiation of industry-to-industry quota agreements. These agreements whose scope expanded over the next twenty years had the advantage for Turkish exporters that they raised the price that they obtained for their exports and guaranteed them a permanent share in the Communities' market. The Turkish governments which were conscious of their failure to abide by the obligations contained in the Protocol did not object to this situation.

The quantitative restrictions on Turkish exports of cotton yarn also had an unexpected effect. They forced Turkish industrialists to use surplus cotton yarn locally which meant moving to higher value-added products starting with T-shirts and moving up the scale of the textile and clothing sector. Each time a product threatened to flood the Community market and faced quantitative restrictions, Turkish industrialists were encouraged to move one rung up in the scale so that over the years Turkey acquired one of the most competitive textile and clothing industries in the world and for many years its products constituted Turkey's chief exports to Community countries. It is doubtful that the same result could have been achieved in the absence of the association as then the Community would have been free to impose tariffs.

By the mid-1980s, the import substitution policy which had been the mantra of politicians, bureaucrats and industrialists alike began to be seriously questioned. It became clear that infant industries, such the motorcar industry refused to grow up behind the high protective barriers that coddled them. Turkey had suffered several economic crises that had aggravated the political situation. In addition, it was clear

that if the Customs Union was not completed by 1 January 1995 as envisaged in the Additional Protocol, the preferential treatment accorded to Turkey would cease to exist and Turkish products would lose their tariff advantage in Community markets.

In addition, Turkey made a fresh application to accede to the Communities in April 1987. The response it received two years later was that first the Association should evolve as planned and the Customs Union be completed on schedule.

Despite the fact that nothing had been done to prepare Turkey for that over the previous 18 years, and the shortness of the remaining time available, the government accepted the Community proposal and frantic efforts were made to complete the Customs Union on time.

It soon became clear that the Customs Union was not simply about eliminating tariffs on bilateral trade and aligning on the Common Customs Tariff. All sorts of things needed to be done to ensure that a level-playing field was achieved between the two sides and that the terms of competition were equalized between them.

Turkey was required to adopt legislation to protect intellectual and industrial property. Prior to the completion of the Customs Union, intellectual property protection had been very weak, and had been based on outdated legislation going back to the 1880s. There was no functioning patent registration system and Turkey was a paradise of counterfeit products of all kinds, ranging from branded clothing products to pharmaceuticals and mechanical parts of all sorts. From the EU perspective it was imperative that discipline be introduced into this area since products manufactured in Turkey or imported from abroad would be in free circulation inside the territory of the Customs Union, ie Turkey and the members of the European Union.

Similarly, and for the same reasons, Turkey was expected to adopt EU industrial standards and regulations in all of the so-called regulated sectors. As this required time, the certification of products manufactured in Turkey took effect gradually and in those areas where conformity had not been certified, Turkey had to continue to allow its products to be checked for conformity-assessment by competent authorities in EU countries before they were allowed into the EU market. Suggestions of having different standards for products destined for the domestic market and exports had been voiced but they were rejected as impractical.

Nevertheless, the Customs Union was formally completed on 31 December 1995, a year later than required. However, no country including among Turkey's trading partners quibbled about the one year delay. Parallel to it and shortly afterwards, Turkey concluded a separate free-trade agreement with the European Coal and Steel Community (ECSC) which provided for the elimination of tariffs and quantitative restrictions on imports of coal, iron and steel products. The conclusion of a separate

agreement had been made necessary by the fact that the ECSC had not yet at the time been absorbed into the EU.

At the time when the Customs Union was completed, the EU still maintained a restrictive policy on imports of textiles and clothing from close to 30 developing countries, under the Multifibre Agreement negotiated in the GATT. Turkey had relied for protection on the very high tariff that it had been applying prior to the completion of the Customs Union. As a result, it had hardly any imports from any of these countries but it was expected to adopt quotas similar to those of the EU as otherwise imports into the EU would have been diverted through Turkey and would have demolished the protective system built there. Of all the concerned countries only India rejected the deals offered to them that opened the Turkish market to their products but not to the same extent that would have prevailed in the absence of quotas. India made this issue into a matter of principle, claiming with some justification that these arrangements were incompatible with Article XXIV of the GATT under which customs unions and free-trade areas should not raise barriers to the trade of third countries. It took the issue to the World Trade Organisation and won the case. However, the MFA expired in 2005 and all quantitative restrictions on imports of textile and clothing products into the EU and Turkish markets were abolished as a result.

Under the Customs Union, Turkey is allowed to apply higher but not lower duties on imports from third countries than those provided for the Common Customs Tariff. It was also expected to align on the Union's preferential trade policy towards third countries. As regards elements such as the Generalized System of Preferences applied to developing and least-developed countries, Turkey was able to fulfil its obligations because the GSP is applied unilaterally and no reciprocity is required.

Problems arose with the free-trade agreements that the EU has concluded with a vast number of countries in all regions of the world. Those countries are under no particular obligation to conclude similar agreements with Turkey though they have been encouraged to do so by the EU. Most have complied with the request but some such as Mexico and South Africa have not, because they have concluded that the volume of their trade with Turkey did not justify such an agreement and that in any case when their exports to Turkey transited through an EU country, they entered the Turkish market free of duty as there exist no rules of origin within the Customs Union that would permit easy identification of the source of the product.

Thus, cars manufactured in Mexico by a German company entered the Turkish market through Germany, free of the customs duty that would have been payable if they had come directly from Mexico. When the Turkish authorities discovered that the particular model of the car that found its way to Turkey was only manufactured in Mexico and not in Germany or any other EU member state, a waiver was sought and obtained from the Commission for these cars to be subjected to the duty payable for imports from Mexico even though they continued to arrive from Germany.

Over the years, the functioning of the Customs Union has been quite satisfactory. Contrary to widespread expectations, Turkish industry has not only survived but thrived since completion of the Customs Union. Whereas prophets of doom had predicted that the domestic car industry which had been created exclusively for the domestic market would collapse after the Customs Union, the opposite has happened. The main manufacturers, themselves offshoots of European companies have integrated their production patterns with those of foreign plants controlled abroad by those companies. Thus, certain models are produced in Turkey primarily for the export market which means that they satisfy EU regulations. Moreover, Japanese and Korean manufacturers have been attracted to Turkey by the advantage that the Customs Union gave them in terms of access to the EU market. As a result, cars and other vehicles have displaced textiles and clothing as Turkey's biggest export product.

Nevertheless, several criticisms have been directed at the Customs Union over the years. These can be grouped under two separate headings:

1. Under the Customs Union, Turkey is expected to align on the EU's external trade policy, both preferential and non-preferential, and apply any changes to it that the EU may decide to implement. However, Turkey has no say in the elaboration of this policy, nor is it consulted when changes are considered and adopted. When the EU is negotiating agreements with third countries, such as Free-Trade Agreements, Turkey is not involved in the process. The EU encourages its partners to negotiate parallel agreements with Turkey but there is no legally binding obligation for those countries to do so and at least two have resisted the pressure over the years, as we have seen earlier.
2. The other side of the coin is that Turkey faces constraints in the conduct of its trade policy with neighbouring countries or others that may not have bilateral agreements with the EU. Since Turkey is not allowed to apply on its imports a tariff lower than the Common External Tariff in order to avoid the risk of trade diversion, it cannot conclude preferential trade agreements with countries that do not have such agreements with the EU unless a waiver is granted by the Union which has only happened very rarely since the Customs Union was completed. Waivers were sought and obtained in the past for the implementation of free-trade agreements with Syria, Georgia and Macedonia after the Commission concluded that the risk of trade diversion from those countries was minimal.

The Customs Union remains incomplete work. Its structure was designed in the 1970s at a time when European construction was at its preliminary stage and the Single Market very far from even the drawing board. So the Customs Union naturally did not cover any policy areas such as services, government procurement, dispute settlement and others.

An attempt was made after the completion of the Customs Union to complement it with a Free-Trade Agreement that would have covered services. Several rounds of

negotiations were held in Brussels with the European Commission in 1999-2001 which could have led to the parallel opening of the respective procurement and services markets but they foundered essentially for two reasons:

- a. The Turkish government of the day was not prepared to open professional and financial services, as well as the country's procurement market to foreign competition;
- b. On the EU side, Austria and Germany principally, but perhaps other member states were not prepared to envisage even the minimum degree of movement of physical persons that a free-trade agreement on services would have required.

As a result of this, the effort at closing some of the gaps in the Customs Union were abandoned. Prior to this, a market-access agreement for agricultural products had been concluded in 1998 between the two parties but that was never fully implemented because animal health considerations and the powerful meat and dairy lobby in Turkey prevented successive governments from opening the meat market to imports.

The failure to make progress towards addressing the missing parts of the Customs Union did not matter at first because the Customs Union was not expected to remain in effect as a separate instrument for a long time. Its completion coincided with the preparations for the "big bang" enlargement which began in earnest in 1997. Turkey was only accepted as a candidate for accession to the EU two years later and accession negotiations began in 2005. While there was never a precise timetable or target date for the conclusion of these negotiations, previous experience had indicated that they lasted around seven years on average. The timespan had tended to become longer with each enlargement but nevertheless, all accession negotiations had been completed successfully and Turkey had no reason to believe at the beginning of the exercise that its own accession process would have a different ending.

For that reason, the weaknesses of the Customs Union were not addressed immediately, despite early misgivings about them. However, within a few years after the accession negotiations started, they began to confront serious obstacles which first slowed them down and then stopped them altogether. The perspective of accession began to fade away gradually to the extent that it has now completely disappeared for all practical purposes.

As a result, attention has been drawn back to the Customs Union and what needs to be done to fill in its gaps and deal with its weaknesses. The European Commission requested the World Bank to prepare an impartial report which was published in 2014 and made a number of suggestions to address these gaps and weaknesses. This study remains to this day the only comprehensive analysis of the impact and potential benefits for both sides of modernizing the Customs Union. In broad terms, it concludes that both sides would benefit if current barriers on trade in agricultural products and

services were removed and each side opened its procurement market to the other. It also finds that an effective dispute settlement mechanism is needed, that road transport permits should be liberalized, a “green” visa system introduced for *bona fide* business people and a better consultation system put in place for dealing swiftly with “trade irritants”, mainly measures that one of the parties accuses the other of taking in contravention of Customs Union rules.

The European Commission conducted its own impact assessment which concluded in December 2016 with a recommendation for a Council Decision “authorising the opening of negotiations with Turkey on an Agreement on the extension of the scope of the bilateral trade relationship and on the modernisation of the Customs Union.” (SWD(2016) 475 final)

However, this authorisation has not been given so far, essentially for political reasons. The European Parliament, in a resolution adopted on 3 March 2019 recommended the suspension of accession negotiations but left the updating of the Customs Union as an option “but only if there are concrete improvements in the field of democracy, human rights, fundamental freedoms and the rule of law.” On 18 June 2019, the Council noted that “Turkey continues to move further away from the European Union.....no further work towards the modernisation of the EU-Turkey Customs Union is foreseen.” Despite occasional calls for modernisation negotiations, this remains the last word on the topic.

It therefore looks as if the Customs Union is neither likely to be replaced by accession nor modernized and extended to include all the missing sectors and topics. Despite this unhappy state of affairs which is likely to continue for the foreseeable future, nobody in Turkey is suggesting that the Customs Union be terminated. The EU remains Turkey’s biggest trading partner and source of foreign direct investment. Even in the absence of structural improvements to the relationship with the EU, Turkey does not have an alternative to replace it with.

Having said that, it cannot be claimed that the Turkey-EU Customs Union can serve as a model for any other country. Indeed, other than Turkey and the micro-states Andorra and San Marino, there are no non-EU member countries that have entered into a Customs Union with the EU. As we have seen, the Customs Union had been intended as a stepping stone for accession. However, that model has never been followed in any of the enlargements that have occurred since the EEC was created in 1958. No acceding country has been asked to complete a Customs Union with the EEC/EC/EU before accession. The burden in terms of the asymmetry of the relationship was simply too high to be countenanced by sovereign nations even for a temporary period until accession happened. It would therefore be even more difficult to carry for a departing nation such as the UK which wouldn’t even have accession as a goal.

References

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