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The Turkish FTA Puzzle

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Abstract

According to the textbook definition of a customs union, member states of such a union liberalize mutual trade while they adopt a common external tariff or, more broadly, a common trade policy towards third countries. Likewise, art. XXIV of the GATT stipulates that “substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union”. It is – at first sight - surprising to see then that the EU and Turkey negotiate and sign FTAs separately, while being bound by a customs union at the same time. This is the puzzle which is addressed in this short article. We illustrate the actual divergence in FTA policies, show the reasons behind it, and point to the sub-optimality of the current arrangement. We also show the relevance of this case for the post-Brexit EU-UK trade relations.

Keywords: Brexit, customs union, EU, free trade agreement, Turkey

Introduction

The crucial difference between a customs union and a free trade area (FTA) is a central part of the debates about the post-Brexit arrangements between the UK and the EU. It is well known that, among other differences, a customs union implies a common external tariff (CET), while an FTA does not. The choice between either option is not solely about whether the UK will continue to adhere to EU's external tariff levels but is also intimately linked to the status of the Northern Ireland customs territory. This was and is a major complication. In principle, either a customs union is agreed between the UK and the EU (implying that no customs border is needed between Northern Ireland and Ireland, but leaving the UK without any autonomy as regards its trade policy towards third countries), or an FTA is agreed upon (giving the UK space for negotiating new trade deals with the US, the Commonwealth and other countries, but requiring intra-Irish border controls). Any other solution would have to be both creative and imperfect, unless the parties fall back on WTO rules, which is also an undesired option.

Following the start of the 2001 Doha negotiations round, WTO (World Trade Organization) members adopted a Ministerial declaration, which amongst a number of other goals stressed their commitment to the WTO 'as the unique forum for global trade rule-making and liberalization, while also recognizing that regional trade agreements (RTA) can play an important role in promoting the liberalization and expansion of trade and fostering development' (WTO Ministerial Declaration, 2001). In recent years, RTAs have risen both in number and reach, frequently seen by States as a way to accelerate and deepen integration between economies and to promote trade. According to the statistics of the WTO (i.e. RTAs notified to the Secretariat), as of May 2020, 303 RTA's were in force (WTO Regional Trade Agreements Database, 2020).

According to international trade textbooks, members of a customs union adopt a common external trade policy. Likewise, customs unions are defined in paragraph 8(a) of Article XXIV of GATT 1994 as "[...] the substitution of a single customs territory for two or more customs territories, so that (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and (ii) subject to the provisions of paragraph

9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union".

According to GATT 1994 Article 24 par. 7(a), any free trade agreements or the formation of a customs union has to be notified and information provided by the contracting party, so that other WTO members can have an opportunity to cross-reference whether the agreement fulfills the condition within the same article. This procedure has been further enhanced in 2006 via the establishment, on a provisional basis, of a new transparency mechanism for all RTAs, which provides for early announcement of any RTA and notification to the WTO Secretariat (RTA: Transparency Mechanism for RTAs, 2020). Most importantly, 'the duties and other regulations', which are imposed upon third parties after the conclusion of the customs union/free trade agreement 'shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce' applicable to the territories excluded from the RTA (Article 24.5 GATT). This is calculated through an overall assessment of weighted average tariff rates and of customs duties collected based on import statistics from a previous representative period (pre-formation of the RTA).

Now, when looking at Turkey, one observes that it is both part of a customs union with the EU and negotiating FTAs with third countries in parallel. At the end of August 2019, Ruhsar Pekcan, Turkey's Trade Minister, announced its Export Master Plan, with a focus on 17 target countries. These included amongst a number of others: the U.S., China, Mexico, Japan, Russia and India. Seeking FTAs with several of these countries is part of the strategy. Moreover, Turkey's aim is to increase the proportion of high-tech exports from 3,5 to 5% of total exports (Anadolu news agency, 2019; Turkey Ministry of Trade, 2020). For that purpose it intends to combine its FTA policy with the creation of specialized free trade zones. This combination of being part of a customs union with the EU and simultaneously negotiating and signing FTAs is the puzzle we are addressing here.

EU-Turkey Customs Union and FTAs with Third Countries

The formal relationship of Turkey and the EU is based on the *Agreement creating an association between the Republic of Turkey and the European Economic Community*, also known as the Ankara agreement, signed in 1963. Article 2(2) envisages the progressive establishment of a customs union. Article 10 of this agreement stipulates 'that custom duties on imports and exports and all charges having equivalent effect, quantitative restriction and all other measures having equivalent effect' shall be prohibited in respect to the trade in goods. Furthermore, Turkey is obliged to adopt the Common Customs Tariff of the Community (in relation with third parties) and

approximate its laws to other Community rules in external trade (Association Agreement between EEC and Turkey, 1977). The integration with the EU was upgraded and deepened by Association Council (EU-Turkey) Decision No 1/95, which stipulated the abolition of all distortive mechanisms that result in an unfair advantage over the other party and legally established the Customs Union between the Republic of Turkey and the European Union. Article 16 (1) of the *Decision No. 1/95 of the Turkey-EC Association Council on implementing the final phase of the Customs Union* provided that Turkey ‘shall align itself progressively with the preferential customs regime of the Community...’ and that ‘this alignment will concern both the autonomous regimes and preferential agreements with third countries’. These agreements should be negotiated ‘on mutually advantageous basis with the countries concerned (Decision № 1/95 of the EC-Turkey Association Council of 22 December 1995 on implementing the final phase of the Customs Union, 1996).

As Turkey is not a member of the EU, it is not involved in the negotiations of trade agreements between the EU and third countries. However, one would expect to see that the conclusion of FTAs between Turkey and third-parties would closely mirror the conclusion of similar agreements between the EU and the same third parties. However, when looking at the pattern of EU and Turkish trade agreements with third countries, it is not exactly in line with this expectation (table 1).

There is a perfect match for 18 countries or country groupings (out of more than 40 signed by the EU) where the EU and Turkey have FTAs in force with the same countries. In 11 more cases, the logic is also respected, in the sense that Turkey initiated negotiations with countries with which the EU concluded negotiations earlier. It is also true in a few cases where both are negotiating. However, there are many cases where Turkey is not negotiating with trade partners of the EU, and there are even cases where Turkey takes the lead and cases where Turkey has negotiated and concluded trade agreements where the EU is absent.

How then to explain this mismatch between the EU and Turkish FTAs with third countries? Several reasons can be identified: Firstly, as mentioned above, there is necessarily a time delay between the signing of an EU FTA and the corresponding Turkish FTA because Turkey does not take part in the EU negotiations. Secondly, third countries are not necessarily interested in negotiating with Turkey after negotiating with the EU, as their trade flow in goods is mostly directed towards the EU Common market and they get automatic access to the Turkish market upon concluding an agreement with the EU. Thirdly, the EU-Turkey Customs Union only applies to industrial goods. Agricultural products are excluded and governed by special rules, taking into account the Common Agricultural Policy (CAP) of the Community.

Table 1: EU and Turkish FTAs with Third Countries

	Turkey FTA in force	Turkey FTA under adoption or ratification	Turkey FTA being negotiated	No Turkey FTA	Total
EU FTA in force	Albania Bosnia-Herzegovina Chile EFTA [1] Egypt Faroe Islands Georgia, , Israel Korea, Rep. Moldova, Rep. Montenegro Morocco North Macedonia Palestinian Authority Serbia Singapore Syria [2] Tunisia	Lebanon	Algeria Cameroon Canada Central America Colombia-Peru Ecuador Mexico Japan South Africa Ukraine [4]	Andorra Armenia CARIFORUM (EPA) Ivory Coast Eastern and Southern Africa (interim EPA) Ghana Jordan [8] Papua New Guinea/Fiji SADC San Marino	42 [5]
EU FTA under adoption or ratification			MERCOSUR Vietnam	Eastern African Community (EPA) Haiti (CARIFORUM) West Africa (EPA)	1
EU FTA being negotiated	Malaysia [7]		India [7] Indonesia GCC [7] Thailand [7] USA (TTIP) [7]	Australia Central Africa (EPA) [7] China New Zealand Philippines	11 [6]
No EU FTA	Mauritius, Economic Cooperation Organization	Kosovo Sudan Qatar Venezuela	Pakistan Congo, D.R. Djibouti Chad Seychelles Libya Other ACP Countries	[all other possible combinations]	
Total	20	5	17 [3]		

[1] For the EU, covered by separate agreements with Iceland, Switzerland-Liechtenstein, Norway, and EEA

- [2] Turkey suspended the FTA with Syria on Dec. 6, 2011
- [3] Includes Turkish initiatives launched to start negotiations (8 countries/country blocks). Turkey has – in addition – created a working group with UK.
- [4] Provisionally applied
- [5] This number does not include the EC treaty, treaty with Overseas Countries and Territories (OCT), EU-Turkey agreement and accession agreements (with the exception of Ecuador). It includes the four agreements with EFTA countries.
- [6] This number does not include agreements that are being re-negotiated/deepened (e.g. Morocco, Tunisia).
- [7] EU negotiations on hold
- [8] Turkey-Jordan FTA was repealed by Jordan in 2018.

Sources: <https://rtais.wto.org/UI/PublicMaintainRTAHome.aspx>;
<https://www.trade.gov.tr/free-trade-agreements>; <https://ec.europa.eu/trade/>

Likewise, services and public procurement are not included. Turkey is therefore not hindered by the customs union to negotiate trade agreements related to agricultural goods, services and/or public procurement. The Turkey-Singapore FTA, concluded on 1 October 2017, was the first agreement concluded by Turkey which includes government procurement as part of the package, as well as services. Finally, the imperfect match is due to Turkish trade negotiations activism when it engages in FTA negotiations with countries that are not in the process of negotiating with the EU or do not have an FTA with the EU currently in force.

Conclusion: Current Problems and Several Avenues for Resolution

There are several concluding remarks and inferences that can be made from the developments observed above that show that the imperfect match between the EU and Turkish FTAs causes significant problems and stresses the asymmetric nature of the relationship.

Firstly, Turkey suffers revenue losses, as imports from third countries via trade deflection via the EU result in tariff revenue losses for Turkey.

Secondly, the current arrangement results in a ‘latecomer effect’, where Turkish exporters are put into a disadvantageous position vis-à-vis EU exporters. This is based on two premises, including that Turkey, being in a customs union arrangement with the EU, is bound to apply the CET for the industrial products, as well as rules of origin requirements not applying in a customs union (in contrast to FTA). The combination of these two rules means that all FTAs concluded by the EU provide direct access to the Turkish market for the EU partner without the reciprocal access guaranteed to Turkish exports on the EU partner’s market, until Turkey concludes a similar FTA. The latter

arrangement can take a significant amount of time, resulting in a preferential status for EU exporters during the time lag.

Thirdly, the current EU-Turkey arrangement is seen as somewhat outdated, as it excludes key sectors, such as the services sector and agriculture. To remedy this issue, back in December 2016, the EU Commission proposed the modernization and extension of the current deal to the agricultural, services and public procurement sectors, as well as including the respect of democracy and fundamental rights as an essential component of the agreement (European Commission, 2016). However, progress on this issue has stalled for a number of years. In March 2019, the European Parliament recommended ‘to suspend EU negotiations with Turkey’, whilst leaving the option of modernization of the agreement open (European Parliament, 2019).

Further to these difficulties, on 2 April 2019, the EU requested WTO consultations with Turkey in response to Turkish measures, resulting in a progressive forced localization in Turkey of the production of parts of pharmaceutical products exported to Turkey. In essence, the measure provides that if commitments of localization are not provided by foreign producers, then these products will be excluded from the reimbursement scheme of Turkey’s social security system. This results in the deterioration of competitive opportunities for foreign products, in comparison to domestically-produced ones. Furthermore, it seems that once a foreign producer has localized production of a certain pharmaceutical product pursuant to the localization requirement, that product can no longer be imported into Turkey, resulting in a prohibition or restriction, which is a non-tariff barrier to trade (i.e. a quantitative restriction). These Turkish measures are in violation of not only Article XI:1 GATT, but also of Article 5 of Decision No 1/95 of the EC-Turkey association Council of 22 December 1995, which installed the prohibition of ‘quantitative restrictions and all measures having equivalent effect’ (EU Permanent Mission to the WTO, 2019).

The existing limited version of the customs union in place between the EU and the Republic of Turkey (excluding agricultural products, services and public procurement), despite the aforementioned shortcomings, does still bear its fruits and can be considered compatible with Turkey’s ability to negotiate trade agreements with third countries. This means that this scenario could possibly be taken by the UK in planning its future relationship with the EU. However, to maximize the trade potential of both parties, some modifications could be suggested. The EU could allow Turkey observer status in relevant Council meetings discussing trade negotiations, particularly when decisions are made in areas directly related to the customs union with Turkey, enabling future RTAs to reflect truly common arrangements for both sides. In the current geo-political constellation it is not clear, though, whether this is a feasible option. A second-best

solution would be to introduce the process of parallel negotiations, whereby Turkey would negotiate its own FTAs, which closely mirror the FTAs of the EU. This is what is partly already seen in Table 1 and the partially overlapping FTAs. However, the respective agreements could differ in some respects; important differences would have to be remedied. Finally, the European Commission could incorporate a ‘Turkey clause’ into its FTAs with third parties, which would ask the third parties to conclude similar FTAs with Turkey. This mechanism was already used in the EU-Algeria FTA, signed in 2005, but fifteen years later, the Algeria-Turkey FTA is still being negotiated. However, this provision cannot be structured in a binding manner, hence its ultimate effectiveness is questionable.

In sum, the co-existence of an EU-Turkey Customs Union with Turkey negotiating a different portfolio of FTAs can be explained and is, apparently, compatible with WTO rules. However, it is far from an optimal solution. All suggestions to fine-tune this situation depend on two premises: geo-political proximity and trust, on the one hand, and willingness to harmonize the trade regulatory framework, on the other. The coming months will reveal how the UK and Turkey compare on these points

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