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Abstract

This paper seeks to explain why, in May 2015, the European Union (EU) and Turkey have chosen to modernize their Customs Union instead of directly completing Turkey's accession process, how they will most likely do so, and the implications thereof for Turkish EU membership. I argue that Turkey and the EU seek to modernize the Customs Union because of the EU's increased quest for bilateral free trade agreements after the failure to conclude the Doha Development Round, the flawed implementation of the institutional provisions of the 1963 Ankara Agreement, and the stalemate in EU accession negotiations. The Customs Union is likely to be modernized by liberalizing agriculture, services and public procurement and by improving the implementation of the 1963 Ankara Agreement. The modernized Customs Union will most probably be the institutional basis for EU-Turkey relations in the near future. However, in a better future conjuncture of bilateral relations, it may then serve as a further step for Turkey's accession to the EU.

Introduction

Association and accession are two parallel processes in the bilateral relations between the EU and Turkey. Association started when the Ankara Agreement was signed on 12 September 1963, while the accession negotiations started on 3 October 2005.¹ Both processes have culminated in a considerable level of approximation of Turkish laws with EU legislation. Initially, association was seen as a further step towards accession and, therefore, it was designed as an asymmetrical arrangement.² These asymmetries have become more evident since the accession negotiations have not progressed smoothly.³ To remedy these shortcomings of the Customs Union and to extend its substance, Turkey and the EU have on 12 May 2015 declared their intention to modernize it.⁴

The idea of modernizing the Customs Union has in particular gained impetus after the World Bank issued its report "Evaluation of the EU-Turkey Customs Union" on 28 March 2014, which was financed by the European Commission.⁵ One month before the report was issued, Turkey and the EU established a Senior Official Working Group on the Update of the EU-Turkey Customs Union and Trade Relations (SOWG) on 28 February 2014, following a meeting between the Commissioner for Trade and the Turkish Minister of Economy.⁶ The SOWG held several meetings to discuss the modernization and issued a report on 27 April 2015, highlighting three pillars for the future modernization:⁷ the first pillar concerns a better implementation and/or an amendment of the Customs Union Decision 1/95; the second pillar is the extension of the Customs Union to new areas like agriculture, services and public procurement; and the third pillar deals with the improvement of the institutional structure.

Another meeting between the Commissioner for Trade and the Turkish Minister of Economy was held on 12 May 2015 after which it was announced that Turkey and

¹ Agreement Establishing an Association Between the European Economic Community and Turkey of 12 September 1963, *Official Journal of the European Union*, L 361/1, 29 December 1964, [hereafter, "Ankara Agreement"].

² Interview with Nicola Danti, MEP (S&D) and Substitute Member of INTA Committee, via email, 4 April 2017.

³ *Ibid.*; Interview with Michele Villani, Principal Administrator on Turkey and Trade, DG NEAR, European Commission, Brussels, 28 March 2017.

⁴ European Commission, "EU and Turkey Announce Modernisation of Custom Union", Brussels, 12 May 2015.

⁵ World Bank, "World Bank Group Report: EU-Turkey Customs Union Boosts Trade, But Needs Strengthening", Istanbul, 8 April 2014.

⁶ Report of the Senior Officials Working Group on the Update of the EU-Turkey Customs Union and Trade Relations, 27 April 2015, p. 2, [hereafter, "SOWG Report"].

⁷ *Ibid.*, pp. 2-4.

the EU would seek negotiating mandates for the modernization.⁸ Moreover, the EU adopted a new trade strategy "Trade for All" in October 2015 where it stated that

as it currently stands, the customs union covers only industrial goods and lacks a mechanism for settling disputes. A modernized customs union should release the untapped economic potential of areas like services, agriculture and government procurement. A reformed customs union could also pave the way for associating Turkey with future EU FTAs [free trade agreements].⁹

The Office of the Prime Minister of Turkey issued the 65th Government Programme in May 2016 where it lists the modernization as an objective, in addition to EU membership.¹⁰ Moreover, in the Medium Term Fiscal Plan (2017-2019), the intensification of trade integration with the EU and the elimination of the shortcomings of the Customs Union through the modernization are mentioned.¹¹ Lastly, the EU-Turkey Statement of 18 March 2016 "welcomed the ongoing work on the upgrading of the Customs Union".¹²

The European Commission adopted draft negotiating directives on 21 December 2016. Negotiations will start when the Foreign Affairs Council adopts the mandate. Currently, trade-related aspects of the modernization are discussed in the Trade Policy Committee and political aspects are discussed in the Working Party on Enlargement and Countries Negotiating Accession (COELA).¹³ Meanwhile, the European Parliament's Committee of International Trade (INTA) adopted a draft report in January 2017.¹⁴ Politically sensitive issues may not be resolved at COELA and they may be taken to the Committee of Permanent Representatives or the Council of the EU. No member state opposed the adoption of the mandate by the Council of the EU until recently.¹⁵ However, the continuing row between Germany and Turkey

⁸ European Commission, "EU and Turkey Announce Modernisation of Custom Union", *op.cit.*

⁹ European Commission, *Trade for All: Towards a more Responsible Trade and Investment Policy*, COM(2015) 497 final, Brussels, 14 October 2015, p. 34.

¹⁰ Office of the Prime Minister of Turkey, *65. Hükümet Programı*, Ankara, 24 May 2016, p. 126.

¹¹ Ministry of Development of Turkey, *2017-2019 Orta Vadeli Plan*.

¹² EU-Turkey Statement, Brussels, 18 March 2016, par. 7.

¹³ Interview with a Counsellor from the Permanent Representation of a member state to the EU, Brussels, 5 April 2017.

¹⁴ European Parliament, Committee on International Trade, David Borrelli (rapporteur), *Draft Report on 'Towards a New Trade Framework between the European Union and Turkey and the Modernisation of the Customs Union*, 2016/2031(INI), Brussels, 10 January 2017.

¹⁵ Interview with a Counsellor from the Permanent Representation of a member state to the EU, *op.cit.*

may complicate the adoption of the mandate.¹⁶ Most of the member states favour the adoption of the mandate as long as it includes their concerns.¹⁷ Once adopted, the negotiations for the modernization may last at least until 2020.¹⁸

This paper aims to explain why the EU and Turkey have recently chosen to focus on further trade integration instead of directly completing the accession process, how they intend to proceed, and the implications thereof for the accession negotiations. First, it is argued that Turkey and the EU seek a modernization of the Customs Union because of the EU's quest for bilateral free trade agreements with more, and more important, partners after the failure to conclude the Doha Development Round in the World Trade Organization (WTO). Other reasons to modernize the Customs Union are the flawed implementation of the institutional provisions of the Ankara Agreement and the stalemate in Turkey's accession negotiations with the EU. Second, Turkey and the EU plan to modernize the Customs Union by liberalizing agriculture, services and public procurement and by improving the implementation of the Ankara Agreement. Third, the modernized Customs Union will most probably remain the institutional basis for EU-Turkey relations in the near future. However, when their relations improve again, the upgraded Customs Union could serve as a further step for Turkey's accession to the EU.

In the following sections, economic, institutional and political reasons for the modernization will be evaluated. Then, institutional and substantial aspects of the modernization will be discussed. Finally, the likely implications of the modernization for the accession negotiations will be discussed. The modernization of the Customs Union is an interesting case given the fact that Turkey is simultaneously negotiating accession. Many institutional and substantial aspects of the modernization could be achieved by immediately completing the accession process. Yet, Turkey and the EU opted for the modernization. In addition to documents and secondary literature, interviews with officials from both sides help to understand their expectations regarding a modernization and their views of the relationship between association and accession.

¹⁶ Ç. Özdemir, "AB'nin Gümrük Birliği Tehdidi Ne Kadar Gerçekçi?", *Deutsche Welle*, 9 August 2017.

¹⁷ Interview with a Counsellor from the Permanent Representation of a member state to the EU, *op.cit.*

¹⁸ S. Doveri-Vesterbye & M.S. Akman, "Introduction and Background", in S. Doveri-Vesterbye & M.S. Akman (eds.), *A Modernized Customs Union: Expert Interviews and Analysis*, Brussels, European Neighbourhood Council, 2017, p. 5.

The Reasons for the Modernization

This section sets out the reasons why Turkey and the EU are modernizing the Customs Union despite the continuing accession negotiations.

Economic and Political Reasons

Turkey and the EU expected economic benefits from establishing the Customs Union which is limited to industrial products and industrial components of processed agricultural products.¹⁹ Today, Turkey is the fifth largest trading partner of the EU and the EU is Turkey's biggest trading partner.²⁰ The EU accounts for an average of 44% of Turkey's total exports and an average of 37.5% of total imports since 2010.²¹ The top five export destinations for Turkey are Germany, the United Kingdom, Italy, France and Spain.²² Although the Customs Union does not cover investments, Turkey has bilateral investment agreements with 26 member states.²³ Hence, in 2015, almost 57.6% of foreign direct investment (FDI) to Turkey came from the EU.²⁴

Developments in the EU's Common Commercial Policy have considerably influenced the Turkish economy because of the increased trade integration between Turkey and the EU. The Common Commercial Policy has changed significantly after the establishment of the Customs Union, creating challenges for Turkey. For instance, Decision 1/95 stated that Turkey had to comply with EU preferential trade regimes, that is, conclude FTAs with the EU's FTA partners and align with the EU's autonomous trade regimes, such as the Generalized System of Preferences, until 2001.²⁵ However, in the face of the failure to conclude the Doha Round and after some of the 'Singapore issues' (government procurement, competition policy and investments) were

¹⁹ EU-Turkey Association Council, "Decision 1/95 of 22 December 1995 on Implementing the Final Phase of the Customs Union (96/142/EC)", *Official Journal of the European Union*, L 035, 13 February 1996.

²⁰ European Commission, "European Union, Trade in Goods with Turkey", Brussels, 17 February 2017, p. 2.

²¹ World Trade Organization, *Turkey Trade Policy Review*, WT/TPR/S/331, Geneva, 9 February 2016, p. 21.

²² K. Binder, *Reinvigorating EU-Turkey Bilateral Trade: Upgrading the Customs Union*, Briefing, European Parliamentary Research Service, PE 599.319, Brussels, March 2017, p. 3.

²³ European Commission, *Commission Staff Working Document: Impact Assessment Accompanying the Document Recommendation for a Council Decision Authorising the Opening of Negotiations with Turkey on an Agreement on the Extension of the Scope of the Bilateral Preferential Trade Relationship and on the Modernisation of the Customs Union*, SWD(2016) 475 final, Brussels, 21 December 2016, p. 9 [hereafter, "European Commission Impact Assessment"].

²⁴ Binder, *op.cit.*, p. 3.

²⁵ EU-Turkey Association Council, "Decision 1/95", *op.cit.*

dropped from the agenda at the 2003 Cancún Ministerial Conference, the EU started to conclude deep and comprehensive FTAs in line with its 2006 Global Europe Strategy.²⁶ These changes in the Common Commercial Policy have created certain challenges for Turkey given its lack of participation in EU decision-making. For instance, Turkey has had difficulties concluding FTAs with the EU's FTA partners.²⁷

Given that Turkey applies the Common External Tariff (CET) of the EU for industrial products and the fact that rules of origin do not apply in a Customs Union, all FTAs concluded by the EU provide direct access to the Turkish market via trade deflection through the EU. Their access to the Turkish market is not reciprocal until Turkey concludes a similar agreement with these countries. Thus, when the EU concludes an FTA, Turkey eliminates all of its tariffs for industrial products towards that country. However, the FTA partners of the EU keep applying the tariffs until they conclude an FTA with Turkey. The potential of trade deflection via the EU's internal market to the Turkish market is especially important for the Transatlantic Trade and Investment Partnership (TTIP). If TTIP was implemented, industrial products from the United States would have free access to the Turkish market via trade deflection, yet without reciprocity for Turkish goods on the US market.²⁸ In addition, Turkish products would have to compete with US products on the EU market.²⁹ Therefore, Turkey seeks to negotiate its own FTA with the US.³⁰ Another option would have been to allow the accession of countries like Turkey, Mexico and Canada to TTIP.³¹ However, accession to TTIP or a separate FTA with the USA would imply that Turkey has to undertake a higher level of trade integration in areas such as agriculture, services and public procurement.³² Alignment with the relevant EU *acquis* and horizontal rules through the

²⁶ European Commission, *Global Europe: Competing in the World*, COM(2006) 567 final, Brussels, 4 October 2006, p. 6.

²⁷ Interview with Murat Yapıcı, Director General for EU Affairs, Ministry of Economy of Turkey, via email, 27 March 2017.

²⁸ E. Yalcin, R. Aichele & G.J. Felbermayr, *Turkey's EU Integration at a Crossroads (GED Study)*, Bertelsmann Stiftung, Gütersloh, April 2016, p. 12.

²⁹ G.J. Felbermayr & M. Larch, "The Transatlantic Trade and Investment Partnership (TTIP): Potentials, Problems and Perspectives", *CESifo Forum*, vol. 14, no. 2, 2013, pp. 49-60.

³⁰ M. Yapıcı, Director General for EU Affairs, Ministry of Economy of Turkey, "Turkish Perspective on FTAs under the Turkey-EU Customs Union with a Special Focus on TTIP", presentation, Brussels, INTA Committee, 18 June 2013.

³¹ S. Akman, "AB-ABD Transatlantik Ticaret ve Yatırım Ortaklığı: Türkiye Açısından Bir Değerlendirme", *Ankara Avrupa Çalışmaları Dergisi*, vol. 13, no. 1, 2014, p. 20.

³² Interview with Balázs Kiss, Policy Coordinator for Trade Relations with Turkey, DG Trade, European Commission, Brussels, 5 April 2017.

modernization may facilitate Turkey's accession to TTIP or the conclusion of an FTA with the USA.³³

The unfulfilled trade potential of a Customs Union which is limited in substance is another economic reason for the modernization.³⁴ However, the liberalization of services and agriculture cannot be negotiated under the accession negotiations given that the Council of the EU decided in December 2006 to suspend accession negotiations on eight chapters of the EU *acquis* until Turkey applies the Customs Union equally to all member states, including to Cyprus.³⁵ This is a politically sensitive issue. Due to the lack of credibility of the accession process and the decreased legitimacy of EU demands, recognition by Turkey of the Republic of Cyprus would be politically costly and hard to justify for the Turkish government. Turkey supported the Annan Plan for the unification of Cyprus in 2004 when accession was a realistic objective. Therefore, because of the 2006 Decision of the Council of the EU which applies to services and agriculture but not to public procurement, Turkey and the EU decided to negotiate the liberalization of services and agriculture within the framework of the modernization. The liberalization of public procurement could be negotiated under the accession talks, but this is challenging for Turkey.³⁶

Moreover, the EU mentioned the possibility of "long transitional periods, derogations, specific arrangements or permanent safeguard clauses" regarding the free movement of persons, structural policies or agricultural funds if Turkey acceded to the EU.³⁷ These proposals would curtail Turkey's expected membership benefits and have thus further reduced the credibility of accession. The modernization will not entitle Turkey to benefit from the Common Agricultural Policy funds or the free movement of persons, but it may facilitate the free movement of workers through the liberalization of services.

The employment of trade defence measures like anti-dumping, safeguards and countervailing duties in bilateral trade in line with article 44 of Decision 1/95 is another

³³ Interview with Kim Jørgensen, Permanent Representative of Denmark to the EU and former Ambassador to Turkey, Brussels, 5 April 2017.

³⁴ European Commission Impact Assessment, *op.cit.*, p. 9.

³⁵ Council of the European Union, "2770th Council Meeting General Affairs and External Relations General Affairs", *Press Release, C/06/352*, Brussels, 11 December 2006.

³⁶ K. Dawar & S. Togan, *Bringing EU-Turkey Trade and Investment Relations up to Date*, Workshop, European Parliament DG for External Policies, PE. 535.014, Brussels, May 2016, pp. 38-39.

³⁷ Council of the European Union, *Negotiating Framework Document*, Luxembourg, 3 October 2005, par. 12.

economic reason.³⁸ Nonetheless, the Association Council may suspend their application entirely when it concludes that Turkey has implemented internal market-related aspects of competition, state aid control and other relevant parts of EU *acquis* "and ensured their effective enforcement".³⁹

Lastly, transportation quotas, transit visas and motor vehicle taxes imposed by some member states on Turkish trucks impede the free movement of goods and create additional expenses for exporters.⁴⁰ This is an important issue given that 40% of Turkey's trade is transported over land.⁴¹ However, these quotas, visas and taxes are considered to be prerogatives of member states and they do not want to renounce them.⁴² The EU and Turkey have different views regarding the nature of this issue. According to Turkey, they are unfair, because they impair the free movement of goods within the Customs Union.⁴³ Yet, in the view of some member states, they relate to "the service of cross-border road haulage" which is a member-state competence not covered by the Customs Union and they are "imposed on the means of transport, not on the goods themselves being transported by the latter".⁴⁴

Turkey needs to transpose the EU *acquis* in its entirety in the accession process while the modernization does not require an entire transposition.⁴⁵ Turkey may not be willing to accept all the costs of entirely adopting the EU *acquis* in the accession negotiations which "are an open-ended process" and "the outcome of which cannot be guaranteed beforehand".⁴⁶

Institutional Reasons

In addition to the economic and political reasons elaborated above, there are several institutional shortcomings of the Customs Union that will be tackled through the modernization. First, decision-making in the Association Council is cumbersome

³⁸ EU-Turkey Association Council, "Decision 1/95", *op.cit.*, art. 44.

³⁹ *Ibid.*

⁴⁰ Case C-65/16, *Istanbul Lojistik Ltd v. Nemzeti Adó-és Vámhivatal Fellebbviteli Igazgatóság*, 2017, (not yet reported), Opinion of AG Øe Saugmandsgaard of 6 April 2017, par. 38.

⁴¹ World Bank, *Evaluation of the EU-Turkey Customs Union*, Report no. 85830-TR, 28 March 2014, p. 50.

⁴² Interview with Michele Villani, *op.cit.*

⁴³ Case C-65/16, *op.cit.*, par. 73.

⁴⁴ *Ibid.*, par. 72.

⁴⁵ Interview with a Counsellor from the Permanent Representation of a member state to the EU, *op.cit.*; Interview with Haluk Nuray, Brussels Representative, Economic Development Foundation, Brussels, 28 March 2017.

⁴⁶ Council of the European Union, *Negotiating Framework Document*, *op.cit.*, par. 9.

because it meets only twice a year and its decisions are taken unanimously.⁴⁷ Second, the association institutions provide a platform for an exchange of views. Turkey cannot influence EU decision-making through the current institutional structure, which makes it more difficult to align with the relevant EU *acquis*. Third, some institutional provisions of the Ankara Agreement are not implemented properly.

The non-implementation of the consultation procedure is an important problem. Its operationalization is necessary to facilitate Turkey's participation in decision-shaping and to ensure its alignment with the EU *acquis*. According to this procedure, the European Commission needs to informally consult experts from Turkey when it drafts a legislation "in an area of direct relevance to the operation of the Customs Union" and when it consults experts from member states.⁴⁸ The areas of direct relevance are legislation in the fields of trade policy, technical barriers to trade, competition, intellectual property rights and customs.⁴⁹

In addition, the European Commission needs to communicate all the proposals in these areas to Turkey when "transmitting its proposal to the Council".⁵⁰ Before the Council of the EU adopts a decision, "the Parties shall, at the request of either of them, consult each other again within the Customs Union Joint Committee".⁵¹ A similar consultation procedure applies when Turkey drafts a proposal in an area of direct relevance to the functioning of the Customs Union. In such a case, Turkey needs to seek the views of the European Commission.⁵² Thus "the Turkish legislator may take his decision in full knowledge of the consequences for the functioning of the Customs Union".⁵³

In addition to the consultation procedure, the European Commission needs to "ensure Turkish experts are involved as far as possible in the preparation of draft measures".⁵⁴ These provisions are not implemented properly. The participation of Turkey in technical committees under the European Commission is set out in Decision

⁴⁷ BKP Development Research & Consulting, *Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, and an Assessment of Its Possible Enhancement*, European Commission DG Trade, Final Report, 26 October 2016, p. 148 [hereafter, "BKP Impact Assessment"].

⁴⁸ EU-Turkey Association Council, "Decision 1/95", *op.cit.*, art. 55.

⁴⁹ *Ibid.*, art. 54.

⁵⁰ *Ibid.*, art. 55.

⁵¹ *Ibid.*

⁵² *Ibid.*

⁵³ *Ibid.*, art. 57.

⁵⁴ *Ibid.*, art. 59.

1/95.⁵⁵ The list of these committees is in Annex 9.⁵⁶ It may be modified by the Association Council upon a recommendation by the Customs Union Joint Committee.⁵⁷ For instance, the list was extended to the Textiles Committee in 1995 and to the Technical Regulations Committee in 1999.⁵⁸ It has not been updated since then. As a result, Turkey cannot participate in some technical committees like the Trade Defence Instruments Committee, the Generalized Preferences Committee or the Committee on Trade Retaliation.

The association relationship also lacks an effective dispute settlement mechanism. For instance, Turkey and the EU may take “any dispute relating to the application or interpretation of the [Ankara] Agreement” to the Association Council.⁵⁹ The dispute should concern the EU, a member state or Turkey.⁶⁰ Consequently, disputes concerning natural persons cannot be resolved at the Association Council.⁶¹ The Association Council may settle a dispute by a unanimous decision or it may unanimously decide to refer it to the Court of Justice of the EU (CJEU) or to other courts.⁶² In practice, it is difficult for the Association Council, which is composed of representatives of member state governments, of the Council of the EU and of the European Commission as well as members of the government of Turkey, to take a unanimous decision for the resolution of a dispute.⁶³ It is even more difficult to decide unanimously in order to refer a dispute to the CJEU.⁶⁴ The non-observance of EU case law by Turkish courts increases the need for an effective dispute settlement mechanism. If there was close cooperation between the Turkish courts and the CJEU,

⁵⁵ *Ibid.*, art. 60.

⁵⁶ Committee on Nomenclature, Customs Code Committee, Committee on External Trade Statistics.

⁵⁷ EU-Turkey Association Council, “Decision 1/95”, *op.cit.*, art. 60.

⁵⁸ EU-Turkey Association Council, “Decision No. 6/95 of 22 December 1995 on Extending the List of Committees Referred to in Annex 9 to Decision No 1/95 of the EU-Turkey Association Council (96/146/EC)”, *Official Journal of the European Union*, L 035, 13 February 1996; EU-Turkey Association Council, “Decision No 2/1999 of 8 March 1999 Concerning the Extension of the List of Committees Referred to in Annex 9 to Decision No 1/95 on Implementing the Final Phase of The Customs Union (1999/208/EC)”, *Official Journal of the European Union*, L 072, 18 March 1999.

⁵⁹ Ankara Agreement, *op. cit.*, art. 25.

⁶⁰ *Ibid.*

⁶¹ E. Göral & M. Dartan, “The Customs Union in the Context of EU-Turkey Relations: An Evaluation of Current Debates”, *Marmara Journal of European Studies*, vol. 24, no. 2, 2016, p. 15.

⁶² Ankara Agreement, *op.cit.*, art. 25.

⁶³ European Economic and Social Committee, Section for External Relations, Dimitris Dimitriadis (rapporteur), *Enhancement of EU-Turkey Bilateral Trade Relations and Modernisation of the Customs Union*, Opinion, REX/468, Brussels, 14 December 2016, par. 5.5.

⁶⁴ Göral & Dartan, *op.cit.*, p. 15.

a dispute settlement mechanism would be less important, like in the case of the European Economic Area (EEA, see below).

Overall, the most cited reasons for the modernization by the Turkish side are the asymmetric structure of the Customs Union and the transportation quotas.⁶⁵ The asymmetry is mainly evidenced by the fact that Turkey unilaterally needs to align with the Common Commercial Policy which results in trade deflection. This could be corrected by enabling Turkey's participation in EU decision-shaping. The issue of transportation quotas is currently before the CJEU (see below). The most cited motivations for the EU are the liberalization of agriculture, services and public procurement and the introduction of an effective dispute settlement mechanism.⁶⁶

The next section deals with the question of how Turkey and the EU are most likely going to modernize the Customs Union. Given that negotiations have not started yet and limited information is available, the question of how they could or should modernize it is addressed as well.

The Contents of the Modernization

The institutional and substantial aspects of the modernization will be evaluated separately. However, the modernization of the substance without improving the institutional provisions may cause a perpetuation of the institutional problems. Institutional improvements are also crucial for a better redistribution of future economic benefits.

Institutional Aspects

The 1992 EEA Agreement between the EU and three member states of the European Free Trade Association (EFTA) – Norway, Liechtenstein and Iceland – may help draw some insights for the Customs Union's institutional modernization. For instance, the European Commission should "informally seek advice from experts of the EFTA states in the same way as it seeks advice from experts of" member states of the EU when a proposal is drafted.⁶⁷ This provision is implemented quite effectively.⁶⁸ There is a similar

⁶⁵ Interview with Faruk Kaymakçı, Ambassador and Permanent Delegate of Turkey to the EU, Brussels, 16 March 2017; Interview with Murat Yapıcı, *op.cit.*, Interview with Haluk Nuray, *op.cit.*; Interview with Dilek Aydın, EU Representative, TÜSİAD and TÜRKONFED, Brussels, 16 March 2017.

⁶⁶ Interview with Michele Villani, *op.cit.*; Interview with Balázs Kiss, *op.cit.*

⁶⁷ Agreement on the European Economic Area of 2 May 1992, *Official Journal of the European Union*, L 1, 3 January 1994, art. 99, [hereafter, "EEA Agreement"].

⁶⁸ Interview with Georges Baur, Assistant Secretary-General, EFTA Secretariat, Brussels, 31 March 2017

non-implemented consultation procedure for Turkey. In addition, EEA EFTA states participate in the public consultation processes initiated by the European Commission before the adoption of a proposal.⁶⁹ They can also communicate written comments after the European Commission adopted its proposal.⁷⁰ Lastly, EEA EFTA states can “submit comments before the Council of the EU adopts a common position”.⁷¹ Thus, they play a role in decision-shaping.

Regarding the participation of EEA EFTA states in the technical committees under the European Commission, “as wide a participation as possible [...] in the preparatory stage of draft measures” is ensured.⁷² Accordingly, EEA EFTA states can participate in the expert meetings and committees of the European Commission alongside the member states of the EU.⁷³ No voting is held in these meetings. The difference with the case of Turkey is that EEA EFTA states are allowed to participate in all committees under the European Commission as long as these committees are relevant for the EEA Agreement.⁷⁴ There is no exhaustive list as provided in Annex 9 of Decision 1/95. Similar decision-shaping mechanisms should be operationalized for Turkey. Jørgensen stated that in his view all member states seem to agree that the quest of Turkey for a closer involvement in the Common Commercial Policy was fair.⁷⁵ The extension of the Customs Union may further necessitate Turkish participation in technical committees concerning agriculture, services and public procurement.

Apart from that, the EEA Joint Committee has significant decision-making powers. When the EU adopts a legislation relevant for the functioning of the EEA Agreement, the EEA Joint Committee decides on the necessary amendments to the relevant Annex of the EEA Agreement “to guarantee the legal security and the homogeneity of the EEA”.⁷⁶ If EU legislation is added to the Annex, it becomes EEA law. When the EU drafts a proposal, EEA EFTA states hold discussions within working groups, sub-committees and finally the EEA Joint Committee as to whether the concerned proposal is related to the EEA Agreement and which amendments are necessary for

⁶⁹ European Free Trade Association, “Decision Shaping in the European Economic Area”, *EFTA Bulletin*, 1-2009, March, p. 23.

⁷⁰ *Ibid.*, p. 24.

⁷¹ *Ibid.*

⁷² EEA Agreement, *op.cit.*, art. 100.

⁷³ Interview with Georges Baur, *op.cit.*

⁷⁴ *Ibid.*

⁷⁵ Interview with Kim Jørgensen, *op.cit.*

⁷⁶ EEA Agreement, *op.cit.*, art. 102.1.

the Annex.⁷⁷ The Customs Union Joint Committee does not have such an authority. It was established in 1995 “to carry out exchange of views and information, formulate recommendations to the Association Council and deliver opinions”.⁷⁸ Though limited, there are two decision-making functions of the Customs Union Joint Committee. One of these is when Turkey cannot align its external tariffs simultaneously with the CET. In this case, the Committee may decide “to grant a period of time for this to be undertaken”.⁷⁹ Another possibility for decision-making is when trade deflection happens because of differences between the Turkish legislation and the EU *acquis* or because of different levels of implementation.⁸⁰ In such a case, the affected party may take immediate safeguard measures and notify them to the Committee which may unanimously decide to keep, amend or abolish these measures.⁸¹

In the case of Turkey, the decision-making power is mainly bestowed upon the Association Council. This results in delays in the resolution of problems because the Association Council only meets twice a year and deals with issues at a technical level instead of at a political one.⁸² The non-observance of EU case law by the Turkish courts is another important issue. There is an exemplary practice in the EEA which could serve as a basis. The EFTA Court has to apply all the jurisdiction of the CJEU relevant for the EEA Agreement before and after entry into force of the EEA Agreement.⁸³ In practice, the CJEU directly communicates all its relevant decisions to the EFTA Court.⁸⁴ Given this procedure of “dialogue of courts”, there has been no need for the dispute settlement mechanism hitherto.⁸⁵

Regarding trade defence measures, their use is not allowed for in the EEA Agreement.⁸⁶ As mentioned earlier, the Association Council may suspend them if Turkey sufficiently aligns with “internal market related aspects of competition, state aid control and other relevant parts of EU *acquis*”.⁸⁷ Therefore, Turkey should sufficiently harmonize with the relevant EU *acquis* and ensure its effective implementation throughout the modernization negotiations.

⁷⁷ Interview with Georges Baur, *op.cit.*

⁷⁸ EU-Turkey Association Council, “Decision 1/95”, *op.cit.*, art. 52.

⁷⁹ *Ibid.*, art. 14.

⁸⁰ *Ibid.*, art. 58.

⁸¹ *Ibid.*

⁸² BKP Impact Assessment, *op.cit.*, p. 148.

⁸³ Interview with Georges Baur, *op.cit.*

⁸⁴ *Ibid.*

⁸⁵ *Ibid.*

⁸⁶ EEA Agreement, *op.cit.*, art. 26.

⁸⁷ EU-Turkey Association Council, “Decision 1/95”, *op.cit.*, art. 44.

Apart from the institutional shortcomings, Turkey and the EU aim at extending the substance of the Customs Union, remedy trade deflection and eliminate transportation quotas.

Substantial Aspects

There are three options to resolve trade deflection from the EU's FTAs. First, the EU and Turkey may jointly negotiate FTAs with third countries.⁸⁸ Second, the EU may negotiate an FTA for both Turkey and the EU.⁸⁹ Third, the EU could ask its FTA partners to open their markets for Turkish goods until they conclude FTAs with Turkey.⁹⁰ The last option seems the most feasible one. Substantial aspects may include horizontal issues as well. For instance, the Ankara Agreement or Decision 1/95 do not have provisions on sanitary and phytosanitary rules (SPS), sustainable development, geographical indications, energy and raw materials, small and medium-sized enterprises (SMEs), capital movements or the protection of FDI.

Turkey and the EU are expected to follow a selective approach in extending the Customs Union to agriculture, services and public procurement. For instance, agriculture will be liberalized by a bilateral FTA, and most probably, it will not encompass all agricultural products.⁹¹ In addition, there will not be a single market in services.⁹² Only certain services regulated by EU regulations or directives may be liberalized and the free movement of workers may be negotiated under Mode 4 which "covers natural persons who are either service suppliers [...] or who work for a service supplier and who are present in another [country] to supply a service".⁹³ A modernized Customs Union may have provisions similar to the WTO Government Procurement Agreement or "include further concessions in certain areas of coverage".⁹⁴ Turkey may need transition periods for eliminating domestic price advantages, bidder eligibility restrictions, local production conditions and other exceptions.⁹⁵

⁸⁸ M. Yapıcı, "Turkish Perspective on FTAs under the Turkey-EU Customs Union with a Special Focus on TTIP", *op.cit.*

⁸⁹ *Ibid.*

⁹⁰ *Ibid.*

⁹¹ Interview with Michele Villani, *op.cit.*

⁹² Interview with a Counsellor from the Permanent Representation of a member state to the EU, *op.cit.*

⁹³ World Trade Organization, "Movement of Natural Persons".

⁹⁴ Dawar & Togan, *op. cit.*, pp. 38-39.

⁹⁵ European Commission Impact Assessment, *op.cit.*, p. 11.

Regarding transportation quotas or transit visas, Turkey and the EU should first decide whether they relate to cross-border road haulage services or the free movement of goods. If these measures concern the cross-border road haulage services for which only member states are competent, they may be eliminated via bilateral agreements.⁹⁶ If they are about the free movement of goods, they should be eliminated because of the Customs Union. The issue is before the CJEU due to a dispute between Hungary and Turkey about which the Hungarian Court requested a preliminary ruling on 18 January 2016.⁹⁷ The Advocate General issued his opinion on 6 April 2017, underlining that the motor vehicle tax increases costs and “the end prices of those goods”.⁹⁸ On the relationship between transport services and the free movement of goods, he argued that although Hungarian rules are mainly related to transport services, they may be considered to constitute charges having equivalent effect to a customs duty, “since the exercise of free movement of goods is necessarily linked to the carriage of those goods”.⁹⁹ If the CJEU adopts the opinion of the Advocate General, the elimination of transportation quotas, transit visas or motor vehicle taxes may be easier than expected.

Certain benefits will accrue both to Turkey and the EU from the extension of the Customs Union. Yet, Turkey will incur higher adaptation costs than the EU. For instance, in addition to the elimination of agricultural tariffs, Turkey needs to align with EU rules on SPS. Under the current preferential regime, 20% of Turkish agricultural tariff lines are duty-free for the EU while 56.4% of EU agricultural tariff lines are duty-free for Turkey.¹⁰⁰ Thus, Turkey needs to liberalize more and accept EU rules. The same holds true for services. In Turkey, there are more services that require citizenship as a prerequisite than in the EU, and Turkey will need to align with EU rules on the mutual recognition of qualifications. In public procurement, it is basically up to Turkey to eliminate all its restrictive measures.

This is maybe why the extension of the Customs Union to new sectors is mostly articulated by the EU while Turkey refers to trade deflection and transportation quotas as the most outstanding reasons for the modernization. Turkey may liberalize these

⁹⁶ Interview with Michele Villani, *op.cit.*

⁹⁷ Case C-65/16, *op.cit.*, par. 40.

⁹⁸ *Ibid.*, par. 73.

⁹⁹ *Ibid.*

¹⁰⁰ World Trade Organization, *Turkey Trade Policy Review, op.cit.*, p. 56.

sectors if the expected benefits of eliminating the aforementioned shortcomings and the extension are higher than the expected costs.

Is Modernization a Permanent Alternative to or a Step towards Accession?

The idea of a privileged partnership with Turkey was first elaborated in November 2002 in a newspaper article.¹⁰¹ A more concrete model was developed by politicians thereafter. For instance, a German parliamentarian presented a detailed proposal in 2004.¹⁰² It was then voiced by several member-state politicians on different occasions.¹⁰³ According to this plan, the institutional relations between Turkey and the EU should be improved by taking inspiration from the institutions of the EEA.¹⁰⁴ The Customs Union should, for example, be extended to services, but not yet introduce the free movement of workers, only visa facilitation.¹⁰⁵ Finally, Turkey's membership "in European foreign, security and defence policy structures on an equal basis" should be ensured.¹⁰⁶

However, Turkey stated many times that it would not accept any alternative to accession.¹⁰⁷ It may have viewed attempts to intensify the Customs Union as reducing the probability of accession. Therefore, the Turkish Ministry for EU Affairs stated that the modernization "should take place without creating an alternative path to Turkey's EU membership".¹⁰⁸ As a matter of fact, Turkey accepted to modernize the Customs Union only after the expected costs of maintaining an asymmetric and substantially limited Customs Union outnumbered its expected benefits, when the TTIP negotiations were launched.¹⁰⁹

Although Jørgensen argues that "the issue of a replacement was not raised at EU level", he agrees that "Turkey may still fear the replacement of accession talks by the modernization".¹¹⁰ A modernized Customs Union will most probably be the

¹⁰¹ H.A. Winkler, "Wir erweitern uns zu Tode", *Zeit Online*, 13 November 2002.

¹⁰² K.T. zu Guttenberg, "Preserving Europe: Offer Turkey a 'Privileged Partnership' Instead", *The New York Times*, 15 December 2004.

¹⁰³ H. Williamson, "Merkel Calls for Rethink of Turkey's EU Membership" *Financial Times*, 2 June 2005; M. Beunderman, "Austria Moots Alternative to Turkish EU Membership", *EU Observer*, 31 August 2005; V. Giscard d'Estaing, "A Better European Bridge to Turkey", *Financial Times*, 24 November 2004.

¹⁰⁴ zu Guttenberg, *op.cit.*

¹⁰⁵ *Ibid.*

¹⁰⁶ *Ibid.*

¹⁰⁷ N. Watt, "Turkey Says It's All or Nothing on EU Proposal", *The Guardian*, 3 September 2005.

¹⁰⁸ Ministry of EU Affairs of Turkey, "Customs Union", Ankara, 14 April 2017.

¹⁰⁹ Interview with Michele Villani, *op.cit.*; Interview with Balázs Kiss, *op. cit.*

¹¹⁰ Interview with Kim Jørgensen, *op.cit.*

institutional basis for EU-Turkey relations in the near future. If the accession negotiations do not re-accelerate, the Customs Union will be the platform for ensuring strategic cooperation and increased trade integration.

Another opinion is that the modernization may help place Turkey in one of the concentric circles in an EU of differentiated integration.¹¹¹ The idea of differentiated integration was revived after the European Commission published the “White Paper on the Future of Europe” in March 2017 which makes some projections as to the future of the EU by 2025.¹¹² In this model, “one or several coalitions of the willing emerge to work together in specific policy areas”.¹¹³ According to some experts, if Turkey follows an ambitious reform agenda, it could secure its place in one of the concentric circles.¹¹⁴

However, there is no clear answer in official EU documents on the relationship between association and accession. Turkey’s association was designed to prepare the country for accession. However, although the Customs Union was established in 1995, accession has not happened and it is not likely to happen soon.

The modernization may facilitate the accession process in the longer term through the harmonization of laws.¹¹⁵ After the Customs Union will be modernized, Turkey will need less harmonization of laws if accession talks re-accelerate in the future.¹¹⁶ In addition, an official interviewed argued that increased economic benefits from the modernization may positively change the public opinion and thus improve the prospect of membership in the longer term.¹¹⁷ For an EEAS official interviewed, the failure to modernize the Customs Union may distance Turkey further from the EU. In his view, “the modernization is a small subset of everything that is negotiated under the accession negotiations” and therefore, if Turkey and the EU do not succeed in the modernization, the accession process will become more difficult.¹¹⁸

¹¹¹ Interview with Dilek Aydın, *op.cit.*; Interview with an EEAS official, Brussels, 28 March 2017; Economic Development Foundation, “We Should Take Our Place in a Multi-Layered EU”, 3 March 2017.

¹¹² European Commission, *White Paper on the Future of Europe: Reflections and Scenarios for the EU27 by 2025*, COM 2017(2025) final, Brussels, 1 March 2017.

¹¹³ *Ibid.*

¹¹⁴ Interview with Dilek Aydın, *op.cit.*

¹¹⁵ Interview with Murat Yapıcı, *op.cit.*; Interview with Dilek Aydın, *op. cit.*; Interview with Balázs Kiss, *op. cit.*

¹¹⁶ Interview with a Counsellor from the Permanent Representation of a member state to the EU, *op.cit.*

¹¹⁷ *Ibid.*

¹¹⁸ Interview with an EEAS official, *op.cit.*

The Committee on Foreign Affairs of the European Parliament called on the European Commission to include political conditionality on human rights and fundamental freedoms in a modernized Customs Union.¹¹⁹ Cyprus also wants to use the modernization as a political leverage *vis-à-vis* Turkey. According to an official, “it is paradoxical to consider the upgrade of the Customs Union without Turkey implementing the current Customs Union arrangement equally to Cyprus”.¹²⁰ Cyprus has the power to place its own conditionality into the mandate because the modernization will be achieved via Association Council decisions or new protocols “as part and parcel of the [Ankara] Agreement”.¹²¹ The Ankara Agreement is an association agreement and requires unanimity when the Council of the EU adopts the mandate.¹²² The implementation of a future agreement may depend on a unanimous decision by the Council of the EU and the consent of the European Parliament which is based on simple majority voting. Depending on the content, ratification by the parliaments of member states may also be necessary.¹²³ Thus, the preferences of the European Parliament should be observed during the negotiations.¹²⁴

It is difficult to say whether the EU can convince Cyprus or like-minded member states not to include political conditionality in the mandate for the sake of the negotiations. According to Terzi, if Cyprus is convinced not to refer to the Cyprus issue and if the Customs Union is modernized successfully, the participation of Turkey in future EU decision-shaping alongside all member states, including Cyprus, may facilitate Turkey’s socialization with EU norms and values.¹²⁵ Cyprus may accept not to block the modernization negotiations if it concludes, as Greece did in 1999, that engaging Turkey within the EU and thus facilitating Turkey’s socialization with EU norms and values may help resolve bilateral differences.¹²⁶ Another, less likely option is the fulfilment by Turkey of the political conditionality regarding the Cyprus issue in the

¹¹⁹ European Parliament, Committee on Foreign Affairs, Kati Piri (rapporteur), *Draft Opinion for INTA on Towards a New Trade Framework between the European Union and Turkey and the Modernisation of the Customs Union*, 2016/2031(INI), Brussels, 23 January 2017, par. 6.

¹²⁰ Interview with an official, Permanent Representation of Cyprus to the EU, via phone, 12 April 2017.

¹²¹ SOWG Report, *op.cit.*, p. 4.

¹²² European Union, “Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union of 13 December 2007”, *Official Journal of the European Union*, C115, 9 May 2008, art. 218 TFEU.

¹²³ *Ibid.*

¹²⁴ S. Gstöhl, & D. De Bièvre, *The Trade Policy of the European Union*, Basingstoke, Palgrave, forthcoming, chapter 3.

¹²⁵ Interview with Özlem Terzi, Associate Professor at Istanbul University and Visiting Scholar at the College of Europe, Bruges, 26 April 2017.

¹²⁶ *Ibid.*

mandate.¹²⁷ If the mandate asks Turkey to apply the Customs Union equally to all member states including Cyprus, and if Turkey accepts this, the 2006 Decision of the Council of the EU on suspending the accession negotiations on eight chapters or individual vetoes by Cyprus on the opening of negotiations on other chapters would come to an end.¹²⁸ Therefore, Terzi concludes that both options would facilitate Turkey's socialization with the EU and improve the prospect of accession in the future.¹²⁹

Conclusion

This paper sought to explain why the EU and Turkey have chosen to modernize their Customs Union despite Turkey's continuing accession process, how they are likely to do so, and the implications thereof for Turkey's EU membership.

The economic reasons for the modernization are manifold. The failure to conclude the Doha Round and the trade deflection resulting from the increasing number of FTAs concluded by the EU, and in particular the TTIP negotiations, have been influential. In this respect, TTIP negotiations and the possibility of trade deflection are particularly important. Also, the unfulfilled trade potential has pushed Turkey and the EU to consider liberalizing agriculture, services and public procurement. Turkey is interested in the free movement of workers and the elimination of transportation quotas, transit visas and motor vehicle taxes. Another reason is the quest for eliminating trade defence measures.

The institutional reasons are related to the flawed design and non-implementation of the Ankara Agreement and Decision 1/95. Decision-making in the Association Council is cumbersome because of the unanimity rule, and other institutions of the association do not have significant decision-making powers but provide only a platform for the exchange of views.¹³⁰ The consultation procedure is not implemented properly and the European Commission does not communicate its proposals to Turkey. In addition, the participation of Turkey in technical committees of the European Commission is limited. Lastly, there is no effective dispute settlement mechanism and Turkey does not observe EU case law.

¹²⁷ *Ibid.*

¹²⁸ *Ibid.*

¹²⁹ *Ibid.*

¹³⁰ BKP Impact Assessment, *op.cit.*, p. 148.

The reasons of the modernization are more economic and institutional than political. Even the institutional reasons are intrinsically economic because they aim at increasing the economic benefits of the Customs Union by improving the institutional aspects. Turkey and the EU expect to achieve immediate economic benefits from an upgraded Customs Union. The political reasons, that is, the interests and policy choices of the EU and the political dynamics of Turkey-EU relations, rather determined the broader conjuncture which resulted in the consensus on modernizing the Customs Union. In other words, because of the stalemate of the accession negotiations, both sides seek to maximize their economic and institutional benefits through the modernization.

The main concern of institutional modernization is to guarantee the simultaneous application of the EU *acquis* and enable Turkey's participation in EU decision-making. Turkey and the EU seek to implement the consultation procedure. The participation of Turkey in all relevant technical committees of the European Commission is another issue on the agenda. The powers of the Customs Union Joint Committee should be upgraded in a way that all EU legislation relevant for the Customs Union should be incorporated into EU-Turkey association law. An effective dispute settlement mechanism should be established. The dialogue between the CJEU and Turkish courts should be developed for the observance by Turkey of EU case law. Lastly, for the elimination of trade defence measures, Turkey should align with the relevant EU *acquis*.¹³¹

Preventing trade deflection from the EU's FTAs is an important issue to deal with under substantial aspects. A good solution for this could be to make trade deflection reciprocal with the EU asking its FTA partners to open their markets to the Turkish goods until they conclude FTAs with Turkey.¹³² In addition, a modernized Customs Union may have provisions on horizontal issues like SPS rules, sustainable development, geographical indications, energy and raw materials, SMEs, capital movements or the protection of FDI.¹³³ The extension to agriculture, services and public procurement could be achieved by separate agreements not including all agricultural goods or

¹³¹ EU-Turkey Association Council, "Decision 1/95", *op.cit.*, art. 44.

¹³² M. Yapıcı, Director General for EU Affairs, Ministry of Economy of Turkey, "Turkish Perspective on FTAs under the Turkey-EU Customs Union with a Special Focus on TTIP", *op.cit.*

¹³³ European Parliament, Committee on International Trade, David Borrelli (rapporteur), *Draft Report on 'Towards a New Trade Framework between the European Union and Turkey and the Modernisation of the Customs Union*, *op.cit.*, p. 5; European Commission Impact Assessment, *op.cit.*, p. 12.

services.¹³⁴ Free movement of workers may be negotiated under Mode 4. Regarding public procurement, a modernized Customs Union may have provisions similar to the WTO Agreement on Government Procurement or “include further concessions in certain areas of coverage”.¹³⁵ The elimination of transportation quotas, transit visas or motor vehicle taxes may be ensured by a ruling of the CJEU, if the Court adopts the opinion of the Advocate General.

Transportation quotas and trade deflection, especially from TTIP, are the most cited reasons by Turkey for the modernization. Therefore, Turkey may have weaker incentives for modernizing the Customs Union in case the issue of transportation quotas is resolved by a ruling of the CJEU or the US Administration under President Trump finally calls the stalled TTIP negotiations off. Turkey has little if no influence on the EU institutions, norms and rules. It is rather a rule taker. Turkey's interests are inevitably influenced by the interests of the EU because of its dependence on EU trade policy and the dependence of the accession process on unanimity.

The modernization can also be framed as an attempt to compensate for the slowing down of the accession process. If Turkey was on the brink of joining the EU, the Customs Union would not have been modernized.¹³⁶ The strategic aspect of EU-Turkey relations is strong because of their increased trade integration, common neighbourhood, foreign policy objectives of the EU and the regional role of Turkey. Their broader interests can be dealt with by either accession or tailor-made partnerships like the EU-Turkey Statement of 18 March 2016 or cooperation through different platforms like the G20 or the North Atlantic Treaty Organization.

The likely implications of the modernization of the Customs Union for the accession negotiations are twofold. If EU-Turkey relations improve, the modernization may serve as a further step for Turkey's accession to the EU because of an increased socialization and harmonization of laws. Yet, it will most probably be the institutional basis for Turkey-EU relations in the near future. Although many argue that the modernization would be a further step towards membership in the longer term, some noted that in case accession does not happen, a modernized Customs Union will anchor Turkey more strongly to the EU.¹³⁷

¹³⁴ Interview with Michele Villani, *op.cit.*

¹³⁵ Dawar & Togan, *op.cit.*, pp. 38-39.

¹³⁶ Interview with a Counsellor from the Permanent Representation of a member state to the EU, *op.cit.*

¹³⁷ Interview with Michele Villani, *op.cit.*, Interview with Nicola Danti, *op.cit.*

If the modernization is politicized in the sense of introducing conditions for politically sensitive issues in the mandate of the Council of the EU, it may not succeed. The politicization of the mandate and the failure of the modernization may distance Turkey even further from the EU. One of the reasons of the slowing down of the accession process is the lack of credibility, which discourages Turkey from complying with EU demands. Therefore, for the sake of the success of the modernization, politicization should be avoided. The EU should not approach the Customs Union as a platform for exerting political conditionality over Turkey and the political dialogue should be maintained within the accession process.

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