

EU-Turkey customs union: Modernisation or suspension?

SUMMARY

Turkey is the EU's fifth largest trading partner, while the EU is Turkey's largest. The association agreement concluded between the European Economic Community (EEC) and Turkey in 1963 was an interim step towards the country's accession to the EEC, membership of which it had applied for in 1959. The EU-Turkey customs union came into force in 1995, and Turkey obtained EU candidate status in 1999. In December 2004, the European Council decided that Turkey qualified for EU accession, making it possible to open negotiations to this end. In 2008, the Council of the EU adopted a revised accession partnership with Turkey. Since 2016, EU-Turkey relations have suffered due to a deterioration of democratic principles, human rights and the rule of law in Turkey, in the wake of a failed military coup. A European Commission recommendation of 21 December 2016 to launch talks with Turkey on modernising the EU-Turkey customs union was halted by the General Affairs Council of 26 June 2018, which concluded that no further work in this direction should be planned.

In 2019 and 2020, Turkey's military operations in Syria, Libya and the eastern Mediterranean, coupled with its maritime disputes with Greece and Cyprus, further eroded its relations with the EU. Following some positive signs by Turkey, on 1 October 2020 the European Council once again gave a green light to modernising the customs union, provided that constructive efforts to stop illegal activities vis-à-vis Greece and Cyprus were sustained. The European Council also stressed that in case of renewed unilateral actions or provocations in breach of international law, the EU would use 'all the instruments and the options at its disposal', including in accordance with Article 29 of the Treaty on European Union and Article 215 of the Treaty on the Functioning of the European Union, to defend its interests and those of its Member States. However, in the light of Turkey's recent conduct and given that the EU-Turkey customs union has not been modernised, but not suspended either, the EU could agree on some new sanctions, as called for in the European Parliament's 26 November 2020 resolution on escalating tensions in Varosha.



In this Briefing

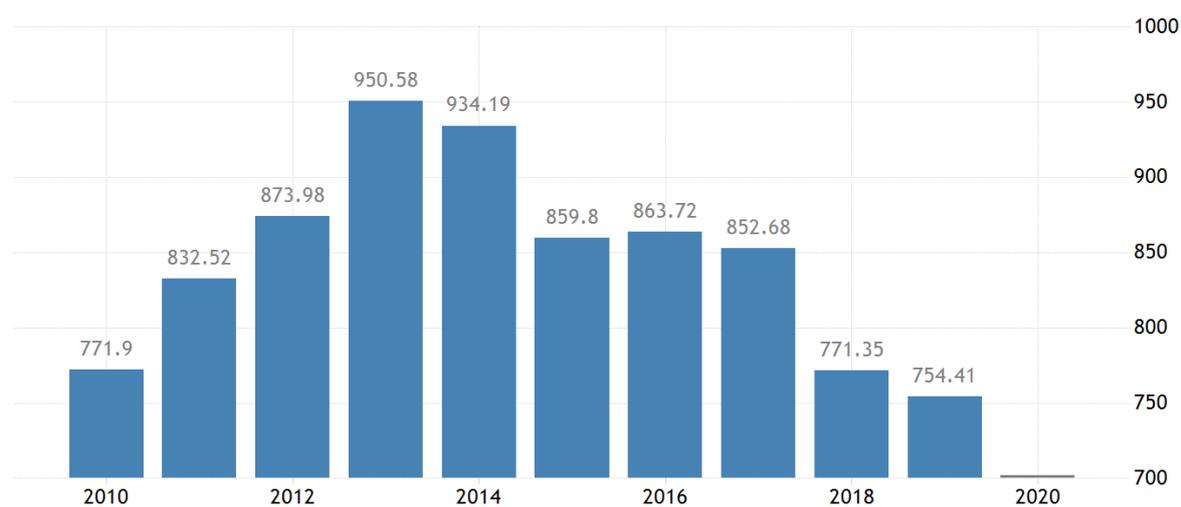
- Turkey's increasing geopolitical and economic fragility
- The EU-Turkey customs union: Recent developments
- To modernise or to suspend the EU-Turkey customs union?
- European Parliament position

Turkey's increasing geopolitical and economic fragility

Turkey's membership of the World Trade Organization (WTO), the Organisation for Economic Co-operation and Development (OECD), the North Atlantic Treaty Organization (NATO) and the Group of Twenty (G20) is a measure of its importance in the global political and economic context. Turkey has been linked to the EU by an [association agreement](#) since 1964, and a [customs union](#) since 1995. The European Council granted Turkey the status of candidate country in December 1999 and accession negotiations with it opened in October 2005. However, in recent years, EU-Turkey relations have stalled as a result of divergent positions on several issues, a deterioration of human rights and democracy in Turkey, and geopolitical competition. This recent evolution has found its way into the European Commission's language: while up until 2015-2016 it used to refer to Turkey as a 'strategic partner', in its 2020 [report on the country](#) it called it a 'key partner'.

The year 2020 has not been easy for any country and Turkey is no exception: not only has its economy been damaged by the coronavirus pandemic but also by broader balance of payments problems, inflation and [autocratic](#), nepotistic management of key monetary and economic institutions, including the Central Bank and the Ministry of Finance. Even though some of these challenges are common for emerging market economies (EMEs), the Bank of International Settlements (BIS) [estimated](#) in November 2020 that the depreciation of the Turkish lira (TRY) during the first wave of the pandemic (February-May 2020) was the sharpest among the currencies of the world's 17 EMEs, and twice as high as during the financial crisis of 2008. The economic views of the Turkish President, Recep Tayyip Erdogan, sometimes referred to as '[Erdoganomics](#)', as well as his direct interference with the decision-making of the Turkish Central Bank, have further corroded markets' and investors' confidence in his country. While until recently [two-thirds](#) of foreign direct investment (FDI) to Turkey came from the EU Member States, this trend is currently stalled. As part of this trend, US\$1.4 billion earmarked for investment in Turkey by the Volkswagen Group was initially 'paused' and later cancelled and moved to Slovakia.

Figure 1 – Decline in Turkey's gross domestic product (GDP) levels since 2016 (US\$ billion)



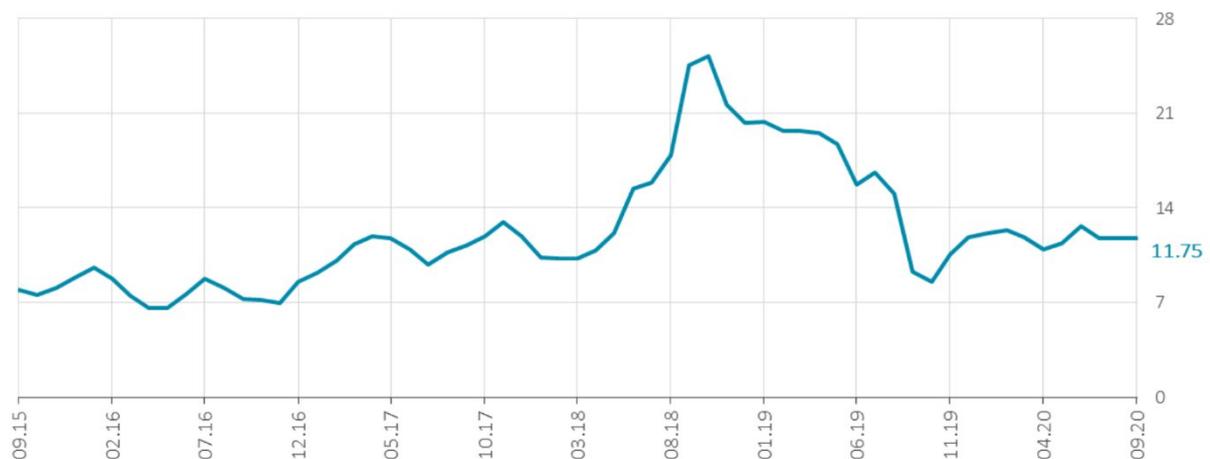
Source: [World Bank, Trading Economics](#), 2020.

The Turkish economy has been under-performing for two years now, which has put [its currency into free fall](#): in 2020, the euro [gained](#) 48 % and the US dollar 37 % versus the lira. The lira reached a record low against both currencies on 6 November, when Erdogan laid off the Central Bank Governor, Murat Uysal, only 16 months after he took office, and [appointed](#) the former Finance Minister, Naci Agbal, in his place. In an effort to fight rampant inflation (11.75 %), on 19 November the Central Bank 'decisively' [increased its key interest rates](#) from 10.25 % to 15 %. This move was welcomed by the markets, and the lira was temporarily stabilised. The Central Bank took this

decision despite [political pressure from Erdogan](#), who had stated the day before that 'we should not allow our investors to get crushed under high interest [rates]'. According to a Chatham House [paper](#) by Fadi Hakura from early 2020, 'a credit-fuelled economy' stores up trouble for Turkey, highlighting the country's excessive dependence on credit. In September 2020, [Moody's](#) downgraded Turkey's sovereign debt to 'B2' with a negative outlook, putting the country in the same rating category as Egypt and Tunisia.

Erdogan has tried to remodel Turkish society to please his core electorate, '[pious Turks](#)', in line with political Islam. The 'one-man rule' aspect of his decisions on internal and external policy became even more prominent after the 2015 elections, when his religious-conservative Justice and Development Party (AKP) lost 10 % of its vote. Despite remaining the biggest political party, the AKP could not form a single-party government based on the [parliamentary majority](#) it had enjoyed since it first came to power in 2002. The unsuccessful military coup of 2016 accentuated the autocratic tendencies of the regime still further. Erdogan concentrated power through [constitutional amendments](#) restricting democracy and the rule of law, in line with a project referred to as one of '[imperial presidency](#)'. His presidential powers include appointing senior officials, imposing states of emergency, issuing decrees and dissolving parliament, and would permit him to continue to rule until 2029. According to the Bertelsmann Stiftung's [Sustainable Governance Indicators](#), Turkey is an 'autocratic' country; in 2020 it was ranked last out of 41 countries studied, with 2.9 points (out of 10) for 'quality of democracy'.

Figure 2 – Turkey's consumer price index (CPI), September 2020



Source: [Central Bank of Turkey](#), 2020.

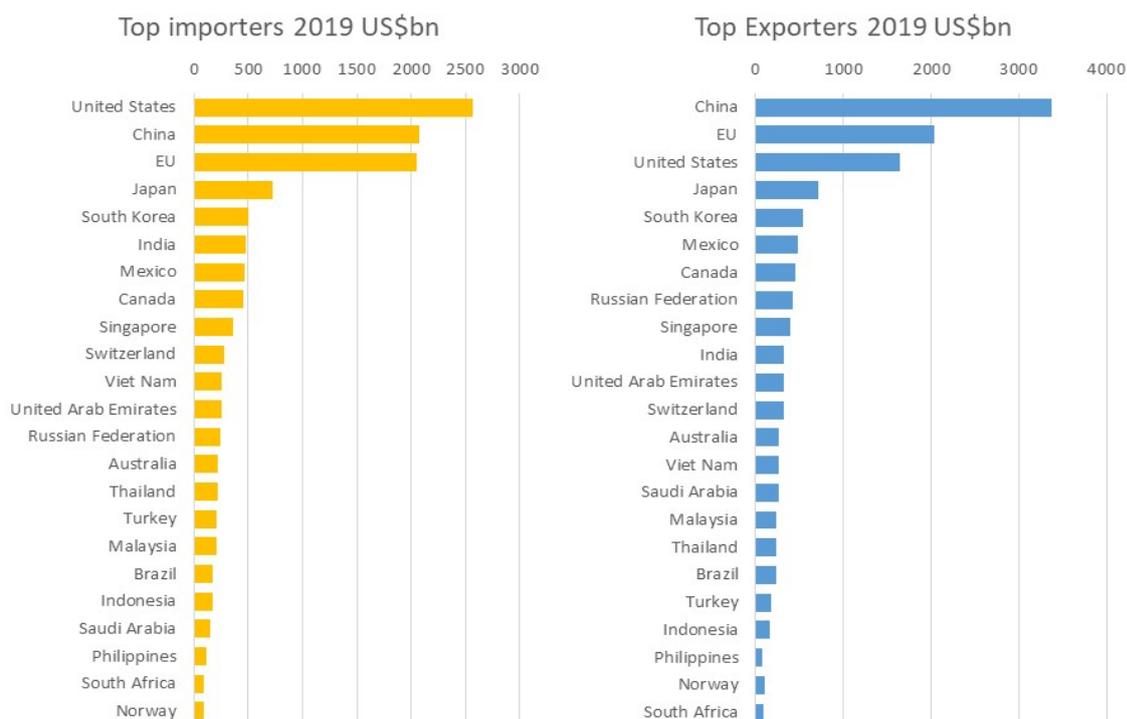
Experts agree that after the March 2019 [local elections](#), when the AKP lost some major municipalities, including Ankara and Istanbul (where Erdogan began his political career as mayor from 1994 to 1998) it became clear that Erdogan's main objective was to remain in power and that he had to secure himself stronger support from the nationalists. One of the main topics discussed during the elections was the [ever-increasing presence of refugees](#) that has resulted in heightened social tensions and clashes with the Turkish population, unleashing anti-Syrian rhetoric. To remedy this problem and the security issue linked to the Kurdish issue, in October 2019 Erdogan launched his country's third [military operation in Syria](#). This move contributed to the further deterioration of the Turkish economy, while also increasing the country's geopolitical isolation. Ankara's move to convert the [Hagia Sophia](#) and several other Christian churches back into mosques has been yet another contentious issue and an illustration of a policy that seeks to create a sphere of influence based on political Islam, stretching from Qatar, across northern Iraq and Syria, to Libya. Turkey's internal problems have been compounded by a worsening of relations with its traditional trade partners and allies, such as the US and the EU, fuelled by its erratic geopolitical decisions, including military interventions in northern [Syria](#) (2019), [Libya](#) (2020), [Nagorno-Karabakh](#) (2020), repeated threats to the EU of a new [refugee crisis](#), as well as stepped up tensions with Cyprus and Greece in

the [eastern Mediterranean](#). For months, the US warned that Ankara risked sanctions under the [Countering America's Adversaries Through Sanctions Act](#), should the [S-400](#) air defence missile system that it bought from Russia be activated. President Donald Trump, however, has held back on implementing the sanctions amid hopes that Erdogan would abstain from activating the missiles. The Trump administration [imposed](#) 25 % tariffs on Turkish steel in March 2018 and doubled them in August 2018. These tariffs, imposed amid tensions over a since-freed US pastor, Andrew Brunson, who was detained in Turkey on charges of links to the Gülenist Terror Group (FETÖ) and the PKK terrorist group, remained in place until May 2019. It is likely that in 2021, as noted by Oxford Analytica expert [Michael Tylor](#), the US 'will continue the policy begun under the Obama administration of building up Cyprus and Greece as strategic partners to replace Turkey'.

The EU-Turkey customs union: Recent developments

The EU is Turkey's key trade partner, although other players are gaining increasing importance. Fifty-six per cent of Turkish exports by value go to the EU, 26 % to Asia, 9.3 % to Africa, 5.6 % to North America and a mere 1.6 % to Latin America. According to Turkey's Trade Ministry, the country's [trade deficit](#), which excludes re-exports through free economic zones, jumped by 119 % to US\$6.42 billion in August 2020, mainly due to a contraction in the EU economies. In March 2020, the European Commission [announced](#) that Turkey would not receive any EU pre-accession funds in 2021-2027, despite the allocation of some €3.5 billion to the country under the Instrument for Pre-accession Assistance (IPA) in 2014-2020. Furthermore, the [EU-Turkey customs union](#) that came into force in 1995 and both parties wished to modernise in 2015 (before the military coup and consequent anti-democratic decisions), could, depending on Turkey's actions in the eastern Mediterranean, be modernised or suspended, as stated in the [European Council conclusions](#) of 1 October 2020.

Figure 3 – Top global traders in goods

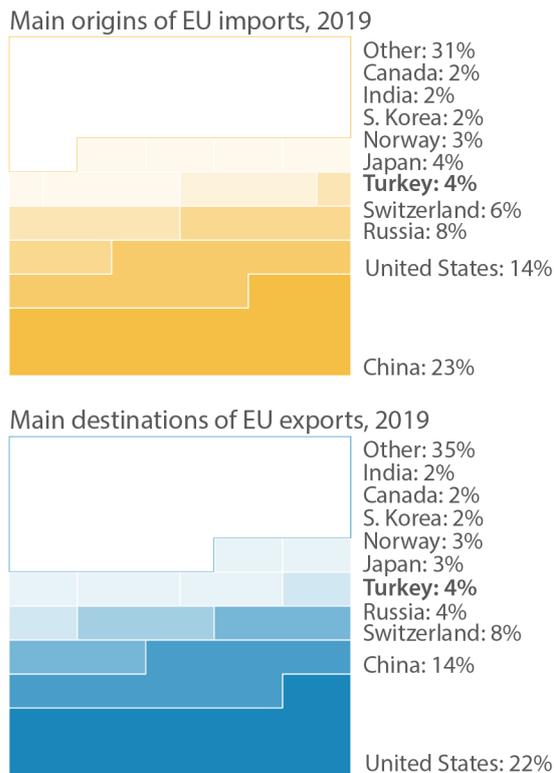


Source: [Eurostat](#), European Commission, 2020.

The legal basis for the EU-Turkey customs union is the [Ankara Agreement](#) (the association agreement from 1963), mainly its Article 28, and the 1993 resolution of the EU and Turkey recalling their will to enter a customs union. The customs union came into force on 31 December 1995,

following the decision of the EU-Turkey Association Council. The existing agreement ensures the free circulation of all industrial goods, but excludes agriculture (except for processed agricultural products), services, right of establishment and public procurement. Furthermore, the EU free trade agreements (FTA) with third countries do not automatically cover Turkey. Given these shortcomings and the asymmetry of the current custom union, in 2015 the EU and Turkey agreed to modernise it. Two options were considered: i) replacing the custom union with a new deep and comprehensive free trade area (DCFTA), which provides for the full liberalisation of trade in industrial goods and preferential access in non-industrial goods areas; and ii) adopting a modernised agreement covering services, right of establishment, public procurement and agriculture (i.e. CU plus a non-goods FTA). On 12 May 2015, the then EU Trade Commissioner, Cecilia Malmström, and the then Turkish Economy Minister, Nihat Zeybekçi, [opted for](#) upgrading the current custom union.

Figure 4 – Key EU trade partners, including Turkey



Source: [Eurostat](#), European Commission, 2020.

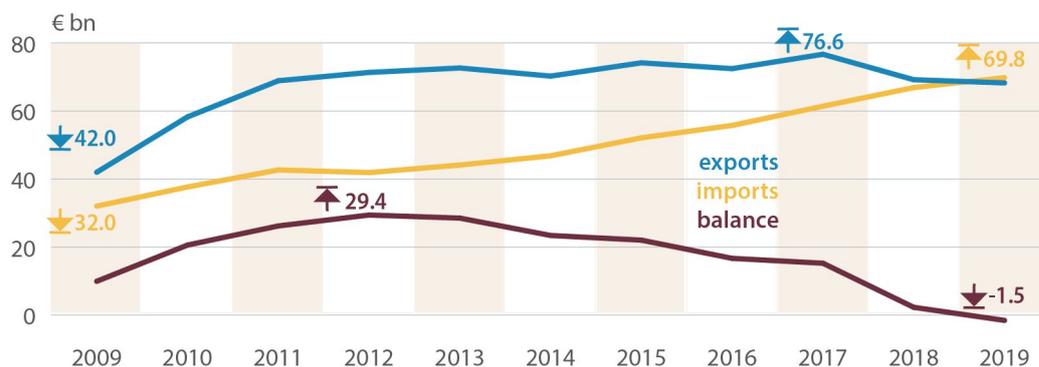
In 2016, there was a possibility to replace the current customs union with a new upgraded agreement and to start negotiations as indicated by the European Commission [recommendation](#) of 21 December 2016 for a 'Council decision authorising the opening of negotiations with Turkey on an agreement on the extension of the scope of the bilateral preferential trade relationship and on the modernisation of the Customs Union'. However, following the deterioration of human rights and the rule of law in Turkey in the wake of the failed military coup in 2016, the EU has adhered to the decision of the [General Affairs Council](#) of 26 June 2018 that ruled out not only the opening of any new chapter in the membership process but also any further work towards the modernisation of the EU-Turkey customs union. The Council noted that 'Turkey has been moving further away from the European Union. Turkey's accession negotiations have therefore effectively come to a standstill and no further chapters can be considered for opening or closing and no further work towards the modernisation of the EU-Turkey Customs

Union is foreseen'. So far, out of 35 accession negotiations [chapters](#), Turkey has opened 15 of which it has closed one, on science and research.

In an effort to diffuse the tension in the eastern Mediterranean, the European Council meeting of 1 October 2020 stated that, 'provided constructive efforts to stop illegal activities vis-à-vis Greece and Cyprus are sustained, the European Council agreed to launch a positive political EU-Turkey agenda with a specific emphasis on the modernisation of the Customs Union and trade facilitation, people to people contacts, High level dialogues, continued cooperation on migration issues, in line with the 2016 EU-Turkey Statement.' However, the leaders noted that, in case of renewed unilateral actions or provocations in breach of international law, the EU would use 'all the instruments and the options at its disposal, including in accordance with [Article 29 TEU](#) and [Article 215 TFEU](#)', in order to defend its interests and those of its Member States. This view was echoed by the European Commission 2020 [report on Turkey](#), which noted that 'in case of renewed unilateral actions or provocations in breach of international law [by Turkey], the EU will use all the instruments and the

options at its disposal in order to defend its interests and those of its Member States'. At the 10-11 December 2020 European Council meeting, EU leaders asked HR/VP Josep Borrell to draw up a report on the state of EU-Turkey political, economic and trade relations and to suggest how to proceed, including on widening sanctions, and submit it to the leaders by the time they hold their meeting in March 2021.

Figure 5 – EU imports from and exports to Turkey, 2009-2019 (€ billion)



Source: [European Commission](#), 2020.

To modernise or to suspend the EU-Turkey customs union?

The 2020 annual report on Turkey noted that the country's 'alignment with the EU *acquis* has continued at a very limited pace and in a fragmented manner'. Instances of backsliding have persisted 'regarding a number of key aspects in the areas of competition on account of an increase in State aid and its lack of transparency, information society and media, economic and monetary policy, customs union, external relations and foreign, security and defence policy'. Despite the fact that the customs union is a cornerstone of EU-Turkey trade relations, Turkey has continued both the practice of introducing new tariff increases on certain products of non-EU origin circulating freely within the customs union, and of forcing foreign producers of pharmaceuticals to move their production to Turkey, a policy that the EU has [challenged](#) at the WTO. Due to the delays caused by the coronavirus pandemic, the [WTO panel](#) does not expect to issue its final report to the parties before the second half of 2021.

The latest European Commission [report on trade and investment barriers](#) also notes that the Commission 'continues to insist on Turkey's compliance with the agreed Customs Union rules and the non-discriminatory implementation of the [Additional Protocol to the Association Agreement](#) towards all Member States, including the Republic of Cyprus'. In 2019, the Commission continued to make use of all means available to raise these concerns, including at the EU-Turkey Customs Union Joint Committee and other bilateral meetings. Regarding Turkey's sustained policy of forced localisation of pharmaceutical production, in April 2019 the EU [launched](#) a WTO case against it, which is its first ever against an EU candidate country. According to the Commission's Directorate General for Trade, the estimated value of pharmaceutical exports from the EU to Turkey likely to be affected by these measures reaches €460 million and, if further implemented, could potentially affect all EU exports to Turkey worth more than €2.5 billion. Earlier in 2020, the EU [opened](#) anti-subsidy probes against certain Turkish hot-rolled flat products of iron, non-alloy or other alloy steel, which could lead to new EU tariffs in 2021. This is even more plausible in light of Erdogan's call for a [boycott of French products](#), which was against the rules of the customs union.

In its 2015 [report](#), the Turkish Industry and Business Association (TUSAID) had stated that the deepening of the customs union 'would accelerate Turkey's integration with the EU economy and thus enhance the dynamics of the country's accession process'. The non-modernisation of the customs union is already a step back in EU-Turkey relations; its suspension would harm both parties

due to the interconnected trade and economic ties. In the past, Turkey has had to accept asymmetries regarding the non-application of some EU FTAs (exclusion of services, right of establishment, etc.) within the current customs union agreement. Following concerns about Turkey's authoritarian regime and its conduct in the EU neighbourhood, more specifically towards the Republic of Cyprus and Greece, and given Erdogan's November 2020 visit to the former resort of Varosha in Cyprus, hopes of any further modernisation of the custom union have faded, as pointed out by the European Council on 1 October 2020. However, the EU is keeping the door open with regard to the evolution of this agreement. An eventual suspension of the agreement would require applying the rules of the 1969 [Vienna Convention on the Law of Treaties](#) (VCLT), which contains no fewer than 13 articles on termination, denunciation, or withdrawal rules that apply when parties to a treaty have not negotiated treaty-specific rules on how to terminate it. Legal scholars Michal Ovádek and Ines Willemys have spoken about the [conceptual variety, legal ambiguity and diverse practice](#) of customs unions from the perspective of international law, underlining both the autonomy of any further EU decision in this matter as well as the complexity of such a decision.

European Parliament position

In July 2017, the European Parliament adopted a [resolution](#) on the 2016 Commission report on Turkey, stating that it 'calls on the Commission to include a clause on human rights and fundamental freedom in the upgraded customs union between Turkey and the EU'. Resolving the Cyprus problem would have a positive impact, and should be addressed to improve conditions for other areas of EU-Turkey cooperation. In the same decision, the European Parliament recalled that 'the customs union can only achieve its potential when Turkey fully implements the Additional Protocol vis-a-vis all Member States', among them Cyprus. Turkey has not implemented the existing customs union rules with regard to Cyprus since it joined the EU on 1 May 2004, and refuses to open its ports and airports to this country's vessels.

In its [resolution](#) of 13 March 2019 on the 2018 Commission report on Turkey, the European Parliament stressed that 'the modernisation of the Customs Union would further strengthen the already strong ties between Turkey and the EU ... a door should be left open for the modernisation and upgrade of the 1995 Customs Union between the EU and Turkey, to include relevant areas such as agriculture, services and public procurement, which currently are not covered'. The EP said however, that the Commission should ensure that the upgraded customs union should include a clause 'making human rights and fundamental freedoms a key conditionality'. In its October 2019 [resolution](#) on Turkish military action in Syria and its consequences, Parliament called on the Council to consider suspending trade preferences under the agreement on agricultural products and, as a last resort, suspending the EU-Turkey customs union. The resolution also called on the Council 'to consider adopting appropriate and targeted economic measures against Turkey'. Furthermore, in a [written question](#) to the Commission, a number of Greek and Cypriot Members of the European Parliament (MEPs) have called for considering a 'total suspension of the customs union,' arguing that Turkey has repeatedly breached its obligations under this trade agreement. In its [resolution](#) of 26 November 2020 on escalating tensions in Varosha, the EP called on the European Council to 'impose tough sanctions in response to Turkey's illegal actions', while recalling that 'further sanctions can only be avoided through dialogue, sincere cooperation and concrete progress on the ground'.

Parliament has been proactive regarding the reduction of IPA funding for Turkey over concerns about lack of respect for human rights, democracy and the rule of law there (see February 2018 [resolution](#) on human rights situation in Turkey). Of the roughly €4.5 billion allocated to Turkey over the 2014-2020 period, €3.5 billion came from the IPA, while the remaining funding came mainly from cross-border cooperation and other programmes. In a [written answer](#) of 17 March 2020 to a question by an MEP, the EU Commissioner for European Neighbourhood Policy and Enlargement Negotiations, Olivér Várhelyi, stated that Turkey would not receive any EU pre-accession funds during the 2021-2027 period.

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