

Roundtable Policy Discussion

European Neighbourhood Council

European Entrepreneurs

MÜSIAD

Socialists & Democrats in EP

Setting the EU-Turkey economic agenda: customs union reform

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***at the European Parliament
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Transformation under the Customs Union

The **overall impact** of the CU has been **positive** on Turkish economy.

CU locked Turkey into a **liberal trade regime**

It increased the **competitive pressure** on Turkish manufacturing industry

Improved **factor productivity**

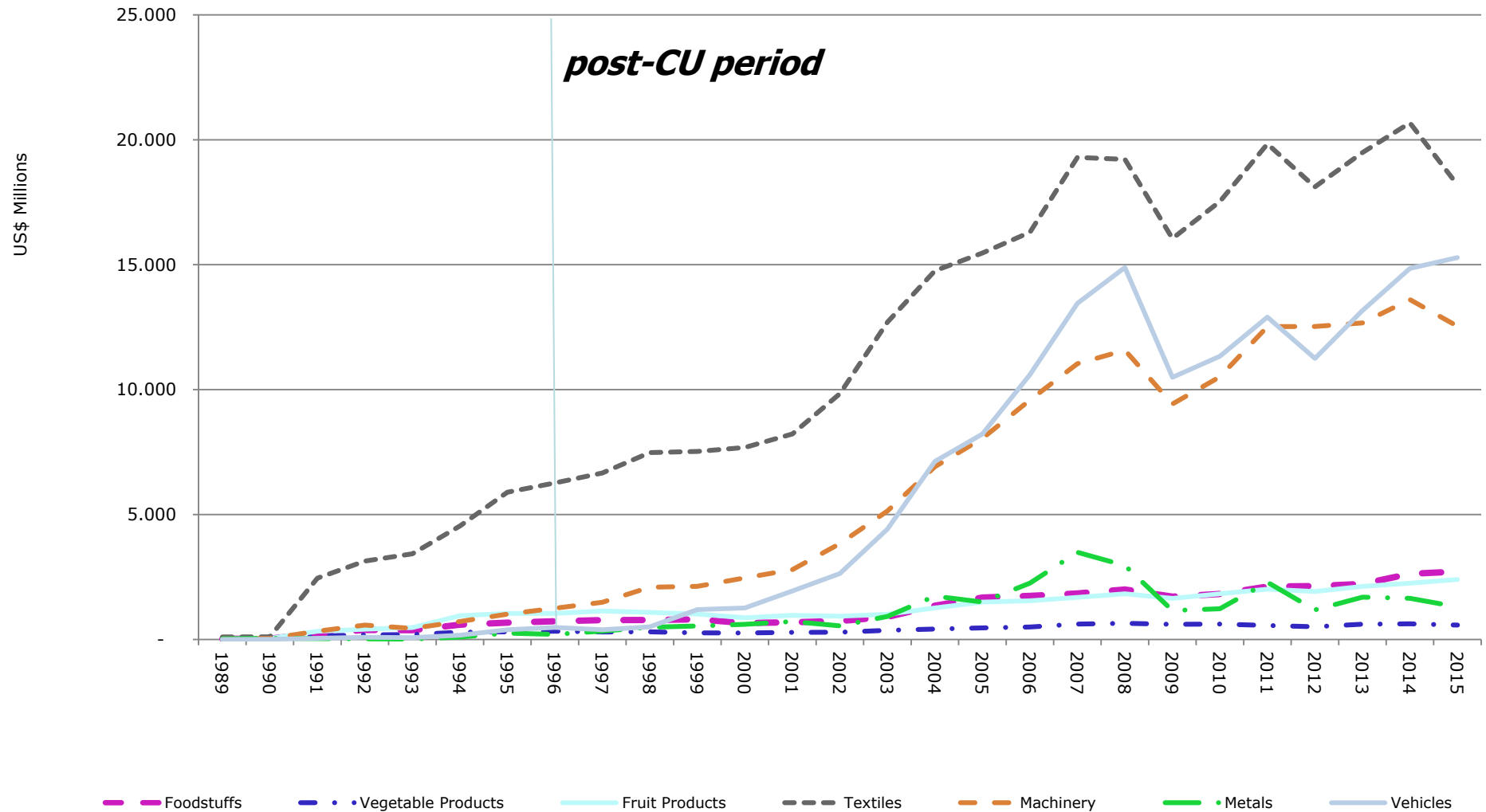
Improved the **welfare** of Turkish consumers,

Raised Turkey's **power of regulatory convergence** into EU acquis, and strengthened its reform process...

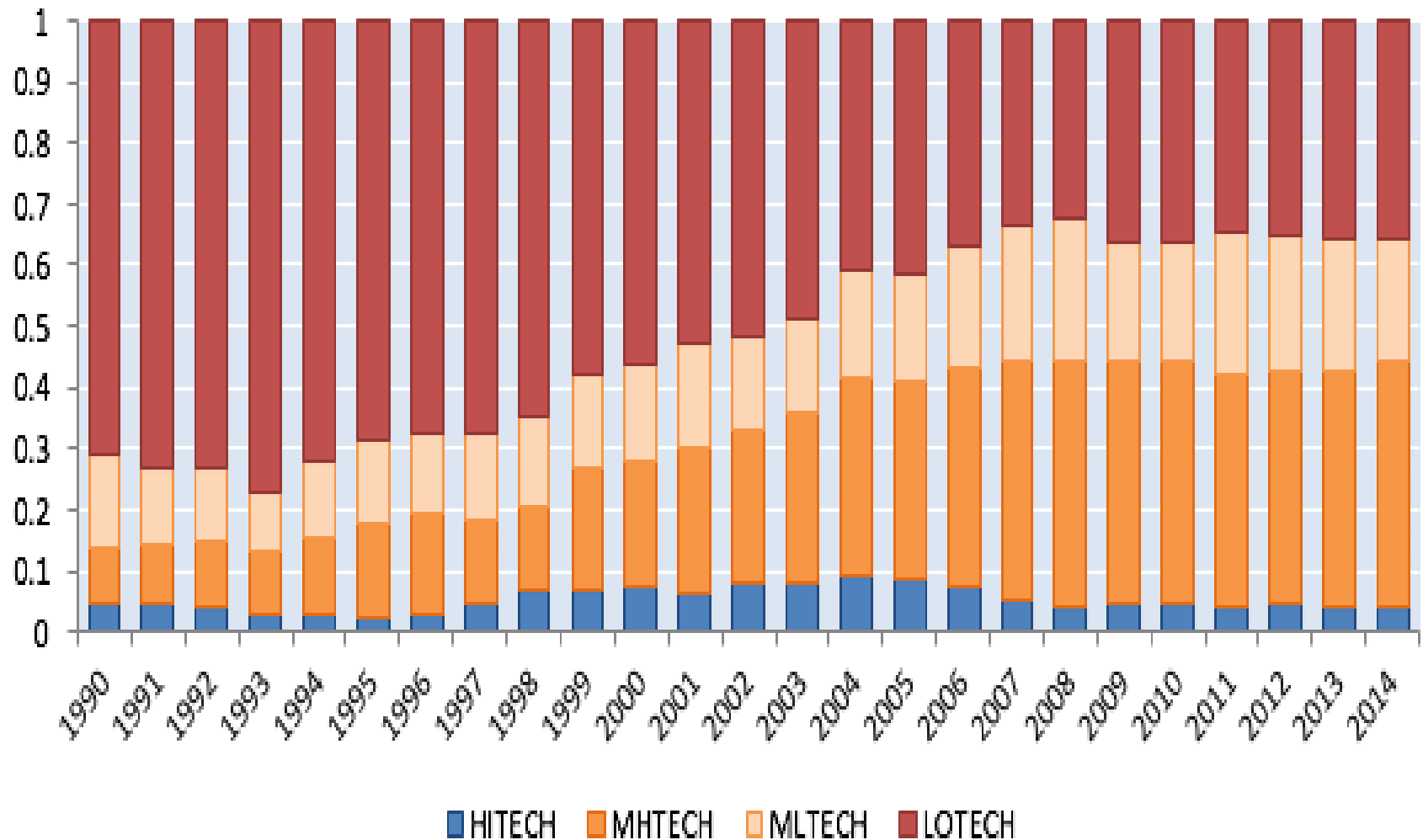
CU, has been a major catalyst for the Turkish economy.

Togan (2000), K. Yilmaz (2011), Akman (2013), World Bank (2014)

Turkey's Exports to the EU: Product Composition (\$ millions) UN Comtrade(2014)


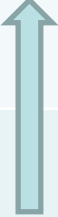
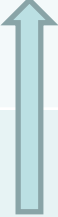



Complexity of Turkish exports to the EU (100% = 1)



Source : Felbermayr, Aichele and Yalcin (2016)

Share of groups in total manufacturing exports (%)

| Group (techn. intensiveness) | 1996 | 2014 |
|---|-------------|--|
| Low | 57.8 | 35.5  |
| Medium Low | 20.8 | 29.7  |
| Medium High | 19.5 | 31.5  |
| High | 1.9 | 3.3  |

CU impact (E. Commission)

- “Turkey has become a high growth, diversified, emerging economy looking to exploit new markets, in part thanks to the CU requirement for Turkey to apply substantially the same commercial policy as the EU (including by aligning itself on the EU`s Common Customs Tariffs) by concluding similar FTAs with the EU`s free trade partners.”

Design flaws in the Customs Union

- CU: an **interim process** (*not an end in itself*) which does not guarantee full integration (i.e. membership) (*Kabaalioglu, 2010; Akman, 2010*)
- Was **not** designed as **a well-equipped regime** to deal with modern day challenges (*World Bank Report, 2014*)
 - **Tectonic shift** in the global economy,
 - Changes in **global production networks** (global value chains)
 - Changes in actors' interests and dynamics in **EU trade policy (FTA etc.)**
- **Institutional void** (*Neuwahl, 1999*)
 - Diplomatic and **intergovernmental character** of institutions,
 - Lack of **parliamentary control**,
 - Absence of recourse to **judicial dispute settlement**
- **Narrow coverage** (not reflecting European internal market and modern trade policy agenda) (*WB, 2014; Ülgen & Zahariadis, 2004*).
- **Asymmetric structure**
 - TR not take part in **decision making process**
 - **Notification deficit** (to ensure transp. in TR's transposition of acquis)
 - **Consultancy mechanisms**
- **No proper compensation mechanism**
 - Financial assistance, Safeguard measures, Adjustment assistance...

The CU, then and now...

- CU entered into force some 20 years ago, reflecting views; expectations and realities of that time.
- As time passed, many things changed:
 - Competition from the Emerging Economies (China et.al.)
 - Globalisation extended (global production networks-GVCs)
 - Behind-the-border issues need attention
 - Global economic and financial crisis
 - Doha Round is deadlocked and multilateral track was downgraded
 - RTAs proliferated (FTAs, DCFTAs, mega-deals –TTIP)
 - Trade protectionism soared and post-Trump global economy

inducing a need to revise the CU.

Change in the EU trade policy

Changing trade patterns and global economic prospects have been fundamental motives to induce the trade policy-makers in the EU to be responsive to, and to re-define a trade policy based on:

a broader agenda and

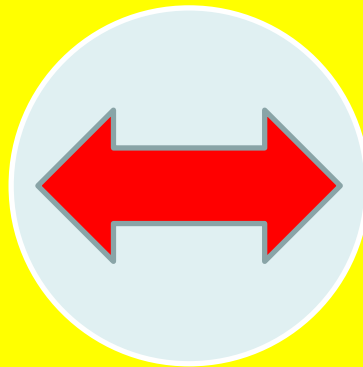
deeper and comprehensive trade agreements with several economies.

Leads to ***Global Europe*** Strategy in 2006.

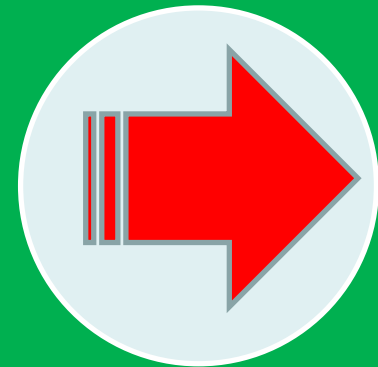
Customs Union: What to do?



Replace CU:
with an FTA
or DCFTA



Standstill CU:
with minor
revisions



updating CU:
deeper
integration



Progress to upgrade the CU

- Mid-2000s Rising critics from TR about EU FTAs
- 2007 Positive agenda asking for CU reform
- 2014 Senior Officials Working Group (SOWG) 'scoping exercise'
- 2014 World Bank study (*Evolution of EU-Turkey CU*)
- 2015-May Memorandum of Understanding to modernise and extend the CU
- 2015-Nov. Heads of States/Gov. to launch preparations for upgrading the CU
- 2016 Domestic procedures and impact assessment
- 2016-Dec. Commission proposal to Council to launch negot.

Problems in the EU

EU

Scope: new areas and rules

Design:

FTAs,
Dispute Settl.,
TR has to meet obligations on alignment

Lack of compliance:
trade barriers by Turkey

TR

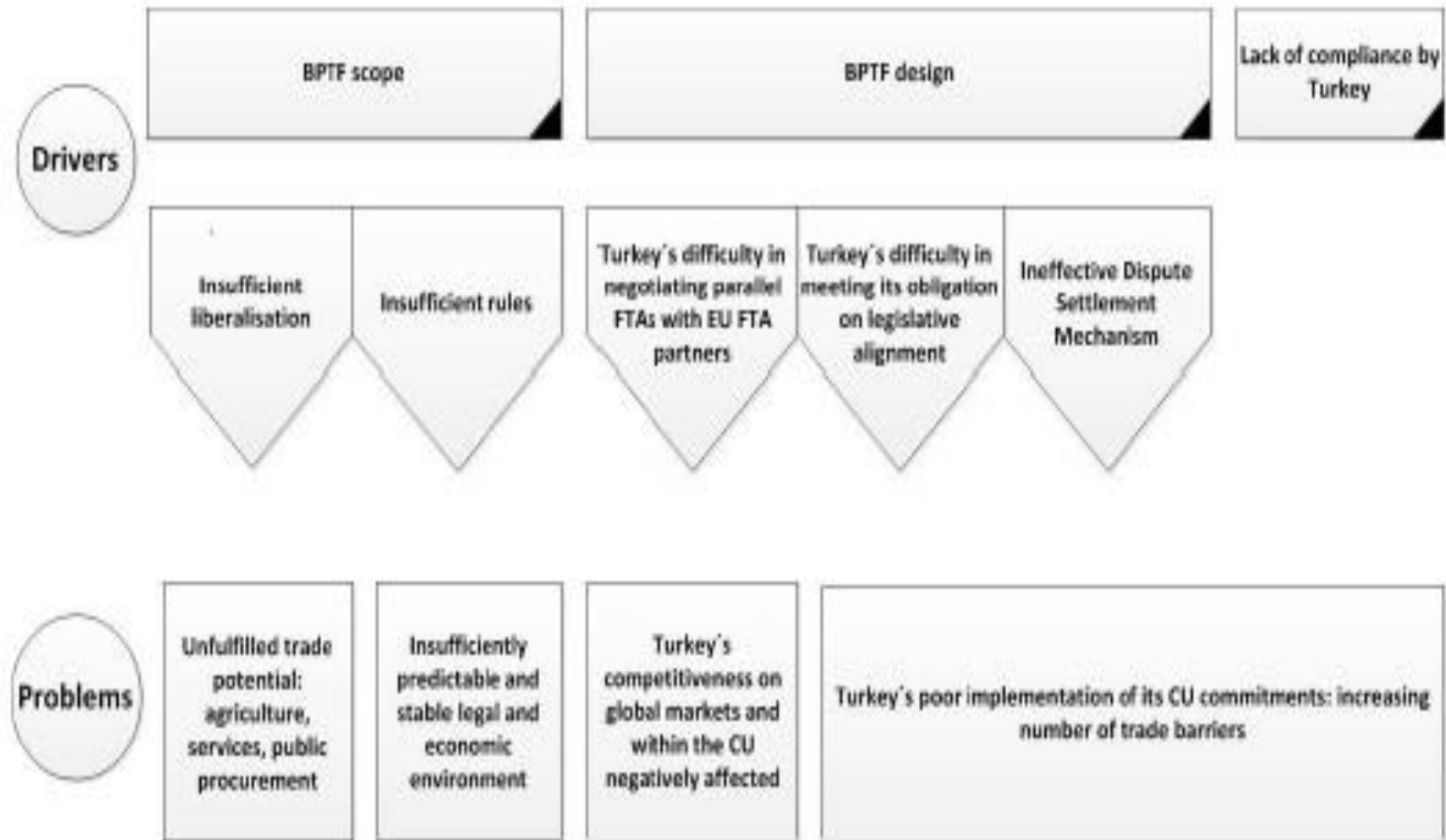
Deepen: to new areas

Structural problems:

FTAs
Decision making
Transport quotas

Modernisation

Problems in the CU (E. Commission)



Updating the CU *(Ministry of Economy, Turkey)*

1. Eradicating structural problems:
asymmetries –FTAs / Decision making

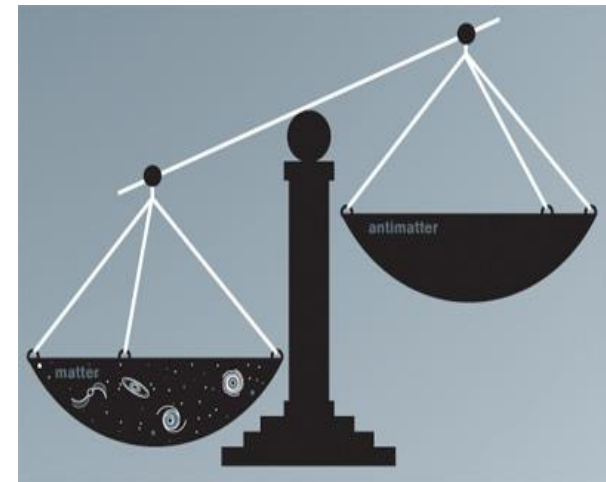
2. Modernising the customs union

3. Deepening the customs union

Challenge: asymmetry in structure

TR has to align itself with EU policy and *acquis*, but cannot participate in decision-making in EU, in areas pertinent to CU.

Turkey is a 'rule-taker'



Asymmetry: EU's FTAs

- *Erosion of preferences in EU market*
- *Turkish exporters cannot have automatic reciprocal access to FTA-partners market, while the opposite is possible due to CCT* 
- *Several EU partners refuse to sign FTA deal with Turkey (Turkey clause)*

Decision making and consultation mechanisms

■ **Currently:**

- Turkey cannot participate in EU trade policy making and consultation mechanism sufficiently (limited involvement)
- The joint decision making mechanism is weak.

■ **TR expects: (based on the EEA modelling)**

- Participation in mechanisms in which trade policy decisions (in the context of the CU) are taken, including all committees (incl. Trade Policy Committee) and agencies;
- **Customs Union Joint Committee** (CUJC) to be revised as a decision body (EEA model)
- CUJC to decide Turkey's adoption of the EU *acquis*

Asymmetry comes from...

- the initial **perception that CU was** meant to be a **temporary** step in the lead up to Turkey's EU accession.
- CU negotiations **reflected the understanding of the day**, naturally without having a proper forecast about the nature and characteristics of XXI. century trade.

2. Modernising the customs union:

- *Technical barriers to trade*
- *Intellectual property rights (IPRs)*
- *Trade facilitation and customs matters*
- *Trade defense instruments*
- *Dispute settlement mechanism*

3. Deepening the customs union:

Agriculture

Trade in services

Public procurement

World Bank proposes:

(World Bank Report, 2014)

- CU has **not fulfilled** its potential:
- Formalize **parallel negotiations** for FTAs
- **Reduce asymmetries** in consultation and decision making mechanisms under CU.
- Widen preferential trade to primary **agriculture and services**.
- First-best solution: progress in **accession negotiations**



Effect on Turkey/EU: FTA or upgraded CU

■ European Commission (BKP-2016):

→ **Enhanced Commercial Framework (ECF):**

- CU with the scope unchanged (industrial products only),
- coal and steel agreement;
- FTA covering the following: agriculture and fishery products, services and establishment, NTBs, and public procurement.

→ **DCFTA:**

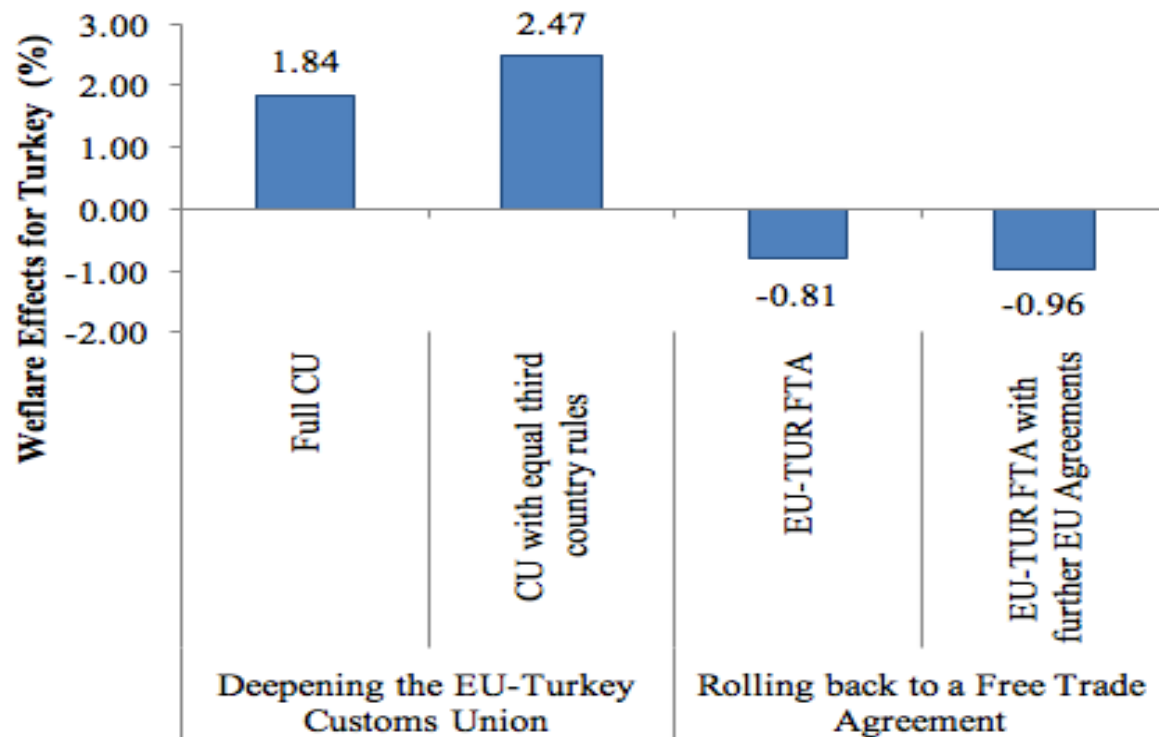
- to replace the CU and establish an FTA that covers all goods trade, including industrial, agricultural, and fishery products, plus services, NTBs (less ambitious), establishment, and public procurement.

cont.

| | Bilateral exports (EUR million) | Welfare (EUR millions) | GDP (%) |
|---------------|------------------------------------|---------------------------|---------|
| EU | | | |
| ECF | 27,062 | 5,388 | 0.007 |
| DCFTA | 7,978 | 1,150 | -0.005 |
| TURKEY | | | |
| ECF | 4,960 | 12,522 | 1.44 |
| DCFTA | -4,342 | -144 | 0.26 |

Effect on Turkey/EU: FTA or upgraded CU

■ Felbermayr et al. (2016):



The challenges in upgrading CU

political

methodic (nature of negotiations)

economic

Challenges: Political

→ *Domestic uncertainties:*

- **Turkey:** domestic political circumstances; slowdown in reform process; mistrust in the EU
- **EU:** uncertainties about its future; Brexit; enduring 'crisis'; increasing anti-trade rhetoric;

→ *Global uncertainties:*

- The 'Trump effect': towards an era of 'sclerosis'
- No success in trade liberalisation: Doha Round, TISA, TTIP...

Challenges to CU negotiations

■ EU:

- Domestic resistance (remember CETA, TTIP...)
- Not all Member States like 'Turkish delight'
- European Parliament resolution to 'suspend negotiations'
 - stressed that suspending work on upgrading the customs union would have serious economic consequences for Turkey.

■ TURKEY:

- Is Turkey ready for reforms (public procurement, SPS, agriculture,...)?
- Rising anti-European discourse

Challenge: who to negotiate and ratify it?

Methods for negotiations:

- by the Assoc. Council: *intergovernmental*
 - New Decisions by the Assoc. Council to reform CU
 - Amend Decision 1/95
- Under Article 207 (TFEU): *supranational*
 - CCP is an area of exclusive competence (TFEU-Art.3)

Challenges in agriculture

Challenge: *to achieve free movement of agro-products*

- TR is seventh largest agricultural producer in the world
- TR has surplus in agro-trade
- Farm population decreases to less than 10%

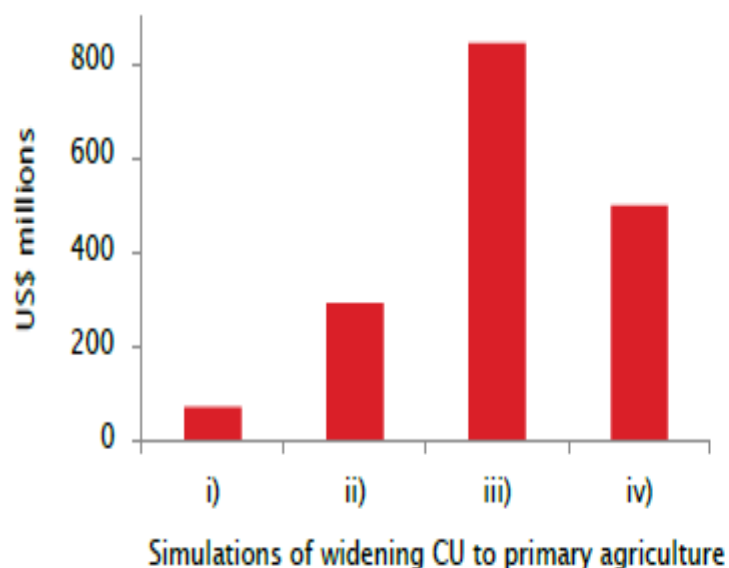
■ But:

- Agricultural productivity is low
- High protection by tariffs (s.a. final bound= 61% - MFN applied = 42%)
- Highest bound rates: up to 225% (animal products), 180% (dairy)
- Import ban on beef and bovines
- TRQ are not bound in WTO Schedules
- Domestic support, not always notified to WTO
- Export subsidies on 44 products
- SPS measures: alignment is low
- A need for modernisation of TR agriculture
- Direct income payment need to be re-instituted

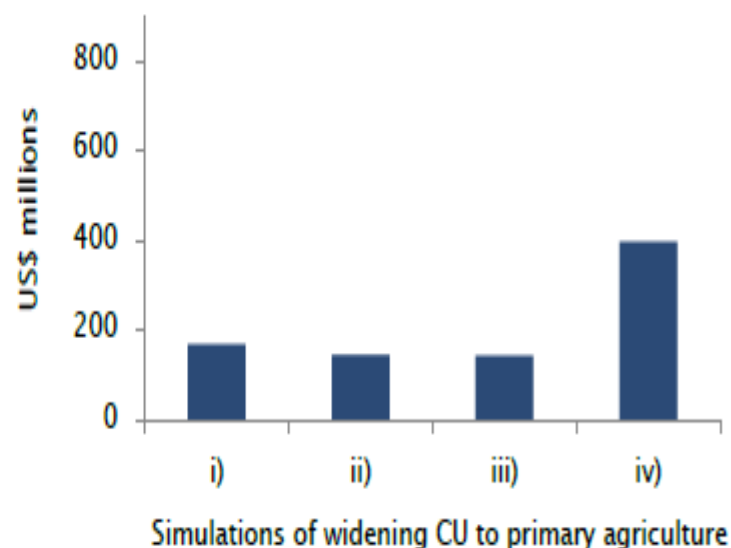
Agricultural liberalisation increases real income in TR and EU

(World Bank, *Evaluation of the Turkey-EU Customs Union-2014*)

a) Change in Turkish real income



b) Change in EU real income



4 scenarios:

- i. EU-Turkey FTA in agriculture
- ii. FTA + EU's common external tariff
- iii. CU in agriculture (common commercial policy)
- iv. Turkish adoption of the CAP

Services

Challenge: *to achieve free trade in services (TR)*

Three types of services:

- 1. under EU wide regulations:** financial, telecom, energy, transport
- 2. regulated by Services Directive 200/123:** legal, accounting, business, construction
- 3. under national regulations:** public/social, health, education

Services

■ Turkey:

→ **Liberalised rules** apply in many areas (distribution, retailing, insurance...) **but** commitments **not bound** (GATS, TISA)

→ **Protected sectors:**

- Postal/courier
- Professional (legal, accounting...)
- Construction

■ EU:

→ **Mode 4** (movement of persons)

→ **Health, audio-visual...**

Public procurement

Challenge: *less transparency, discr. domestic firms*

- TR market is restricted for domestic suppliers:
 - Public Procurement Law subject to amendments
 - Foreign competition is limited due to price preference of up to 15% provided to domestic bidders
 - Thresholds below which there is restriction for participation of foreign bidders (twice that of the EU)
 - Exclusions and exemptions for foreign bidders
 - Transparency in local administrations bids needed
 - Public Procurement Authority cannot monitor defence, security, tech.
- TR has to accede to WTO Government Procurement Agreement (GPA)

Institutional

- TR takes part in several committees related to making and implementation of **technical legislation**
 - Stronger ***consultation mechanism*** to accelerate **transposition** by TR of EU technical legislation beyond 2/97 (old approach): i.e. GMP in pharma., GMOs, REACH, SPS...
 - Turkish experts must be consulted at the drafting stage, not at Council submission stage
 - ***notification deficit*** European Commission each year would propose an updated list of newly adopted acts for Turkey to incorporate into its domestic legal order...Proposal withdrawn.

Institutional

- TR participation as regards **trade policy** (CCP and FTAs) limited.
 - ***Trade Policy Committee*** (ad hoc committee to bring strong coordination and exchange of information)
 - ***CUJC*** need to be empowered to take decisions (like EEA joint committee) and meet regularly as envisaged.

proposals

- Business /NGOs involvement need to be institutionalised
- Trade adjustment financing

Future prospects for TR-EU relationship

'Turkey now stands between a crippling CU that cannot roll-back, and the full membership prospect that is not conceivable in a foreseeable future'...

'CU does **not** seem to be **sustainable** in the long run without a full membership perspective'.