

Customs Union Position Paper

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German - Turkish Chamber of Industry and Commerce (AHK Turkey)
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Contents

Abbreviations	2
Executive summary	4
1. Introduction: The European Union, Turkey, and the CU	6
2. Quantifying CU activities between Turkey and the EU	10
3. Management of CU	20
4. CU upgrade.....	24
5. Current CU and upgrade - business perspectives	31
Brief information on contributor chambers	45
Appendix	48
Bibliography	50

Abbreviations

ADB	Asian Development Bank
ADCs	Additional Customs Duties
AHK Turkey	German - Turkish Chamber of Industry and Commerce
BCCT	British Chamber of Commerce in Turkey
BLCCT	Belgian - Luxembourg Chamber of Commerce in Turkey
BPTF	EU-Turkey Bilateral Preferential Trade Framework
CAP	Common Agricultural Policy
CBRT	Central Bank of the Republic of Turkey
CCFT	Chambre de Commerce Franco Turque (French - Turkish Chamber of Commerce)
CCIIST	Camera di Commercio e Industria Italiana in Turchia (Italian Chamber of Commerce and Industry in Turkey)
CIE	Information Centre on the European Institutions
CU	Customs Union Decision (1995/6 Agreement)
DBA Turkey	Dutch Business Association Turkey
DIT	Department for International Trade (DIT)
EAEC	European Atomic Energy Community
ECSC	European Coal and Steel Community
EEC	European Economic Community
EFTA	European Free Trade Area
EMU	Economic and Monetary Union
ENISA	European Union Agency for Cybersecurity
EU	European Union
EU-27	27 members of the European Union
EU-28	28 members of the European Union (prior to UK's EU exit)
FDI	Foreign Direct Investment
FTAs	Free Trade Agreements
FTZs	Free Trade Zones
GDP	Gross Domestic Product
GDPR	General Data Protection Regulation
GMP	Good Manufacturing Practice
GSP	Generalized System of Preferences
GVCs	Global Value Chains
HS	Harmonized System
İTKİB	İstanbul Tekstil ve Konfeksiyon İhracatçı Birlikleri (Istanbul Textile and Apparel Exporters Association)
MFN	Most Favoured Nation
NGOs	Non-Governmental Organizations
OECD	Organization for Economic Co-Operation and Development
PEM	Pan-Euro-Mediterranean
PTAs	Preferential Trade Agreements

Abbreviations

R&D	Research and Development
ROOs	Rules of Origin
RTA	Regional Trade Agreement
SCCT	Swiss Chamber of Commerce in Turkey
SMEs	Small and Medium-Sized Enterprises
SPS	Sanitary and Phytosanitary
TAREKS	Dış Ticarete Risk Esaslı Kontrol Sistemi (Risk-Based Trade Control System)
TEPAV	Türkiye Ekonomi Politikaları Araştırma Vakfı (The Economic Policy Research Foundation of Turkey)
TEYDEB	Teknoloji ve Yenilik Destek Programları Başkanlığı (Technology and Innovation Grant Programs Directorate)
TL	Turkish Lira
TOBB	Türkiye Odalar ve Borsalar Birliği (Union of Chambers and Commodity Exchanges of Turkey)
TurkStat	Turkish Statistical Institute
TÜBİTAK	Türkiye Bilimsel ve Teknolojik Araştırma Kurumu (Scientific and Technological Research Council of Turkey)
TÜRKBESD	Türkiye Beyaz Eşya Sanayicileri Derneği (White Goods Manufacturers' Association of Turkey)
UAE	United Arab Emirates
UCC	Union Customs Code
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
WEF	World Economic Forum
WTO	World Trade Organization
WWII	World War II

Executive summary

The European Union (EU) is one of the most prominent supranational political and economic integration schemes. The evolution of European economic integration initiated in the 1950s, demonstrates how common values were incrementally built upon economic integration.

Turkey and the EU have facilitated enhanced trade relations through the Customs Union (CU) Decision, which was first implemented in 1996. Over the last two decades, the CU Decision has served as one of the main pillars enhancing the bilateral connection between Turkey and the EU. It has facilitated the integration of trade and customs reform and has been a catalyst for a stronger relationship between Turkey and the EU. While machinery and electronics constitute the main chunk of Turkey's current exports to the EU, Turkey's export basket has gone through a major transformation over the years due to an increase in its exports to the EU. In fact, the European Foreign Direct Investment (FDI) inflows to Turkey has helped fuel the transformation of Turkey's export capabilities. Moreover, increasing bilateral trade flows also paved the way for Turkey's integration to Global Value Chains (GVCs) through the EU network and has enriched both parties' economic well-being.

In 2019, Turkey imported 63.9 billion dollars' worth of goods from the EU-27, and the EU-27 imported 77.9 billion dollars' worth of goods from Turkey. In total, 141.8 billion dollars' bilateral trade volume between the EU-27 and Turkey took place. Currently, 41.6 percent of Turkey's total trade is with its CU Decision partners. Furthermore, Turkey stands out as the fifth largest non-EU export destination for EU countries.

Under the current agreement between Turkey and the EU, respective parties eliminated custom duties and quantitative restrictions in the bilateral trade of industrial goods and a select number of agricultural products. Currently, 81.8 percent of Turkey's exports to the EU face 0 percent tariff rates under the CU Decision's scope. From the EU's perspective, 71.8 percent of its trade flow face 0 percent tariff rates, resulting in a comparative competitiveness advantage for EU countries compared with third countries' access to the Turkish market. In the overall trade baskets of both Turkey and EU-27, the CU provided a 6-7 percent tariff advantage into their bilateral trade. In particular, the CU has played an important role in Turkish electronics and machinery, and clothing exports to EU-27, considering that Turkey enjoys a substantial preferential margin. From the perspective of the EU-27, the same advantage can be observed for electronics and machinery, and transport equipment that is seen to have benefited the most from the preferential margin.

The EU-Turkey CU Decision is assessed as one of the first major step towards Turkey's eventual membership into the EU. However, due to Turkey's prolonged membership process, and major changes taking place in the world economy, an urgent need for an updated, and modernized CU Decision for removing obstacles and enhancing both production and trade activities, has emerged in recent years. The criteria established in the agreement does not address the demands nor the commercial environment that are present today. A revitalized CU Decision would provide new opportunities for Turkey and the EU, and promote a stronger partnership.

EU and Turkey both agree that the CU Decision needs modernization. The talks to modernize the CU have started in 2014 under the initiative of the European Commission. According to empirical impact assessment studies carried out, the modernization of the CU will bring mutual economic benefits for both parties. In particular, the impact assessment performed by the EU projects that the expected gains will reach 5.4 billion euros or about 0.01 percent of EU's Gross Domestic Product (GDP), and 12.5 billion euros or 1.44 percent of GDP for Turkey. According to the impact assessment conducted by the Republic of Turkey Ministry of Trade, the expected gain for Turkey can be proportional to its GDP ranging between 1 percent and 1.9 percent under different scenarios.

The need for a modernized CU Decision may cover, among a number of other topics, new regulatory measures concerning third-party FTA's, liberalizing agriculture, services, public procurement, and also improving the implementation of the agreement. The current CU has been beneficial to Turkey not only in terms of increased trade and competitiveness and transformation of the Turkish industry via the investments in technology, but also via providing the legal and institutional infrastructure of a rule-based free-market economy. As such, a reformed CU is expected to profoundly transform Turkey's political economy in key sectors such as services, procurement, state aid, and trade dispute settlements. It is also anticipated to support transparency, competitiveness, and respect for universal law.

Initiating CU modernization could serve as an opportunity for a better future conjuncture of EU-Turkey relations while providing effective communication and cooperation channels. The COVID-19 pandemic has made the EU consider relocating its supply chains and bringing them closer to neighbouring countries. Given the existing CU between the parties, Turkey has great potential in this diversion. Hence, the recent COVID-19 pandemic and supply chain disruptions could create an opportunity to re-energize the CU upgrade agenda. However, while political prerequisites to modernization create demotivation, initiating a possible CU upgrade will also pave the way to enhancing the rule of law in Turkey by triggering a positive business motivation for both parties.

Within this framework, this paper consists of 5 chapters to (i) share background historical information on the EU's founding principles and the current CU Decision between Turkey and the EU, (ii) quantify the current CU activities and their economic contributions/benefits, (iii) and address the current issues on the management of CU, (iv) while also highlighting the areas for improvement and alternative dimensions to address the common concerns on the agreement by both parties. (v) The report also incorporates an in-depth economic perspective from companies that have commercial activity within the scope of the CU. The position paper also aims to showcase the best practices of companies that have been positively impacted by the CU agreement and the benefits they have gained commercially from the agreement by including case studies of these companies.

This position paper is a collaborative effort of the eight European-Turkish Bilateral Chambers, the Union of Chambers and Commodity Exchanges of Turkey (TOBB), and the Economic Policy Research Foundation of Turkey (TEPAV).

1. Introduction: The European Union, Turkey, and the CU



Today, the European Union (EU) is one of the most prominent supranational political and economic integration schemes. The common values shared by the EU member states enhance solidarity and integrity of the Union not only on an economic level but also on a political one. In this context, as background information, brief history regarding the EU's founding principles and EU-Turkey Customs Union (CU) Decision is provided in this chapter.

1.1. The European Union's founding principles

The EU is currently comprised of 27 countries that act collectively through an institutionalized system of decision-making with a combined Gross Domestic Product (GDP) of 15.6 trillion dollars and a population of 447.5 million.¹ Given that the present-day EU is the apogee of an extended process of cooperation, a brief introduction to the Union's foundation processes is summarized below.

The foundations for the EU dates back to the post-World War II (WWII) era. The primary objective of this integration was to placate the fractious and irredentist elements in Europe through the means of economic integration. Culminating from the aftermath of WWII, the European integration process was initiated in the 1950s mainly as a consequence of numerous wars with the hope of paralyzing states trying to engage in future conflicts with one another.

The predominant idea of European integration was adumbrated via what is known as the Schuman Plan.² In tandem with the goal of maintaining post-WWII peace, the supranational nature of the community, proposed by "a common high authority," reveals the importance attributed to common law and institutions.³ The common values shared by the EU member states enhance solidarity and integrity of the Union not only on an economic basis but also on a political one. Therefore, the EU-founding principles can be grouped into

¹ World Bank World Development Indicators 2019 statistics, authors' calculations.

² "Declaration of 9th May 1950 Delivered by Robert Schuman," Foundation Robert Schuman, European Issue, No.204 (May 2011).

³ Ibid.

1. Introduction: The European Union, Turkey, and the CU

two pillars: while the first pillar is pertaining to abolishing trade and investment barriers, the second pillar is the incorporation of common values shared by member states - the latter being ultimately political in nature.

In the steps taken for the establishment of the Union, sound economic cooperation was prioritized in order to ensure political amalgamation. As such, the economic pillar eventually paved the way for the political pillar to emerge. In the wake of increasing demand for economic cooperation, the integration was instigated by the establishment of three communities consecutively: European Coal and Steel Community (ECSC), European Atomic Energy Community (EAEC), and European Economic Community (EEC).⁴ The establishment of the ECSC in 1951 upon the declaration of the Schuman Plan was a formal step towards economic integration. Following the foundation of this community, ECSC members further committed themselves to cooperation and integration by signing the Treaty of Rome in 1957. The Treaty of Rome, also simply referred to as the Treaty, is accredited for establishing the European Community by encompassing a wide range of objectives “determined to lay on a foundation of even closer union among the European people.”⁵ The creation of the EEC in 1958 with the enactment of the Treaty gave room for achieving economic targets. Consequently, the inauguration of a common market unified by economic policies - involving the free movement of goods, services, people, and capital - via harmonizing regulations and legislation.

Conforming with the levels of economic integration theory, the economic integration process delineated by the ECC was gradually actualized.⁶ The creation of EFTA (European Free Trade Area) in 1960 further enhanced trade between member countries.⁷ While a free trade area like EFTA constituted the first degree of economic integration, the European Customs Union, enacted in 1968 as a more comprehensive agreement, follows suit in terms of complexity. The main difference between the European Customs Union and EFTA is that in the customs union, besides abolishing tariffs amongst member states, participating countries apply a common external tariff against non-members. In 1993, an even higher degree of economic integration was attained with the establishment of the European Single Market (also dubbed the Common Market). After which the members of the Common Market benefited from the free movement of goods, capital, services, and labour, European integration became more profound with its economic dimension, where disparities in policies were aimed at being abolished. The highest degree of integration was realized with the Economic and Monetary Union (EMU), in which monetary, fiscal, and social policies became unified under the control of a supranational authority.

Since 1968, following several waves of expansions, the European Customs Union became one of the most eminent trading blocs in the world. The enlargement of the EU in the last five decades has led to intra-bloc trade reaching up to 63 percent from 46 percent.⁸ From 6 members in 1968 to 27 members in 2021, the EU also has customs union agreements with three non-member countries - namely Andorra, San Marino, and Turkey.⁹

Moreover, as previously touched upon, EU integration is not confined to an economic union: political integration is ensured as well. The evolution of economic integration culminating in the EMU demonstrates how a political union was incrementally built upon economic integration. The elimination of trade barriers facilitated efficient growth amongst member countries resulting in expanding internal trade and creating a robust market. Members of the EU being able to compete successfully with other economies is due in large

⁴ “History of the EU,” Republic of Turkey Ministry of Foreign Affairs Directorate for EU Affairs.

⁵ “Treaty Establishing the European Economic Community,” United Nations Treaty Collection.

⁶ Bela Balassa, *The Theory of Economic Integration* (Routledge Revivals, 2013), 2-3.

⁷ While the founding members of EFTA were Austria, Denmark, Norway, Portugal, Switzerland, Sweden, and the UK; the present-day members are Iceland, Liechtenstein, Norway, and Switzerland.

⁸ European Commission, CIIE, Harvard Dataverse, World Trade Organization Regional Trade Agreements Database, authors' calculations.

⁹ “Customs Union,” European Commission.

part thanks to economies of scale achieved by not being limited to individual domestic markets. The European Single Market allows not only for the trade of goods and services but also the strategic positioning of production amongst member countries. The fact that capital movement is enabled with minimal to no obstacles is rather significant for European economics since it allows companies to invest and raise money smoothly and apply it to the most optimal candidate within the Union.

In other words, production facilities, supply networks, varying forms of services, and any other sort of business operation can be distributed over a wide range of member countries, leading to the creation of multinational companies within the EU that are extraordinarily competitive in the world market. Therefore, such an integration necessitates the unification of policies under the control of a supranational authority such that political integration goes hand in hand with economic integration. Hence, the unification of European nations is ensured not only by economic integration, but also with the adoption of common values. The groundwork for establishing the EU resides in maintaining peace. The abolishment of political conflicts is believed to be achieved by economic integration and fortified by shared values. Democracy and human rights are regarded as ineluctable such that the first steps taken to ensure democracy and human rights in Europe were even before the emergence of the Union. In line with this reasoning, with the Treaty of Lisbon in 1993, the European Council enacted the Copenhagen Criteria, a set of measures that need to be attained by countries hoping to become a member.¹⁰ These criteria encompass economic conditions as well as political conditions in the form of the quality of institutions and democracy. Members still attempt to promote democracy and implement policies complying with the longstanding values and principles of this Union.

1.2. EU-Turkey CU Decision (1995/6 Agreement)

In 1963, Turkey signed an Association Agreement, dubbed the Ankara Agreement, with the EEC. In tandem with the process that initiated this agreement, the EU completely removed customs duties on Turkish industrial goods starting from the 1970s onwards. On the other hand, Turkey's removal of customs duties on EU industrial goods was gradually applied over time.¹¹ Following the expected transitional period for Turkey, the CU Decision took full effect in January 1996, where Turkey entirely eliminated customs duties for industrial goods from the EU.¹²

The CU Decision between Turkey and the EU was the EU's first customs union with a non-member state. The CU Decision between Turkey and the EU was finalized in 1996, 32 years after the inception of the Ankara Agreement. In particular, the objective of the agreement was twofold and aimed to not only remove trade barriers but also to enhance the circulation of goods for both partners. The agreement identified two specific channels for the agreement to be successful. On the one hand, it aimed to establish the free circulation of goods within a territory as defined by the customs agreement, and on the other hand, it required Turkey to align itself with the *Acquis Communautaire* in several internal market areas.¹³ In other words, under the agreement between Turkey and the EU, respective parties eliminated custom duties and quantitative restrictions in the bilateral trade of industrial goods and a designated number of agricultural products. Additionally, Turkey also adopted the EU's Common External Tariff (CET) for products covered by the CU on its third-party country imports. In this context, Turkey became responsible for being in line with the EU's preferential trade agreements that the EU had or would conclude with third party countries.^{14 15}

¹⁰ Pascal Fontaine, "Europe in 12 Lessons," European Commission, January 2014, 9.

¹¹ "Customs Union, Supporting the Growth of EU - Turkey Trade," Delegation of European Union to Turkey.

¹² "Countries and Regions: Turkey," European Commission.

¹³ İhsan Karataş, "The EU-Turkey Customs Union: Towards a Revision of the Legal and Institutional Framework?"

¹⁴ "Modernising the EU-Turkey Customs Union," Economic Research Forum.

¹⁵ "Decision 1/95 of 22 December 1995 on Implementing the Final Phase of the Customs Union (96/142/EC)," EU-Turkey Association Council.

1. Introduction: The European Union, Turkey, and the CU

For Turkey and the EU, the CU has been a significant instrument of integration into each other's market and global markets. For instance, several quantitative assessments confirm the overall positive impact of the CU on Turkey's and the EU's private sectors.^{16 17 18} One of the current public opinion surveys in Turkey shows that the majority of the participants think the CU between Turkey and the EU is beneficial for both parties, while only 7 percent disagree on Turkey's beneficiary status.¹⁹ As such, the second chapter in this report lays out the historical trade and investment figures, the coverage of the CU, the economic benefits of the CU on bilateral trade via tariff analyses, and verifies the positive perception of the public.

The EU-Turkey CU Decision was assessed as a first major step towards Turkey's eventual membership into the EU, as can be depicted from the timetable shared in the Appendix in, Table 1.²⁰ However, due to Turkey's prolonged membership process, and major changes taking place in the world economy considering both production and trade activities, a need for an updated CU Decision has emerged in recent years. Accordingly, the dialogue between the EU and Turkey for a much sought-after upgrade of CU started in early 2014.²¹ In particular, the third chapter lays out the general functioning of the current CU, and the fourth chapter delves into the CU upgrade in detail, taking into consideration the motivations, possible opportunities, and risks pertaining to the next policy options.



¹⁶ Aytuğ et al., "Twenty Years of the EU-Turkey Customs Union: Effects of EU Integration," *Journal of Common Market Studies* 55 (2016): 419-31.

¹⁷ Selahattin Bekmez, "Sectoral Impacts of Turkish Accession to the European Union," *Eastern European Economics* 40 (2002): 57-84.

¹⁸ Glenn W. Harrison A, Thomas F. Rutherford, David G. Tarr, "Economic Implications for Turkey of a Customs Union with the European Union," *European Economic Review* 41 (1997): 861-870.

¹⁹ "Support for the European Union and Perception of Europe in Turkish Public Opinion 2019," İKV.

²⁰ İhsan Karataş, "The EU-Turkey Customs Union: Towards a Revision of the Legal and Institutional Framework?"

²¹ World Bank, "Evaluation of the EU-Turkey Customs Union," 2014.

2. Quantifying CU activities between Turkey and the EU



The CU Decision has served as one of the main pillars over the last two decades in terms of enhancing the bilateral relationship between Turkey and the EU. It has facilitated the integration of trade and customs reform and has been a catalyst for the development of a stronger relationship between the EU and Turkey. The CU Decision has been the main reason for the reduction in tariffs on imports and industrial products. Accordingly, this chapter first provides brief information on the overall structure of the historical trade and investment ties between Turkey and the EU. The following sub-section then quantifies the coverage of the CU on the current trade relations with an emphasis on preferential tariff and competitiveness advantage brought by the CU to underline the importance of the CU in the current bilateral relations.

2.1. Historical trade and FDI ties²²

Turkey and the EU share a long history of trade and investment. As depicted in Figure 1, nearly 50 percent of all of Turkey's exports, spanning the past 40 years, have been to EU nations. In other words, EU has always been a major trade partner for Turkey even before enacting the CU. In addition, an overall increasing trend is particularly visible regarding Turkey's presence in the EU's total trade. In 1980, roughly 0.3 percent of all EU countries' trade was with Turkey; now, however, this figure has more than quadrupled to 1.4 percent. This noticeable increase in Turkey's share in the EU's trade basket also verifies that the CU has enabled an easier penetration for the European business community into the Turkish market.

²² Quantitative analysis in this sub-chapter is presented in such a manner so as to reflect the number of countries that are effectively a part of the CU Decision between Turkey and the EU in the respective year. As of January 31, 2020, the UK became the first country to leave the EU. Since the latest analysis in this sub-chapter is for 2019, the consequences of Brexit are not reflected in the historical figures.

2. Quantifying CU activities between Turkey and the EU

Currently, 41.6 percent of Turkey's total trade is with CU Decision partners. It is a significant figure indicating that seven out of ten export destinations for Turkish products are to EU countries. Similarly, Turkey stands out as the fifth largest non-EU export destination for EU countries in 2018. Machinery and vehicles are an integral part of the EU's exports to Turkey, and this has been the case for the past several decades (see Figure 2). While machinery and electronics are the main portions of Turkey's current exports to the EU, Turkey's export basket has gone through a major transformation over the years. Since nearly half of all Turkish exports are to the EU, the transition in the main export product group also reflects a major change within the Turkish economy itself. Accordingly, Turkey's overall economy has transitioned towards exporting more sophisticated products compared to the previously low technology products such as vegetables, beverages, and food products (see Figure 3).

The witnessed transformation in Turkey's production capabilities towards more sophisticated goods is mainly linked to investment ties. Fluctuating between 35 and 85 percent, most of Foreign Direct Investment (FDI) inflows into Turkey are sourced from EU countries for the last several decades.²³ In order to visualize the importance of FDI inflows, it should be noted that as of 2019, the total inward stock of FDI is 21.6 percent of Turkey's GDP.²⁴ ²⁵ To further elaborate, as of June 2019, more than 70 thousand companies with foreign shareholders are operating in Turkey. Out of which, 23.5 thousand firms have EU shareholders and 4.4 thousand of them are concentrated in the automotive sector, echoing the importance of machinery and electronics trade between the EU and Turkey.²⁶

The number of EU companies compared to the total number of foreign companies in Turkey has helped fuel the transformation of Turkey's export capabilities. While more than half of Turkey's exports are to non-EU countries, it is the demand for sophisticated products from EU nations and investment into companies that could provide them that has led to the drastic transition in Turkey's economy. In the past two decades, Turkey's economy has shifted gears from producing agrarian products to medium-technology products, thanks in large part to EU partners. From the EU's perspective, Turkey has been an investment and trade partner for the last five decades, with the EU having standing out business interests in Turkey. In addition, it is important to note that the CU has had a significant positive effect on bilateral trade, as observed from both import and export figures, with the agreement coming into effect. As can be seen in Figure 4, these trade flows also paved the way for the integration of Turkey to Global Value Chains (GVCs) through the EU network and enriched both parties' economic well-being. In particular, Turkish firms are well integrated with the EU value chains and Turkey contributes significantly to the EU firms' competitiveness. For instance, according to UNCTAD database on global value chains, Turkish value added in Germany's total exports is calculated as 7.5 billion dollars in 2017, which is higher than thirteen EU members.²⁷ Germany is followed by the Netherlands and Italy in terms of Turkey's contribution to their export performances. This perfectly illustrates how Turkish and European economies are attached to each other through strong trade links. In other words, while Turkey has enjoyed a major technological transformation via European investment inflows, Turkey's involvement in European value chains has generated an important growth area for EU companies' market networks.

²³ CBRT, OECD, authors' calculations.

²⁴ GDP is a flow variable, while FDI inflows are taken as a stock variable. Considering this difference, this statistic only shows the relative importance of the FDI inflows, and it does not signify the actual weight of the FDI inflows in the current economy.

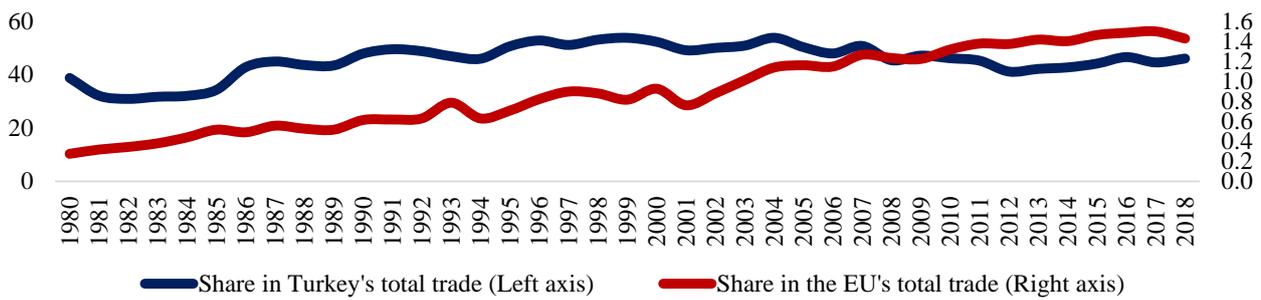
²⁵ UNCTAD, authors' calculations.

²⁶ Alo Maliye, authors' calculations.

²⁷ UN Conference on Trade & Development (UNCTAD) - Eora Global Value Chain Database.

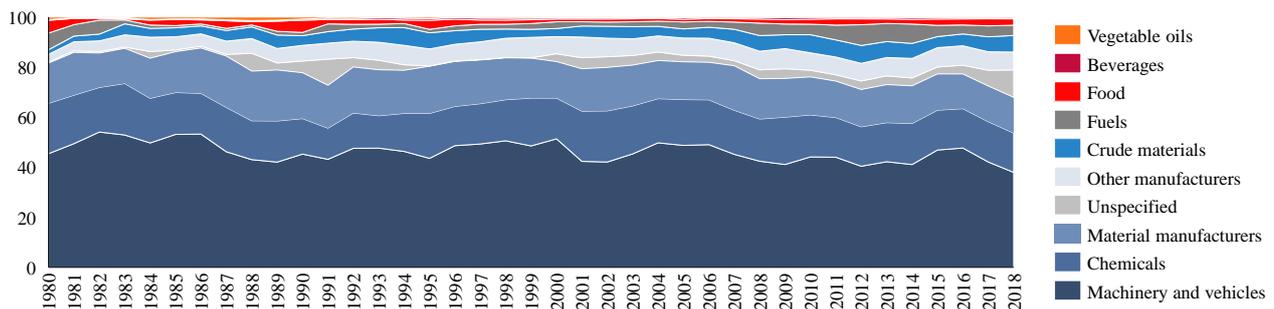
2. Quantifying CU activities between Turkey and the EU

Figure 1 – Historical shares of Turkey-EU trade in each partner's total basket, %, 1980-2018



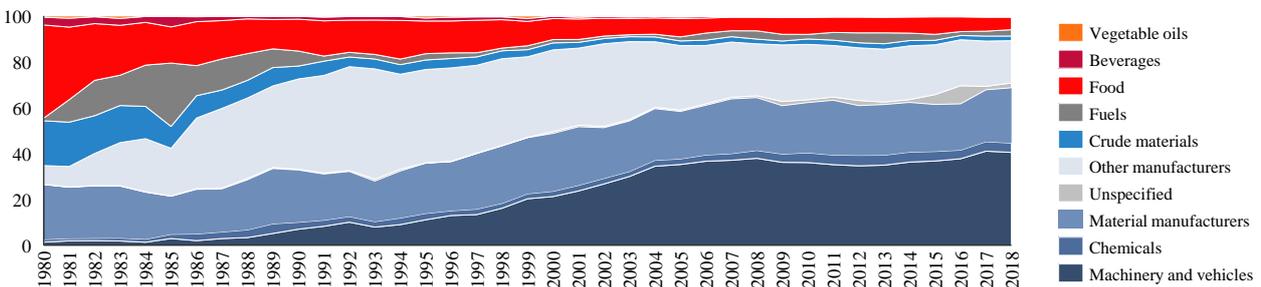
Source: European Commission, CIIE, Harvard Dataverse, WTO RTA Database, authors' calculations

Figure 2 – EU's exports to Turkey by major sectors, %, 1980-2018



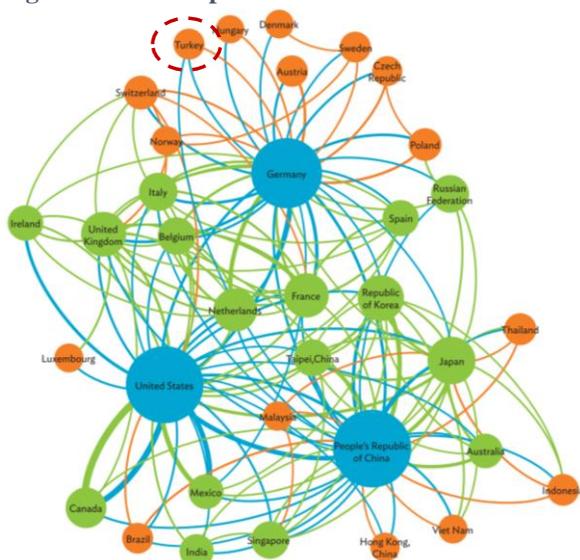
Source: European Commission, CIIE, Harvard Dataverse, WTO RTA Database, authors' calculations

Figure 3 – Turkey's exports to the EU by major sectors, %, 1980-2018



Source: European Commission, CIIE, Harvard Dataverse, WTO RTA Database, authors' calculations

Figure 4 – Global production chains



Source: Abdul Abiad et al., "The Impact of Trade Conflict on Developing Asia," ADB Economics Working Paper Series, December 2018.

2.2. Economic contributions/benefits of the CU on trade by tariff analyses²⁸

The coverage of the CU on the current trade relations

In line with the World Trade Organization (WTO) principles, countries cannot discriminate between their trade partners. In this context, if trade partners are not a part of a bilateral trade agreement such as a Free Trade Agreement (FTA), customs union, etc., or preferential tariff systems such as Generalized System of Preferences (GSP), then they are not allowed to offer each other tariff rates lower than the Most Favoured Nation (MFN) rates. In particular, MFN rates are applied for countries' imports from third countries that do not have any specific preferential trade agreement with the importer country. Currently, due to the CU Decision, tariff rates lower than the MFN rates - 0 percent - are applied to processed products in the trade between Turkey and the EU.

In 2019, Turkey imported 63.9 billion dollars' worth of goods from the EU-27, and the EU-27 imported 77.9 billion dollars' worth of goods from Turkey. In total, 141.8 billion dollars bilateral trade volume between the EU-27 and Turkey took place. Furthermore, members of the European Customs Union have a common MFN list for their third-country imports. Comparing this MFN list with the tariff rates implemented for Turkey's exports to the EU-27 reveals the preferential margin. 82.8 percent of Turkey's current exports to the EU materialized under the scope of the CU Decision. Furthermore, 81.8 percent of Turkey's current exports to the EU face 0 percent tariff rates under the CU Decision's scope, resulting in a comparative competitiveness advantage for Turkey compared with third countries' access to the EU market. From EU's perspective, in 2019, 72.1 percent of the EU's exports to Turkey were realized under the scope of the CU Decision, with 71.8 percent of this trade flow facing 0 percent tariff rates (see Table 1).

In 2019, Turkey's export volume to the EU-27 was overwhelmingly dependent on transport equipment, minerals and metals, electronics and machinery, and clothing. These top 4 sectors constituted 73 percent of Turkey's total exports to the EU. Other sectors received shares below 6 percent, and the top-two performing sectors among these are namely textiles and chemicals. It is worth mentioning that if the textiles and clothing sectors are evaluated as one integrated sector, textiles and clothing will become the second most exported sector of Turkey to the EU members. Given the coverage of the CU, except minerals and metals, most of the trade flows took place under the protection of CU with a 0 percent tariff rate while competitors such as the United States of America (USA) and China do not have preferential tariff advantages in the EU market (see Figure 5).

In the case of the EU's exports to Turkey, the top 4 sectors with the greatest volume of exports are electronics and machinery, chemicals, minerals and metals, and transport equipment. In 2019, 79 percent of the EU's total volume of exports to Turkey were comprised mainly of these top 4 sectors while the succeeding sectors had substantially lower shares in a starkly similar fashion to Turkey's exports to the EU - hence, revealing a concentrated sectoral breakdown in the Turkey-EU bilateral trade. In the case of the CU coverage, as was the case for EU's imports, Turkey's imports from the EU in these particular sectors face 0 percent tariff rates thanks to the CU Decision (see Figure 5).

²⁸ Quantitative analysis in this sub-chapter is presented in such a manner to reflect the number of countries that are effectively a part of the CU Decision between Turkey and the EU in the respective year. As of January 31, 2020 UK left the EU. After the end of the transition period (end of 2020), Turkey and UK have started to trade independent of CU between Turkey and the EU. Since this sub-chapter covers analyses for further improvements in the bilateral trade relations between the EU and Turkey, the presented trade figures do not include UK.

2. Quantifying CU activities between Turkey and the EU

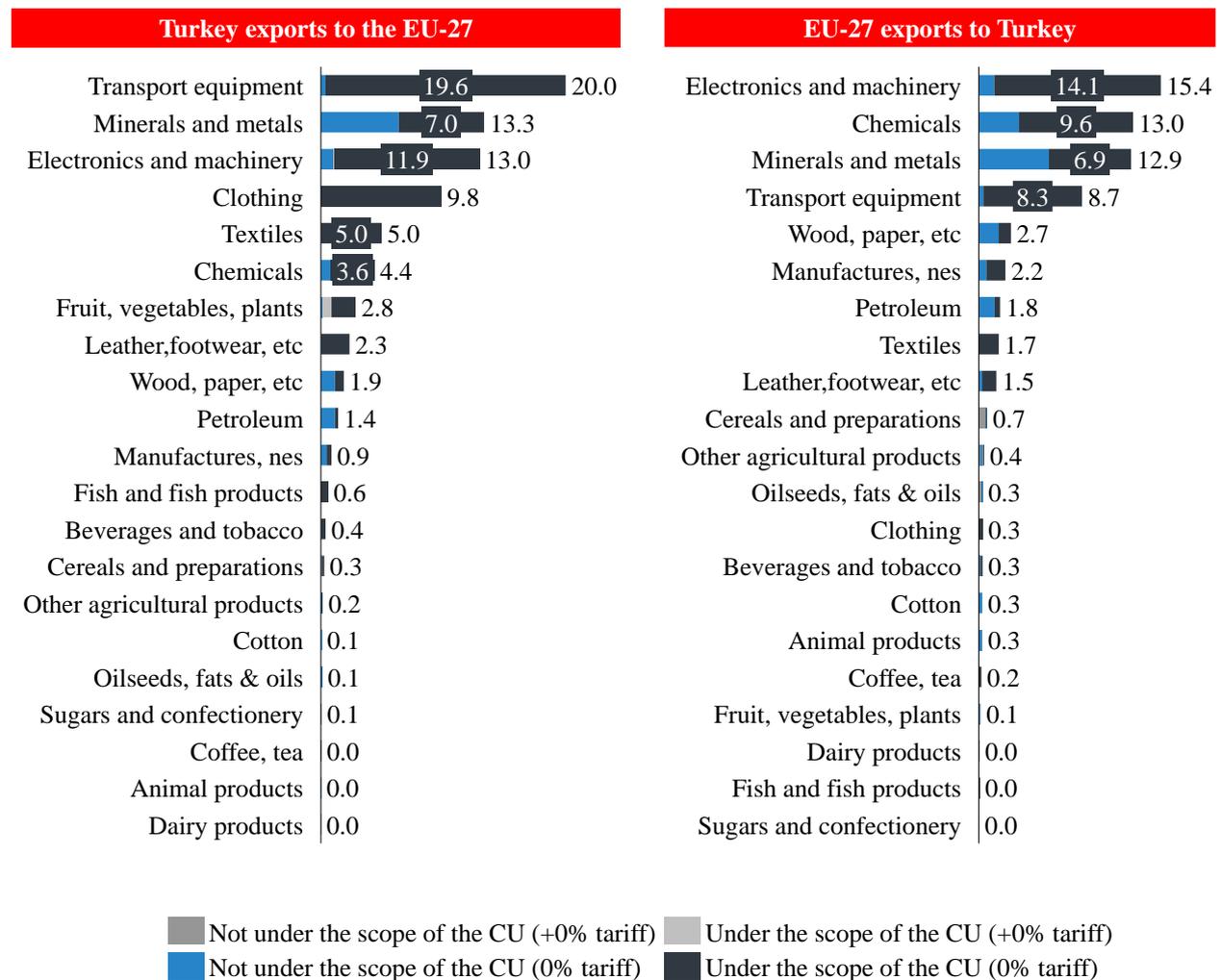
Table 1 – The overall coverage of the CU on the current bilateral trade relations, 2019

	Turkey's exports to the EU-27	EU-27's exports to Turkey
Under the scope of the CU, billion \$	64.5	46.1
0% tariff rate	63.7	45.9
Not under the scope of the CU, billion \$	12.1	17.0
0% tariff rate	12.0	15.9
Cannot be calculated due to data limitations, billion \$	1.3	0.8
Scope of the CU coverage in the respective trade flow, %	82.8%	72.1%
Scope of the preferential tariff advantage in the respective trade flow, %	81.8%	71.8%

Source: Eurostat, ITC Macmap, Official Gazette of the Republic of Turkey, Republic of Turkey Ministry of Trade, TurkStat, authors' calculations

Note: If an applied tariff rate between Turkey and the EU is lower than MFN rates, this product is categorized as “under the scope of the CU” implying a preferential margin.

Figure 5 – Bilateral trade between Turkey and EU-27 according to sectoral breakdown and the CU coverage, billion \$, 2019



Source: Eurostat, ITC Macmap, Official Gazette of the Republic of Turkey, Republic of Turkey Ministry of Trade, TurkStat, WTO, ITC, UNCTAD, authors' calculations

Note: If an applied tariff rate between Turkey and the EU is lower than MFN rates, this product is categorized as “under the scope of the CU” implying a preferential margin.

Note: “nes” is an abbreviation for “not elsewhere specified”.

The preferential tariff and competitiveness advantage

As laid out in the previous analyses, the bilateral trade flow between Turkey and the EU mostly enjoys the elbow room brought by the CU. To be more precise, in this sub-chapter, the preferential tariff advantages will be analysed with respect to competitiveness they provide to Turkey and the EU against third countries accessing their respective partners' domestic markets.

With respect to competitiveness advantage, besides the CU Decision between Turkey and the EU, more than 70 countries outside of the Union have trade agreements with the EU.^{29 30 31} Figure 6 depicts each country's position in the EU-27 trade basket and explicitly shows that Turkey is one of the non-member countries, following South Korea, with the highest trade volume with the EU possessing a trade agreement. Therefore, given the analyses shared in Table 1, it can be stated that the CU coverage favours Turkey against a majority of EU trade partners such as Brazil, China, Russia, Taiwan, and the USA.

Ankara has trade agreements with 23 non-EU member countries - triggering preferential tariff advantages for respective signatories.^{32 33 34} Yet, as seen in Figure 7, except for South Korea and Israel, EU countries enjoy the highest trade share in Turkey's basket. Given the scope of these agreements and their respective trade flows, EU countries have a considerable preferential tariff advantage over Turkey's other major trade partners who do not benefit from any trade agreements, such as China, Russia, and the USA.

Even though respective countries' market shares in the EU and Turkey trade baskets, and the overall trade agreements show the relative competitiveness advantage that the CU provides in comparison with the third markets, further analyses are conducted to scrutinize the actual size of these advantages. In particular, Brazil, China, Russia, Taiwan, and the USA are the major economies with the highest volume of exports to the EU market without benefiting from any particular trade agreement. In the stated cases, MFN rates in line with the WTO principles are applied. As such, MFN rates and the rates faced by Turkey are compared in Table 2. Accordingly, Turkey faces 0.07 percent average tariff rates for its exports to the EU market. Yet, taking the exporter countries' baskets into account, tariff rates of 3.35 percent for Brazil, 3.04 percent for China, 0.58 percent for Russia, 1.93 percent for Taiwan, and 2.14 percent for the USA are applied for their exports to the EU-27 market.

Without benefitting from the CU rates, Turkey would have faced a 6.47 percent average tariff rate instead of the currently advantageous 0.07 percent. In order to demonstrate the possible effect of Turkey's 6 percent tariff advantage, a case study analysis is conducted based on the unit values of exports. Before delving into the unit value analyses at the product level, it should be noted that the EU-27 countries have a preferential tariff advantage of around 7 percent against Turkey's other major import partners such as China, Russia, and the USA, as shown in Table 3, revealing that the tariff rate cuts were advantageous for both the EU and Turkey.

²⁹ "Negotiation and Agreements," European Commission.

³⁰ World Trade Organization Regional Trade Agreements Database, authors' calculations.

³¹ "Trade Agreements," ITC Market Access Map.

³² "Serbest Ticaret Anlaşmalarına İlişkin Genel Bilgi," Republic of Turkey Ministry of Trade.

³³ "Türkiye'nin STA'ları," Republic of Turkey Ministry of Trade.

³⁴ "Yürürlükte Bulunan STA'lar," Republic of Turkey Ministry of Trade.

2. Quantifying CU activities between Turkey and the EU

In order to demonstrate the possible benefits of 6 to 7 percent tariff advantages brought by the CU, an analysis is conducted as a case study using the unit values of exports. As can be seen in Figure 8, CU has played an important role in Turkish electronics and machinery, and clothing exports to EU-27, when it is considered that Turkey has limited price competitiveness in these products but enjoys a preferential margin. From the perspective of the EU-27, the same advantage can be observed for electronics and machinery, and transport equipment that is seen to have benefited the most from the preferential margin (see Figure 9).

To sum up, in the overall trade baskets of both Turkey and EU-27, the CU provided a 6 to 7 percent tariff advantage for their bilateral trade. Especially the electronics and machinery sector, which is the backbone of Turkey-EU bilateral trade, enjoys the preferential tariff advantage at a higher rate. Moreover, as the case study analysis demonstrates, most of the outstanding electronics and machinery products do not have intrinsic price competitiveness. Even if there may be other motivations in this relation besides price competitiveness, it can be inferred that the preferential tariff advantages nourish bilateral trade despite the limited price competitiveness.

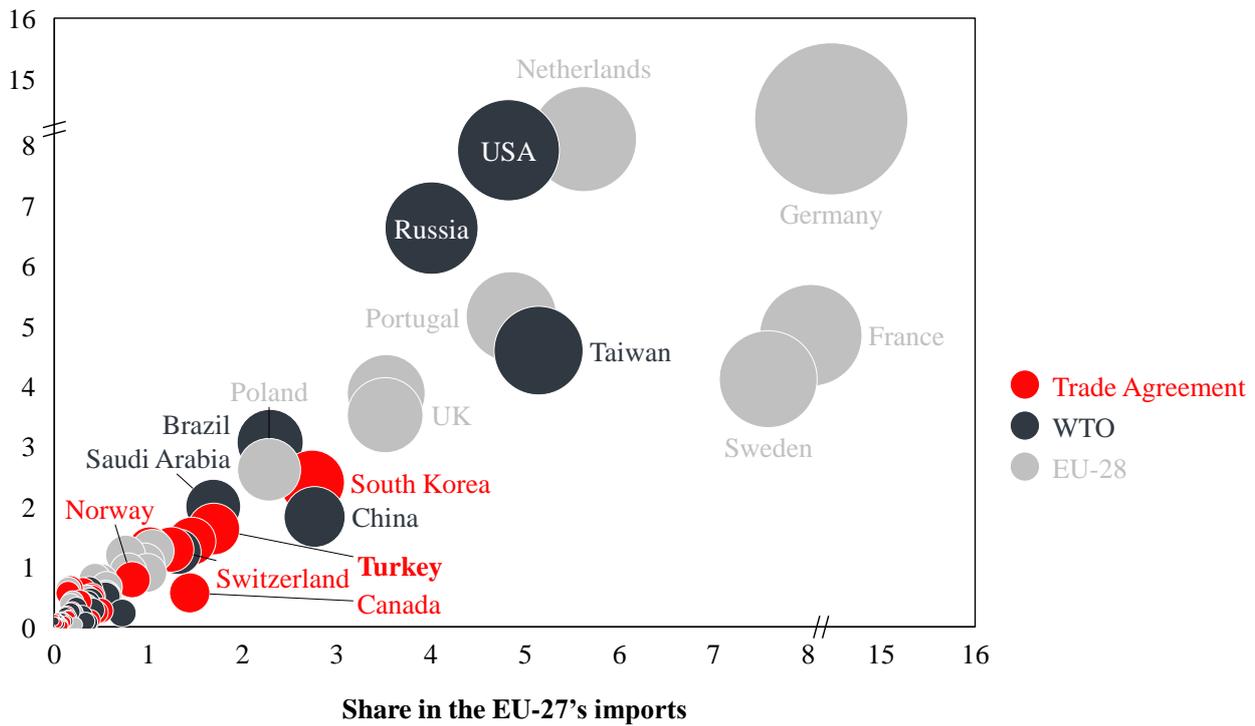
Within this chapter, CU's economic contributions/benefits on bilateral relations are laid out via trade and investment volumes and the preferential tariff margin brought by the CU. Yet, as emphasized in the earlier sections, a customs union agreement offers a deeper economic integration compared to a regular FTA. An earlier analysis conducted by the World Bank quantified the advantages brought by the CU considering the negation of the Rules of Origin (ROOs) on bilateral trade. In particular, it was estimated that implementing an FTA instead of a customs union would yield a decrease in Turkish exports to the EU market by 3.0 to 7.2 percent. From the EU-27 perspective, implementing an FTA instead of the current CU, may result in a 4.2 percent loss in the EU's exports to Turkey under the restrictive ROOs scenario.³⁵

³⁵ World Bank, "Evaluation of the EU-Turkey Customs Union," 2014.

2. Quantifying CU activities between Turkey and the EU

Figure 6 – Trade partners of the EU-27 according to the status of the partner countries, %, 2019

Share in the EU-27's exports

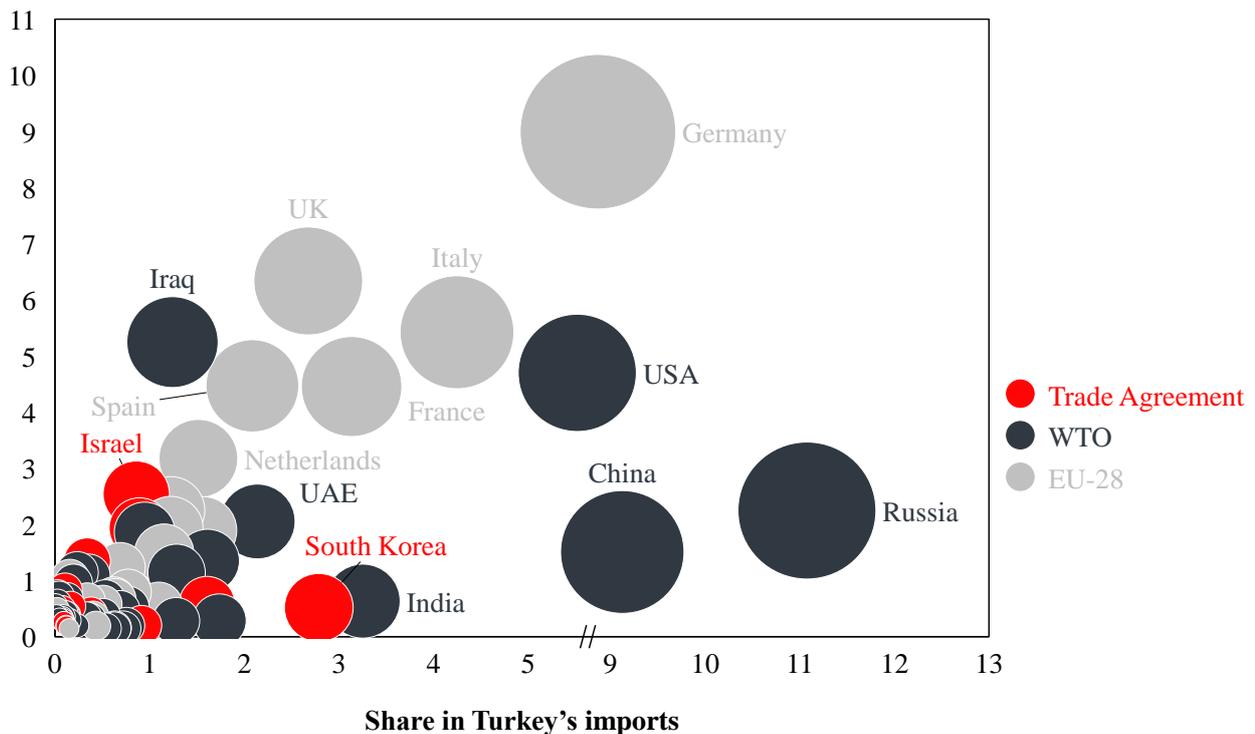


Source: European Commission, Eurostat, ITC Macmap, WTO RTA Database, authors' calculations

Note: Bubble sizes represent the respective countries' total trade volume with the EU-28 in 2019. Partners with less than 5 billion dollars' worth of bilateral trade with the EU-27 are excluded from the figure.

Figure 7 – Trade partners of Turkey according to the status of the partner countries, %, 2019

Share in Turkey's exports



Source: Republic of Turkey Ministry of Trade, TurkStat, authors' calculations

Note: Bubble sizes represent the respective countries' total trade volume with Turkey in 2019. Partners with less than 500 million dollars' worth of bilateral trade with Turkey are excluded from the figure.

2. Quantifying CU activities between Turkey and the EU

Table 2 – Tariff rates faced by the major exporters to the EU-27, 2019

Exporter country	Exports to the EU-27, billion \$	Weighted average tariff rate implemented <u>without any agreement</u> , %	Weighted average tariff rate implemented <u>under the scope of the CU</u> , %
China	404.7	3.04	0.01
USA	257.4	2.14	0.05
Russia	147.6	0.58	0.02
Turkey	77.9	6.47	0.07
Taiwan	30.2	1.93	0.01
Brazil	29.6	3.35	1.09

Source: European Commission, Eurostat, ITC Macmap, WTO RTA Database, authors' calculations

Note: While Turkey exports goods to EU members under the scope of the CU, the other shared countries do so without any agreements. Accordingly, to compare respective preferential tariff advantages brought by the CU, hypothetical rates are shared within the table via grey shading.

Table 3 – Tariff rates faced by the major exporters to Turkey, 2019

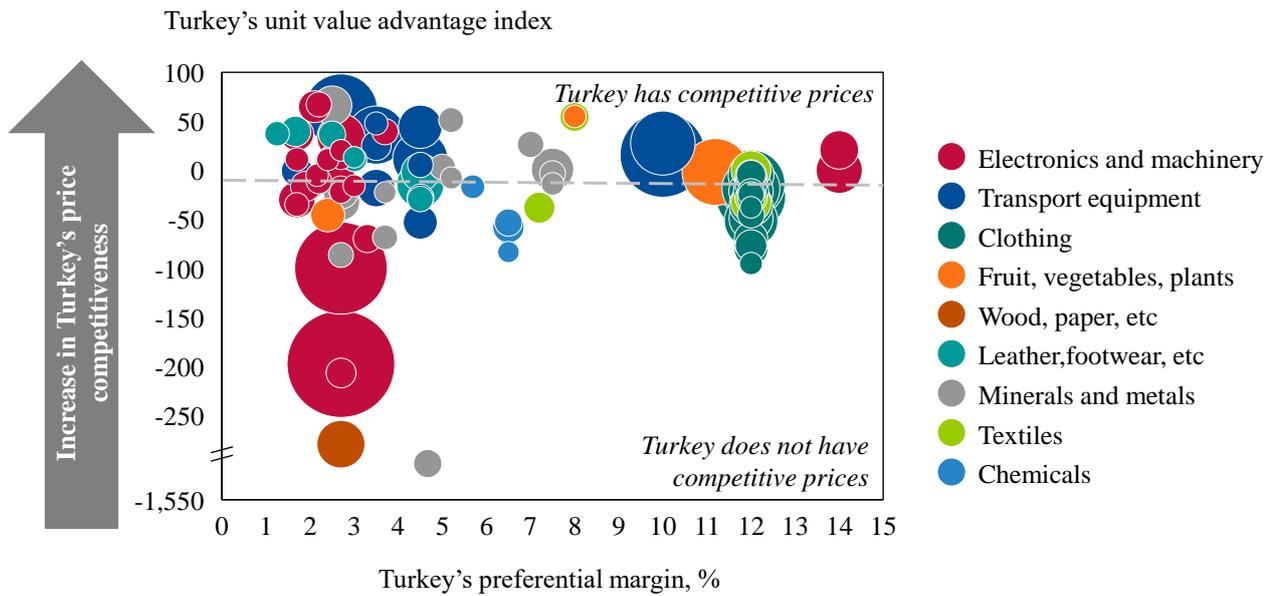
Exporter country	Exports to Turkey, billion \$	Weighted average tariff rate implemented <u>without any agreement</u> , %	Weighted average tariff rate implemented <u>under the scope of the CU</u> , %
Major trade partners without a trade agreement	Russia	22.5	9.50
	China	18.5	8.31
	USA	11.2	3.22
EU-27 partners (CU) (Top 10)	Germany	18.0	6.52
	Italy	8.6	9.38
	France	6.4	7.34
	Spain	4.2	8.84
	Belgium	3.2	5.83
	Netherlands	3.1	6.09
	Romania	2.5	9.94
	Poland	2.5	9.47
	Bulgaria	2.3	5.34
	Czechia	2.2	6.96
EU-27 partners (CU) (All)	63.9	7.35	0.70

Source: Official Gazette of the Republic of Turkey, Republic of Turkey Ministry of Trade, TurkStat, authors' calculations

Note: While EU members export goods to Turkey under the scope of the CU, the other shared countries do so without any agreements. Accordingly, to compare respective preferential tariff advantages brought by the CU, hypothetical rates are shared within the table via grey shading.

2. Quantifying CU activities between Turkey and the EU

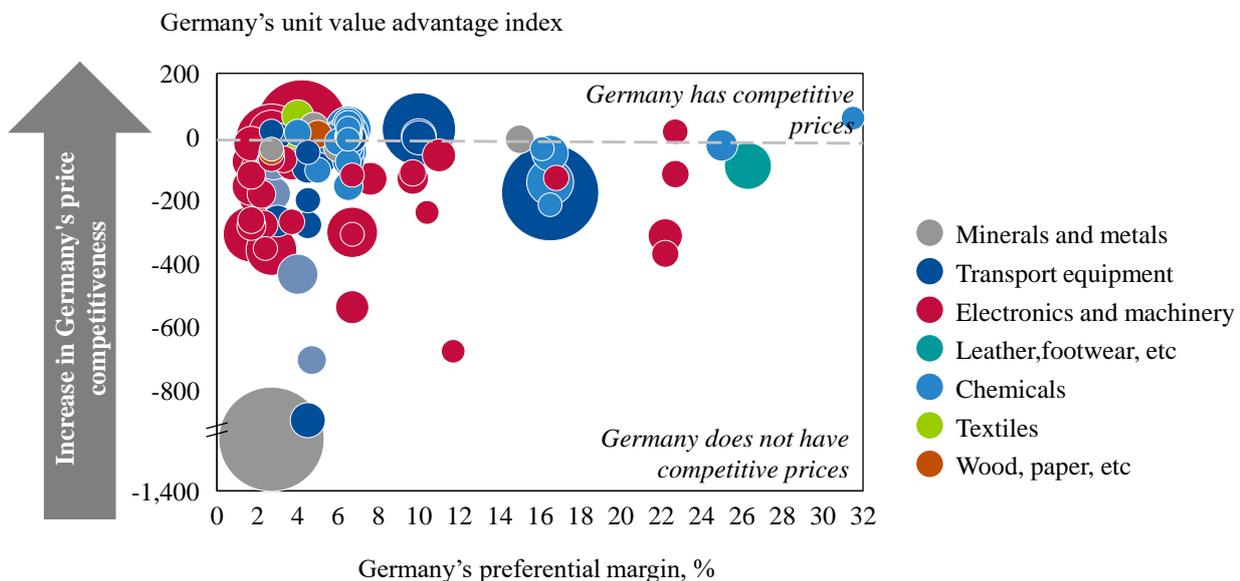
Figure 8 – Case study - unit value analysis to demonstrate the competitiveness advantage for Turkey’s exports brought by the CU, 2019



Source: European Commission, Eurostat, ITC Macmap, WTO RTA Database, WTO, ITC, UNCTAD, “World Tariff Profiles 2018: Applied MFN Tariffs,” authors’ calculations

Note: Each bubble represents a product, bubble sizes represent the volume of Turkey’s exports to Germany. The detailed list of products can be provided upon request. For the sake of comparison, unit values of China’s exports to Germany and Turkey’s exports to Germany are taken into consideration since China is one of the main trading partners of both the EU and Turkey, which does not enjoy any preferential tariff advantage in its trade with the entities in question. Top 100 products with the greatest volume of Turkey’s exports with a positive preferential margin are presented. The unit value advantage index is measured with the percentage difference between the unit values of China and Turkey’s exports to Germany.

Figure 9 – Case study unit value analysis to demonstrate the competitiveness advantage for the EU-27’s exports brought by the CU, 2019



Source: Official Gazette of the Republic of Turkey, Republic of Turkey Ministry of Trade, TurkStat, WTO, ITC, UNCTAD, “World Tariff Profiles 2018: Applied MFN Tariffs,” authors’ calculations

Note: Each bubble represents a product, bubble sizes represent the volume of Germany’s exports to Turkey. The detailed list of products can be provided upon request. For the sake of comparison, unit values of Germany’s and China’s exports to Turkey are taken into consideration since China is one of the main trading partners of both the EU and Turkey, which does not enjoy any preferential tariff advantage in its trade with entities in question. Top 100 products with the greatest volume of Germany’s exports with a positive preferential margin are presented. The unit value advantage index is measured with the percentage difference between the unit values of China and Germany’s exports to Turkey.

3. Management of CU



As laid out in the previous section, the CU Decision has created a supporting foundation for the growth of trade and investment between EU and Turkey by abolishing trade barriers and bringing a competitiveness advantage to both parties. Besides, commercial policies between both entities under the criteria of the agreement have been amended several times throughout the course of its activity. Preferential Trade Agreements (PTAs) have been created to encompass agricultural products as well as updated trade arrangements for steel and coal products allowing these products to be encompassed.³⁶

From a broader perspective, the Turkish government has continually expressed its intention to align with the EU's objectives for accession purposes, but has been met with concerns from member states of the EU regarding adverse developments in several areas. However, Turkey has shown that it is on par with its European counterparts regarding company law, trans-European networks, and science and research.³⁷ It has also maintained "a good level of preparation" in the areas of free movement of goods, intellectual property law, financial services, enterprise and industrial policy, health and consumer protection, customs union, and financial control.³⁸ In a nutshell, bilateral trade relations have proved to be a successful field of cooperation between the EU and Turkey despite some implementation problems.

In detail, the original decisions of the Association Council consisted of six policy areas for implementation of CU policies. These implementation areas can be enumerated as:

³⁶ "Turkey: Customs Unions and Preferential Arrangements," European Commission.

³⁷ European Commission, "Commission Staff Working Document, Turkey 2020 Report, Accompanying the Document, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 2020 Communication on EU Enlargement Policy."

³⁸ Ibid.

3. Management of CU

1. Free movement of goods and commercial policy
2. Agricultural products
3. Customs provisions
4. Approximation of laws
5. Institutional provisions
6. General and final provisions.³⁹

Particular to the free movement of goods, Turkey is regarded as being “at a good level of preparation” by the European Commission.^{40 41} When looking at the customs legislation in line with the CU Decision, Turkey has been largely in compliance in most areas. The implementation of policies regarding the origin, customs value, entrance of goods into the customs area, customs declaration, free movement right, customs regimes with economic impact, movement of goods, customs debt/obligation, and right of objection, are there.⁴² The progress in these areas on legislative alignment efforts can be viewed as mostly successful.⁴³ While certain exemptions have been put in place for specific goods, surveillance procedures are still short of being aligned with European Customs Union obligations among members and Turkey. Furthermore, export restrictions, prior registration requirements, conformity assessments and inspections, licensing surveillance and other documentation requirements for imports, and non-acceptance of EU good manufacturing practices certificates are identified by the European Commission as shortcomings for Turkey’s alignment with the CU.⁴⁴

The CU Decision between the EU and Turkey aims to gather trade to function under the context of a single market. In order to achieve this objective, there must be standardized rules and applications that are followed by both parties to consolidate these methods and platforms under one uniform umbrella. The ability to connect over a standardized platform on areas covering finance, trade, security, and data collection across borders is vital to the success of the CU. While standardization of operations is present in some areas such as CET regarding taxation, Customs Declaration certificates, and acceptance of CE certificates, there are still many areas that need to be approached and standardized within the scope of the agreement, especially with regards to how the commercial trade environment has evolved since the criteria of the agreement was set forth. In particular, there are few cross-cutting legislative areas such as local content requirements in the area of medicines, regulatory data protection, free zones, and duty relief regulations pointed out by the European Commission as areas to be reconsidered to be fully in line with the CU.⁴⁵ While the restructuring of legislation has proved to be beneficial for bilateral trade regarding EU goods in several industries, the deterrence of existing legislation regarding the circulation of goods can be expressly seen in the protocols adopted by Turkey in the pharmaceutical industry. As initial steps have been taken by the Turkish side to integrate EU manufactured pharmaceutical manufacturing processes and certificates, several market access barriers still exist for these industries, and where initial steps have been taken, full alignment has yet to be achieved. Over the past 20 years, the trade and commerce environment has drastically evolved to include variables not

³⁹ “Decision 1/95 of 22 December 1995 on Implementing the Final Phase of the Customs Union (96/142/EC),” EU-Turkey Association Council.

⁴⁰ European Commission, “Commission Staff Working Document, Turkey 2019 Report, Accompanying the Document, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 2019 Communication on EU Enlargement Policy.”

⁴¹ European Commission, “Commission Staff Working Document, Turkey 2020 Report, Accompanying the Document, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 2020 Communication on EU Enlargement Policy.”

⁴² “Customs Union,” Republic of Turkey Ministry of Foreign Affairs Directorate for EU Affairs.

⁴³ European Commission, “Commission Staff Working Document, Turkey 2020 Report, Accompanying the Document, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 2020 Communication on EU Enlargement Policy.”

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*

present during the construction of the initial EU Customs Union policies with Turkey. Hence, the nature of the Turkish legislature in regard to those policies can be contradicting in relation to each sector or even within each industry.

Standardization of platforms and methods is essential to the sustainability and efficiency of the CU Decision. The Union Customs Code (UCC), which is a shift to a paperless customs platform, was established to create greater conformity among members. Turkey has yet to implement this system, which has left the Turkish customs law operating based on the old council regulations.⁴⁶ Furthermore, the initiative towards strengthening market surveillance measures has required further alignment, specifically in creating and improving control mechanisms to reduce risks and enforce security protocols. This initiative relies heavily on the country's IT systems and poses a need for standardization of IT systems between members of the agreement. Without the inclusion of these standardized platforms and communication and data collection methods, a modernized CU would still be inadequate in addressing the major shifts that have occurred compared to the criteria set forth in current agreements. Hence, elements related to the EU's licensing, declaration, and registration processes, as well as that integration of standardizing customs, IT systems, and manufacturing processes, still contain technical barriers that limit the cooperation between the EU and Turkey.

After 2011, Turkey has started to apply Additional Customs Duties (ACDs) on its imports from third countries. Since ACDs are based on ROOs, the products imported from the CU partners are also subject to the ROOs checking to be exempted from these taxes implemented on particular products by the Turkish authorities.⁴⁷ With the increase in the scope of the ACD in 2020, this practice is identified as contradictory to the fundamental principle of the CU by the European Commission.⁴⁸ Yet, recent trade figures show that Turkey's imports from the EU countries seem not to be much affected by ACDs, at least in 2020.⁴⁹

Policies to regulate access to the Turkish and EU road transport markets can also be assessed from a multilateral level. Of all multilateral permits requested from the multilateral quota system, consisting of 54 member countries, the largest number came from Turkey, accounting for more than 10 percent of all total requests. Turkey has continually pushed for the liberalization of transport with EU member states, but this has not been reciprocated by EU member states towards Turkey, thus creating an imbalance in policy regarding the restrictiveness of bilateral quotas in regards to transportation trade and permits.^{50 51}

Moreover, Turkey continues to emphasize the restructuring of visa requirements for its citizens. Visa applications and approval standards for personal and commercial use are becoming increasingly more difficult. The delays and barriers imposed on travel serve to slow growth and efficiency between these two entities. A resolution to these concerns could catalyse increased cooperation between the EU and Turkey.⁵²

Another area requiring specific attention is the consultation and decision-making procedures within the CU. Turkey has undertaken in Decision 1/95 the obligation to align to EU legislation in a number of areas. The Decision provided for consultation and decision-making procedures to ensure Turkey's participation in the

⁴⁶ Ibid.

⁴⁷ Ayşegül Taşöz Düşündere and İlderya Avşar Koyuncu, "Türkiye'de Bir Politika Aracı Olarak İlave Gümrük Vergileri: 2020 İncelemesi [Additional Customs Duties in Turkey as a Policy Tool: 2020 Review]".

⁴⁸ European Commission, "Commission Staff Working Document, Turkey 2020 Report, Accompanying the Document, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 2020 Communication on EU Enlargement Policy."

⁴⁹ Ayşegül Taşöz Düşündere and İlderya Avşar Koyuncu, "Türkiye'de Bir Politika Aracı Olarak İlave Gümrük Vergileri: 2020 İncelemesi [Additional Customs Duties in Turkey as a Policy Tool: 2020 Review]".

⁵⁰ World Bank, "Evaluation of the EU-Turkey Customs Union," 2014.

⁵¹ Samuel Doveri Vesterbye and M. Sait Akman, "A Modernized EU-Turkey Customs Union: Expert Interviews and Analysis."

⁵² 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."

3. Management of CU

preparations of the draft legislation and consultation between the parties aiming to preserve the good functioning of the CU. A lack of effective implementation of those procedures, and the fact that the bodies overseeing the functioning of the Decision lacks effective decision-making powers, have repercussions on the general implementation of the CU. Hence, an upgrade process should not only ensure better implementation of such procedures, but should equip the CU bodies with effective tools to address and make necessary technical adaptations for the proper functioning of the CU.

In fact, the implementation of some aspects of the CU has encountered several obstacles since its inception. High-level discussions toward enhancing cooperation have continued to show progress and highlight the understanding of both entities as an important partner to each other. Yet, both EU and Turkey, while having made progress towards reaching the objectives set forth by the criteria in the agreement, have also had their share of discrepancies. The process towards effective policy implementation of the CU Decision with Turkey is continually being evaluated by both sides and even more so with the demand for a modernized CU looming on the horizon. While the next chapter delves into the CU upgrade in detail, taking into consideration the motivations, possible opportunities, and risks pertaining to the next policy options, some of the current impediments or unutilized opportunity areas regarding the current CU are also elaborated in the fourth chapter.



4. CU upgrade



The initial CU that was completed in 1996 has been beneficial to Turkey not only in terms of increased trade and competitiveness, and transformation of the Turkish industry via the investments in technology, but also by providing the legal and institutional infrastructure of a rule-based free-market economy. In this sense, the original CU contributed a lot to the economic reform program of the early 2000s that brought exemplary economic success to the country. While the existing CU contributed to both European and Turkish private sectors to seize business opportunities, the next section elaborates how the existing CU that had been completed in 1996 seems to be outdated for several reasons, and also discuss possible policy options.

The EU-Turkey trade agreement has provided a notable increase in trade. The process of covering common external tariffs for the products under this agreement, as well as the alignment of the Turkish legislative framework integration into the European Customs Union acquis, is vital for bilateral trade between both entities. The aim to lift restrictions of goods trade between the EU and Turkey has been a work in progress spanning the last 25 years. The need for reforming these protocols in order to take into account the demands of modern bilateral trade environments and the emergence of new commercial variables calls for an urgent revision of the agreement's objectives, procedures, and protocols between the EU and Turkey.

While the CU Decision has been able to influence the bilateral relationships between both entities, it is clear that the agreements in place are currently outdated and in much need of modernization and reform, as elaborated in the next chapter. In fact, what had been envisioned during the creation of the agreement as a strengthening mechanism for bilateral cooperation, and Turkey's accession bid to the EU, has slowly transformed into something else over the last 25 years. While the CU Decision between the two entities can be hailed as a success from several perspectives, it now requires re-working to reach its full potential.

4. CU upgrade

The talks to modernize the CU started in 2014 under the initiative of the European Commission, based on an evaluation report by the World Bank, which was assigned to it by the Commission itself.⁵³ In December 2016, the Commission adopted a recommendation to open negotiations in view of the extension and modernization of the EU-Turkey CU. In particular, the main aim was to bring the CU up-to-date with global economic and commercial developments and increase growth.

The CU upgrade recommendation has been forwarded to the Council, where it has been under consideration ever since. The EU Council has so far failed to approve a negotiation mandate for the European Commission to initiate communication with Turkey for a revision of the current CU. Furthermore, in the meeting of the EU General Affairs Council in June of 2018, the Council noted that Turkey has been moving further away from the EU. Turkey's accession negotiations have, therefore, effectively come to a standstill, and no further accession chapters can be considered for opening or closing, and no further collaboration towards the modernization of the EU-Turkey CU is foreseen.⁵⁴

While the CU was originally introduced, assuming that Turkey would become an EU member in the near future, Turkey's prolonged EU membership process put the CU Decision on hold for 25 years. With the current conjecture, most probably, the CU will continue to be the backbone enhancer of the bilateral trade relations, at least for the near future. Considering the initial intended motivation and the timespan covered until now, several aspects of the current CU became outdated.

Even though upgrading the CU also has a political dimension, several commercial changes necessitate a CU upgrade and commercial benefits to be obtained from this process. Below, changes in the commercial environment that require a CU upgrade, possible commercial benefits of CU modernization, and the next policy options are elaborated.

4.1. Changes in the commercial environment over the past 25-years that mandate a CU upgrade

First of all, the world economy has increasingly globalized over the last several decades. Bilateral or plurilateral collaborations for improving business to business interactions have become more common in tandem with the increased participation into GVCs through FDI flows. In particular, trade agreements globally have been increasing in number and enlarging their scope in the last two decades. For instance, there were merely 50 reciprocal preferential trade agreements in force in 1990. Today, there are more than 300 agreements.⁵⁵ Along with the number, the content of trade agreements have also been changing. In the past, agreements were mostly limited to goods, while today, nearly half of the newly signed agreements are on the provision of services.⁵⁶

In the context of the Turkey-EU economic relations, the EU has gone through a significant enlargement process and has taken steps to make in-depth and comprehensive FTAs with major economies. In particular, FTAs related to a lower level of economic integration compared to the customs union between signatories became more common and thorough business enhancers for the EU market. Notably, current FTAs and investment treaties are more extensive, considering that they also cover areas not addressed by the CU between Turkey and the EU - such as agriculture, services, and public procurement. For instance, FTA

⁵³ World Bank, "Evaluation of the EU-Turkey Customs Union," 2014.

⁵⁴ 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."

⁵⁵ World Trade Organization Regional Trade Agreements Database, authors' calculations.

⁵⁶ Ibid.

4. CU upgrade

between the EU and South Korea has a more in-depth coverage than the CU between Turkey and the EU with respect to implied tariffs on respective total trade baskets.⁵⁷

In addition to the limited scope of the CU in comparison with the newly signed FTAs, the globalization and increased number and content of the FTAs, raise another concern for the current CU structure. In the current implementation of the CU framework, Turkey has the obligation on the basis of the CU Decision No. 1/95 to align itself, without having a say in either the decision-making nor the ‘decision shaping’ of the current CU (Although Decision 1/95 provides for consultation and decision-making procedures in areas related to the functioning of the CU, these provisions are not effectively implemented with regard to FTAs). This asymmetry is especially felt in FTAs that the EU makes with the third countries that have to be defacto assumed by Turkey. The current CU Decision framework obliges Turkey to adopt the same principles and protocols in regard to trade with third-party countries. However, it does not require these third-party countries to reciprocate those same protocols, creating an uneven balance in these trade requirements. In other words, EU’s partners of FTAs can benefit from trade with Turkey with the same benefits that the EU community enjoys, such as tariff-free exports, while continuing to create tariffs on Turkish goods. This point of contention is a serious concern that must be addressed in any CU upgrade process.

The asymmetric structure of the CU, especially in the case of common external policy, necessitates a CU upgrade considering the developments in the last 25 years. Turkey has openly expressed that the CU Decision does not take into account the current trade environment changes and has contested that some components of the agreement are no longer in the best interest of promoting trade between both entities, most pressing of which is trade reciprocation for Turkish companies dealing with third-party countries that are privy to EU trade deals, which Turkey is not a part of. As a more recent development, this asymmetric structure imposed an impediment into the trade agreement negotiations between the UK and Turkey in the context of the former’s exit from the EU. Considering the GVCs in which Turkey is involved via the EU countries, a missing link between the UK and Turkey may still impair the bilateral trade relations between Turkey and the EU depending on the future implementation of the ROOs defined within the new FTAs signed between the EU-UK and Turkey-UK.

From another angle, the COVID-19 pandemic has made the EU evaluate relocating its supply chains, bringing them closer to neighbourhood countries. Given the existing CU between the parties, Turkey has great potential in this diversion. However, the EU is very keen on adherence to the principle of the rule of law in shifting the location of its supply chains. Hence, Turkey should pay great attention to have a functioning rule of law to attract EU’s supply chains. In this context, initiating a possible CU upgrade will also pave the way for enhancing the rule of law in Turkey by triggering a positive business motivation for both parties.

The EU and Turkey both agree that the CU Decision is in need of modernization. The criteria established in the agreement do not address the demands, and commercial environments present today, such as regulation and liberalization of digital trade and e-commerce. A revitalized CU Decision would provide new opportunities for Turkey and the EU and promote a stronger partnership. The trade relationship between the EU and Turkey should focus on revamping the CU Decision to focus on areas strengthening the mechanisms regarding third-party FTA’s, public procurements, services trade, and liberalization of agriculture.⁵⁸

⁵⁷ Ayşegül Taşöz Düşündere, M. Sait Akman, and Hakan Özkavukçu, “Ürün Bazlı Brexit Rehberi [Product Based Brexit Guide]”.

⁵⁸ World Bank, “Evaluation of the EU-Turkey Customs Union,” 2014.

4.2. Possible benefits of CU modernization

According to empirical impact assessment studies, the modernization of the CU would bring mutual economic benefits for both parties. These studies have been prepared by both parties, and the findings are more or less similar. The impact assessment performed by the EU, projects the expected gains to reach 5.4 billion euros or about 0.01 percent of EU's GDP, and 12.5 billion euros or 1.44 percent of Turkey's GDP.⁵⁹ For instance, according to the impact assessment conducted by the Republic of Turkey Ministry of Trade, the expected gain for Turkey can be proportional to its GDP between 1 to 1.9 percent under varying scenarios.⁶⁰ What is expected beyond economic benefits are improvements in the rule of law, which would initially be observed mainly in Turkey's economic sphere, which has a probability of gradually crossing over into the political domain. A reformed CU is expected to profoundly transform Turkey's political economy in key sectors such as services, procurement, state aid, and trade dispute settlements. It is also anticipated to bring transparency, competitiveness, and respect for universal law, at least regarding economic transactions.

While there is no prescribed context for a CU upgrade, a CU upgrade may cover many areas, including agriculture, services, public procurement, state aid, and dispute settlement mechanisms, in addition to changes to improve the implementation of the current agreement. Along with the structural impacts, low hanging fruits should be identified both at the macro and micro economic level within the CU upgrade negotiations. Although there are several analytical economic impact assessments of a CU upgrade from a macroeconomic perspective, product-based analytical findings are most crucial from the point of further raising awareness regarding the possible benefits and risks associated with a CU upgrade for the respective countries. In this note, as a first step, prominent agricultural opportunities are quantitatively analysed. In the case of services, public procurement, and dispute settlement mechanisms, more research, including desk studies and field studies, is required considering the nature of the issues.

First of all, CU covers most of the realized trade between Turkey and the EU-27; however, it does not cover the countries' entire production capabilities since the current CU Decision between Turkey and the EU is limited to industrial products and some processed agricultural goods. In 2019, almost 7 thousand different products were globally imported by the EU-27. Yet, for more than 1 thousand products, in which the EU-27 has a combined global import value of 900 billion dollars, Turkey faces a positive tariff rate for its exports to the EU-27.⁶¹ In the case of Turkey's imports, the EU-27 countries could not access 36 billion dollars' worth of Turkey's demand in a tariff-free way.⁶² While the potential in these agricultural products is explored further in the following analysis, even this simple comparison shows that almost 1 trillion dollars' worth of demand has not been subject to the tariff-free trade in the bilateral relations under the scope of the current CU between Turkey and the EU.

Considering agricultural supply and demand ties of the EU-27 and Turkey, there are possible matches to increase bilateral agricultural trade if tariff barriers are abolished. In Figure 10, each bubble represents a product, while the bubble sizes represent the total volume of the EU-27's imports, while the x-axis depicts the current level of Turkey's global exports, the y-axis demonstrates the current level of tariffs faced by Turkey in the case of exports to the EU-27. For these products, it is observed that Turkey could not benefit from a satisfactory market share within EU-27's total demand. In general, as seen in Figure 10, Turkey is facing very high tariff rates for these particular products. As a whole, there are several cereal products that stand out in which Turkey has the capability of exporting but is facing a tariff barrier, even though there is a

⁵⁹ 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."

⁶⁰ "Gümrük Birliği'nin Güncellenmesi Etki Analizi Çalışması: Basın Bildirisi," Republic of Turkey Ministry of Trade.

⁶¹ European Commission, Eurostat, ITC Macmap, WTO RTA Database, authors' calculations

⁶² Official Gazette of the Republic of Turkey, Republic of Turkey Ministry of Trade, TurkStat, authors' calculations

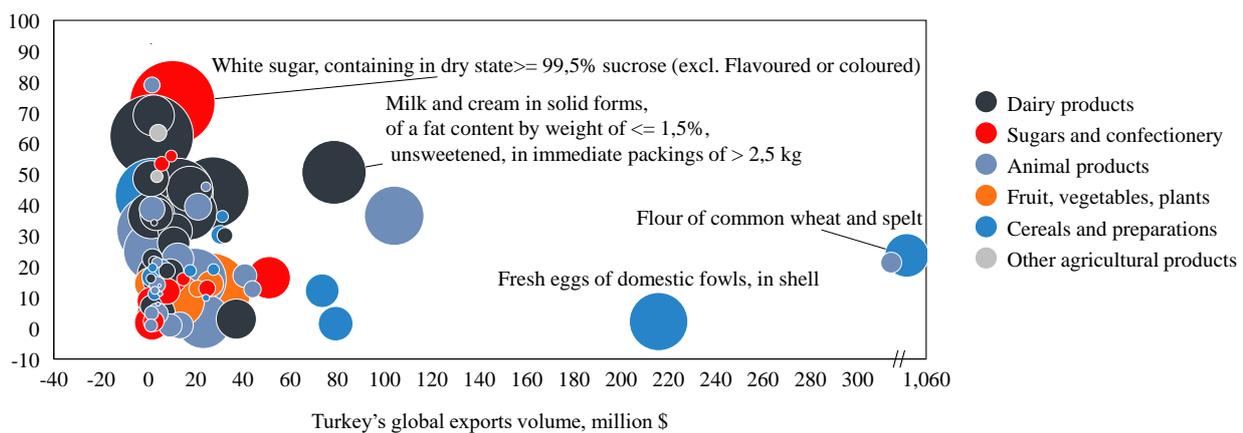
4. CU upgrade

demand from the EU-27 markets. In particular, the flour of common wheat and spelt is one of the products with these specifications. Furthermore, there is a substantial potential for Turkey's dairy products to be sold to the EU-27 market.

Similar to the analyses for Turkey's potential agricultural exports to the EU-27, Figure 11 lays out the EU-27's agrarian export potential. In particular, wheat and muslin stand out with Turkey's high demand for these products and the capacity of the EU-27 countries to export them. Also, EU-27 countries have potential in oilseeds, fats, and vegetable oil product groups.

Figure 10 – Prominent agricultural products in which Turkey can increase its exports to the EU-27 in the case of a CU upgrade, 2019

Tariff rates faced by Turkey in the case of exporting to the EU-27

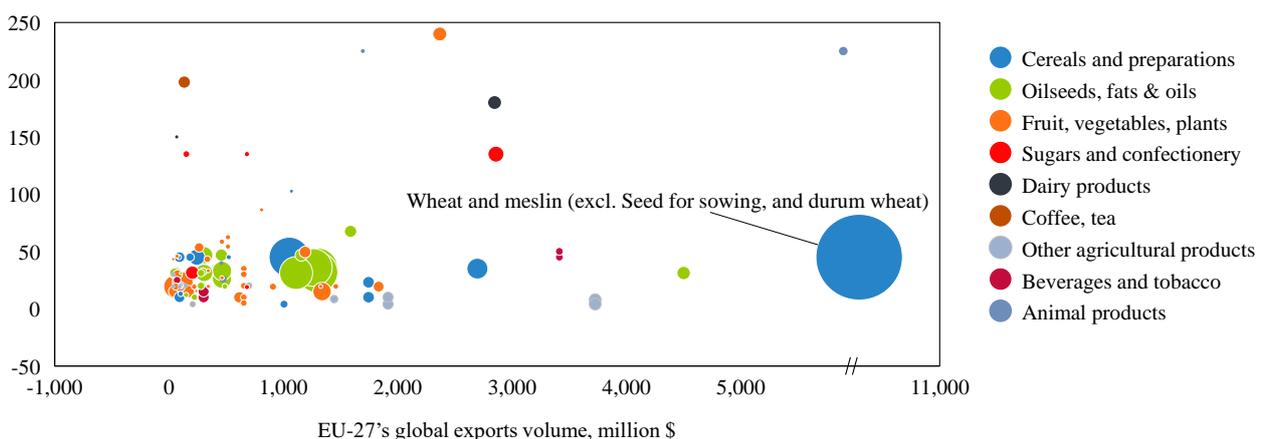


Source: Eurostat, ITC Macmap, TurkStat, WTO RTA Database, WTO, ITC, UNCTAD, “World Tariff Profiles 2018: Applied MFN Tariffs,” authors’ calculations

Note: Each bubble represents a product, and bubble sizes represent the volume of the EU-27’s global imports. The products in which Turkey has a global export volume of more than 1 million dollars are presented in the figure. A detailed list of products can be provided upon request.

Figure 11 – Prominent agricultural products in which EU-27 can increase its exports to Turkey in the case of a CU upgrade, 2019

Tariff rates faced by the EU-27 in the case of exporting to Turkey



Source: Eurostat, Official Gazette of the Republic of Turkey, Republic of Turkey Ministry of Trade, TurkStat, “World Tariff Profiles 2018: Applied MFN Tariffs,” authors’ calculations

Note: Each bubble represents a product, and bubble sizes represent the volume of Turkey’s global imports. The products in which the EU-27 has a global export volume of more than 1 million dollars are presented in the figure. A detailed list of products can be provided upon request.

4.3. Next policy options

Possible CU upgrade scenarios may cover multiple areas; some policy suggestions are elaborated below for each area.

In agriculture, the challenge for Turkey is to achieve free movement of agricultural products between the EU and Turkey. This will require Turkish enterprises to make efforts to be in line with the EU rules on Sanitary and Phytosanitary (SPS) issues. In order to offset possible impediments from the perspective of the Turkish agricultural producers, a series of informative events for raising awareness on the Common Agricultural Policy (CAP) measures and SPS agendas may be provided by respective authorities. In addition, incentives and/or grants may be provided to agricultural producers for the initiation of the respective investments to keep up with such regulatory measures.

Currently, agricultural producers in Turkey and the EU are protected from international competition by an array of import tariffs, export subsidies, and subsidy payments for specific crops. Besides, Turkey has one of the highest tariff rates on agricultural products among OECD countries with the purpose of import protection, and all of Turkey's agricultural tariffs are bound to very high rates.⁶³ In fact, the structure of employment can be a factor that explains the differences between asymmetric reactions from EU-27 and Turkey in the case of agricultural tariff policies. As of June 2020, more than 5 million people were working in agriculture in Turkey, implying that 19 percent of total employment is directly sourced from agricultural activities.⁶⁴ On the contrary, in the EU, the share of agriculture in total employment stands at around 4 percent.⁶⁵ As a policy option, a gradual transition for abolishing tariff rates can be suggested not to harm agricultural employment with a sudden international competitiveness shock. Additionally, there are several processed food products that are exposed to high tariff rates. A gradual transition targeting food products may be an option to initiate the process. It should be noted that even if there can be a gradual initial decline in agricultural employment, in the long-run the possible expected increase in bilateral trade may result in higher productivity and transformation of agricultural and food products, possibly leading to higher employment in the respective sectors.

The challenge for Turkey is to achieve free trade of services between the EU and Turkey. This will require Turkey to adopt and implement the regulatory framework of the EU for each of the service sectors it intends to liberalize. While the share of services is increasing in almost all countries' GDPs, the services sector has become a more critical component in manufacturing activities in the last decades. This process is called *servicification*, and under the current situation, illiberal service sectors in Turkey affect the efficiency of Turkish manufacturing capabilities.⁶⁶ While developing policy options for the inclusion of the services into the CU, the servicification aspect can be further investigated with analytical studies to gain more traction for advocacy within respective countries. In addition, it will be better to have further analyses to highlight the business areas in which there will be a need for reforms and in which the competitive environment will be affected compared to the current outset. Accordingly, in the case of services, more research, including desk studies and field studies, alongside communication with businesspeople, is required.

In the case of manufacturing, even if it is not part of the current CU or CU modernization agenda, there are some variables of the current business environment that have an impact on the bilateral commerce relations. While Turkey is not part of the EU, in order to align Turkish private enterprises with the EU market

⁶³ World Trade Organization, "World Tariff Profiles 2019."

⁶⁴ TurkStat, "Labour Force Statistics," authors' calculations.

⁶⁵ World Bank World Development Indicators 2020 statistics, authors' calculations.

⁶⁶ Thomas Haven and Erik Van Der Marel, "Servicification of Manufacturing and Boosting Productivity through Services Sector Reform in Turkey," World Bank Policy Research Working Paper, November 2018.

4. CU upgrade

regulations, there should be an ongoing effort to keep in line with the market requirements such as General Data Protection Regulation (GDPR), digital trade, and the Green Deal. Even though these topics will not be subject to the CU upgrade agenda, these items should be on the agenda of both the private sector and the public sector to maintain Turkish companies' competitive access to the EU market. For instance, several manufacturing sectors such as steel, textiles, ceramics, glass, paper, and cement, which are heavily reliant on fossil fuels, can be exposed to a potential border carbon adjustment, which, unless tackled with, may eventually impede Turkey's trade with the EU.⁶⁷ As a policy step, considering their carbon intensity, there is a need for an economic assessment of the carbon emissions and the respective investments needed for the sectors/firms in Turkey. Similar to the agricultural liberalization, the Green Deal brings an investment agenda to keep up with international competition. Accordingly, access of Turkish firms to funding sources within the EU structure, to keep up with the clean energy input requirement, will be necessary. This, in turn, will be beneficial to the production, trade, and technical know-how transfer of EU firms specialized in the Green Deal.

In February 2014, the European Council adopted the legislative package for the modernization of public procurement in the EU, the guiding principles of which are competition, non-discrimination, transparency, and integrity. The Turkish Public Procurement Law No 4734 from 2002 sets out principles and requirements to ensure a transparent and fair tendering process, as well as provisions to control corruption and probity. However, the enforcement records of such provisions are perceived to be low. In addition, procurement practices have been criticized for becoming less transparent, as amendments to procurement laws placed tenders in numerous sectors outside the purview of the monitoring watchdog, the Public Procurement Authority. Moreover, judicial reforms in 2012 reduced criminal charges for bid-rigging in public tenders. Turkey should have a transparent public procurement system where the exceptions are limited, and the public procurement authority should strengthen its autonomous regulatory competence.

As the current dispute settlement mechanism, i.e. Association Council, is not functioning as required, there is a definite need for an independent dispute settlement mechanism. In the Association Council, the decisions are made with unanimity and both EU and Turkey have one vote each. This makes the solution of problems stemming from the CU almost impossible. Hence, an independent dispute settlement mechanism would be very functional.

As mentioned earlier, there is no pre-determined binding constraint on how the CU will be upgraded and what this update will cover. However, as laid out in this note, it will be beneficial to revitalize such discussions for bilateral relations to develop ideas about how to approach revision and what its contents may include. This initiation will be perceived as a good signal from the perspective of businesspeople who are eager to promote their bilateral relations. Within this concept, initiating the upgrading studies for the CU without a precondition will also create a communication channel that helps to ensure the attainment of the preconditions such as improving the rule of law and the good governance over the long-term.



⁶⁷ "The European Green Deal's Border Carbon Adjustment: Potential Impacts on Turkey's exports to the European Union, Summary Report of Online Webinar," SHURA.

5. Current CU and upgrade - business perspectives



The CU has already triggered an economic transition in Turkey towards more sophisticated products due to increased FDI inflows, increased global competition, and alignment with EU legislation. As such, Turkey has become a vital part of the European GVCs, allowing more room for European firms to grow, while Turkey transitioned to become an essential market for European goods and a significant buyer from European intermediates. While both parties increased their economic well-being thanks to the current CU, with the contribution of partner European Bilateral Chambers and Turkish companies, several compiled case studies from European and Turkish companies that utilize the CU demonstrate the contributions of the CU and possible rooms for further adjustments in the case of an upgrade. The compiled points regarding the next policy areas that stand out are listed below. The full version of the case studies and inputs are shared on the following pages.

- With a CU update, the hesitations of foreign investors arising from geopolitical tensions will be eliminated. A CU upgrade process will also provide an active communication channel between the EU and Turkey in the long-run, in which further developments can be attained in cross-cutting policy areas.
- Turkey lacks a say over EU's FTA policy; therefore, the potential risks of trade distortions and unfair competition as a result of EU signing new-age FTA agreements with different countries, as well as Turkey's absence from the decision-making mechanisms of the EU, come to the fore as matters that need to be overcome through a CU upgrade.
- To avoid additional custom duties to be imposed on third-country imports of Turkey, imports from EU countries are sometimes exposed to extra bureaucratic efforts. If this is to be resolved in the

5. Current CU and upgrade - business perspectives

modernization of the CU agreement, it would drastically simplify the process regarding imports and exports.

- Through a CU upgrade, current bottlenecks, such as transport quotas and visa restrictions can be alleviated and Turkey will become more attractive to global supply chains, creating a more favourable investment environment for the supply industry - this is also of vital importance for the EU.
- There are several implementation impediments in the current CU. In a CU upgrade process, the following issues might be reconsidered: (i) increasing the extensiveness of the electronic documents such as electronic certificates of origins and electronic A.TR documents and (ii) redesigning product safety inspections and testing procedures to be more efficient and to decrease discrepancies.

Cross-cutting policy areas such as European partnerships with third countries, digitalization, and climate change policies are not the direct subject of the CU upgrade. Yet, it is critical to closely follow these developments, which can have impacts on CU relations. There is a need to develop long-term policies and action plans in line with the current trends that transform the doing business ecosystem for both parties, maybe through developing individual assessment and specific consultation mechanisms. For example, significant and recent developments have been experienced in digital transformation in the EU (cybersecurity, data security, artificial intelligence, etc.). It is vital to complete the legal processes for General Data Protection Regulation (GDPR) compliance and develop a countrywide policy in this field in order to avoid problems when exporting a new generation of connected products to the EU and create the appropriate ecosystem regarding data rights in Turkey. Similarly, the development of Turkey's preparation capacity for the EU's financial support programs, especially the Horizon Europe program, which will start in 2021 and has a fund size of around 90 billion euros, is considered critical. With over 1,200 R&D centres, it is important to develop and continue national mechanisms to increase Turkey's current potential and ability to benefit from these programs more effectively. In addition, it is believed that a new long-term and performance-oriented approach for the TURQUALITY program will further carry the gains of the CU.

CASE STUDY - Arçelik (Turkey)

Entered into force on 01.01.1996, the Customs Union (CU) is one of the most important building blocks of Turkey's integration with the European Union (EU). The structural transformation that took place in Turkey's exporting sectors because of the CU, led to an increase in the competitiveness of Turkey in international markets. The CU contributed to the export-oriented transformation of the management systems of Turkish companies exporting to the EU in line with EU rules and regulations, thereby transforming the way these companies conduct business.

The CU has also added a different dimension to the global competitiveness of Turkey's white goods industry. The sector achieved great success in the production and export of white goods due in most part to the positive effect of the CU. According to the data provided by the White Goods Manufacturers' Association of Turkey (TÜRKBEŞD), the manufacture of 6 main product groups within this sector has increased 17-fold, from 1.6 million units in 1988 to 28,198 million units in 2019. Exports, on the other hand, increased 95-fold, from 230 thousand units in 1988 to 21.8 million units in 2019. According to Trademap data, the exports of the sector have increased approximately 10-fold on a value basis (in dollars) from 2001 to 2019, and as of 2019, a total of 3.96 billion dollars' worth of goods has been exported in 6 product groups. This process allowed for the creation of a strong ecosystem, which led to the establishment of a globally competitive supply industry, thus reducing foreign dependency and creating a technology-oriented and high value-added industrial structure in Turkey.

When Arçelik data on sales to international markets is reviewed, an increase of approximately 7-fold in value-basis from 2001 to 2019 is visible. Evidently, Turkey's achievements and the CU relationship with the EU has been identified as the major driver of this performance.

Turkey's white goods sector realizes approximately 75 percent of all its exports to the EU. In this respect, as the most important trade partner for Turkey and the white goods industry, it is of great importance for Arçelik to closely monitor developments that may affect how business is conducted in the EU market, and to take the necessary precautions in advance.

Although Turkey and the EU have had a tumultuous relationship over the years, the agreement needs to be modernized by also taking into account the conditions required to ensure that the gains of the exporting sectors can continue. In this regard, Turkey's lack of say over the EU's Free Trade Agreement (FTA) policy, the potential risks of trade distortions and unfair competition as a result of the EU signing new-age FTA agreements with different countries (Japan, Vietnam, Singapore, etc.) as well as Turkey's absence from the decision-making mechanisms of the EU come to the fore as matters that are needed to be overcome.

In addition to such structural problems stemming from the asymmetrical structure of the CU, it is critical that developments that may closely affect Turkey's export competitiveness in EU markets should sensitively be considered. The need to develop long-term policies and action plans in line with trends that transform the ecosystem such as digitalization, has become ever-more pronounced with the rise in regionalization, protectionism trends as well as policies led by the EU against climate change, which has exacerbated with COVID-19:

- An important tool of the EU's trade policy, FTAs frame the kind of trade policy that is needed to be followed simultaneously by Turkey and the EU, as required by the rules of the CU between the two entities. However, there is a loss in Turkey's competitiveness against countries with which the EU has signed an FTA but which have not signed an FTA with Turkey. Hence, it is of vital importance for the expectations and sensitivities of Turkey as the EU's CU partner to be considered, and for the necessity of an effectively operating consultation mechanism between the parties to be emphasized in the modernization process, and that gains will be generated on these issues. In particular, it is critical that Turkey's FTA policies are drawn with due consideration of the expected transformation of supply chains within the era we are going through.
- The destructive effect of COVID-19 on global supply chains has pushed all countries and companies to seek-out diverse and alternative resources, geographically. While the EU has been putting efforts into strategies that aim at strengthening supply chains for a rapid and sustainable recovery, as evident from most policy documents it has published post-COVID, it has also been pursuing to lead the development of new environmental and governance standards. For this purpose, the EU has been emphasizing compliance with the Paris Agreement and sustainable development goals increasingly more in its new approach to trade policy. In addition, the EU has adopted the initiative of forming alliances with "like-minded countries" within the framework of EU values while strengthening its own value chains with the "Strategic Autonomy" initiative. In a process where global trade policies are reviewed, there is a need to monitor the partnership initiatives of the EU with other countries and to plan Turkey's current strategies in a way that will increase Turkey's integration with and to the EU.
- The European Commission announced the EU Green Deal on 11 December 2019 as the EU's new growth strategy. Accordingly, in line with the goal of reducing greenhouse gas emissions by at least 55 percent compared to the 1990 level by 2030 and becoming "Carbon Neutral" by 2050, sub-regulations of approximately 50 items will be implemented in the next two years. Considering Turkey's intense commercial relations with the EU, it seems highly likely that this issue will come to the fore in the CU modernization process. Although the carbon mechanism at the country borders, one of the sub-regulations under the Green Deal, has not yet been clarified, keeping Turkey's export competitiveness will be critical. Turkey's relations with the EU over the CU and with Turkey's candidate country status deem the development of individual assessment and specific consultation mechanisms necessary. This is because there currently are sectors that meet EU norms and are in compliance with the EU regulations in terms of both the products and manufacturing facilities in Turkey. It is critical in terms of export competitiveness that these sectors are not subjected to unfair taxation in the mechanism to be established.

- The policy documents published by the EU, especially after COVID-19, clearly emphasize that the healthy recovery plan will have digitalization induced green transformation, hence putting its strategy for digital sovereignty at the forefront. In this respect, significant and recent developments have been experienced in terms of digital transformation (cybersecurity, data security, artificial intelligence, etc.) in the EU. The European Commission has commissioned European Union Agency for Cybersecurity (ENISA) to create the infrastructure for the cybersecurity certificate. “Stakeholder Cybersecurity Certification Group” has been established on the relevant platform, where stakeholder opinions will be received. In addition, Germany, which took over the EU Presidency as of July 2020, has put forward its demand for the implementation of mandatory standards for cybersecurity of “connected” products as soon as possible. In line with such developments, it is important for Turkey to take an active role in both standard-setting and certification processes and develop collaborations in these areas. However, as long as Turkey does not gain the General Data Protection Regulation (GDPR) compliant country status, and uncertainties regarding data processing rights persist, it is likely that Turkey will face difficulties in its integration with the EU in this field. As stated in the 11th Development Plan of Turkey, it is extremely important to complete the legal processes for GDPR compliance and to develop a country policy in this field in order to avoid problems in exporting new generation connected products to the EU and to create an ecosystem in Turkey regarding data rights.
- By ensuring the sustainable development of Turkey’s production infrastructure with innovative technologies over the years, and financial support programs and Research and Development (R&D) incentives carried-out both under the leadership of Turkey’s public institutions and under the coordination of the EU, have supported the pursuit of increasing Turkey’s innovation capacity and reducing its dependence on imports. In turn, very important gains have also been achieved by Turkey’s domestic suppliers that are Small and Medium-Sized Enterprises (SMEs) and white goods sub-industry companies, as they gained ground in the global ecosystem, penetrated EU markets, improved their investment environments, and increased their productivity and exports. Technology and Innovation Grant Programs Directorate (TEYDEB) program, which has been carried out under the coordination of the Scientific and Technological Research Council of Turkey (TÜBİTAK) since 1995, provides project support to the R&D ideas of industrial organizations; contributes to the development of the ecosystem by developing synergy between the private sector and universities, and via creating technology transfer mechanisms. The practice of R&D centres, regulated by Law No. 5746 on Supporting Research and Development Activities published in 2008, has spearheaded the attainment of significant gains in the development of the innovation ecosystem. Hence, this makes the continuation of these improvements by using a performance-oriented monitoring system vital to the process itself.
- In addition, Turkey’s participation in the EU Framework Programs, which is one of the largest civil research programs in the world, with rights equal to those of the EU member states, provides important opportunities for the Turkish private sector. Leading the pack is the Turkish private sector’s ability to work in coordination with the EU on its focus research areas. The research conducted presents the opportunity for Turkey to align itself with the technical regulations implemented by the EU in various fields. The development of Turkey’s preparation capacity for the EU’s financial support programs, especially the Horizon Europe program, which will start in 2021 and has a fund size of around 90 billion euros, is considered very important. With over 1200 R&D centres, it is important to develop and continue national mechanisms in order to increase Turkey’s current potential and ability to benefit from these programs more effectively.
- TURQUALITY mechanism, which entered into force in 2004 and is seen as an exemplary state-sponsored branding program, has played an important role in Turkish brands’ penetration to EU markets by providing financial and operational support. Even though it has achieved great gains over the years, it would be timely to review the TURQUALITY program with due consideration of the changes in global markets. Long-term planning and studies are needed to increase the visibility of Turkish brands, to benefit from the opportunities that may arise after COVID-19 and to ensure Turkish brands’ permanence in relevant markets. On the other hand, the structure of the TURQUALITY program, which is limited to 5 years, is insufficient for long-term goals; hence it will be appropriate to support the branding strategies of Turkish companies in a flexible and long-term manner to adapt to changing market conditions. It is believed that the long-term and performance-oriented approach of the TURQUALITY program will carry the gains of the CU forward.

Conclusion:

The EU market is very important for both the white goods sector and Arçelik. Although Turkey’s efforts to open new export channels to new markets are valuable, the strengthening of existing export-relations with the EU market through the modernization of the CU must be prioritized. A significant level of integration has already been achieved in supply chains and product regulations for 25 years through the CU. Considering the changing global trade environment, the existing structure that allows for the acceleration of penetration to EU markets and facilitates trade with the EU needs to become more functional and revised in a way that fully reflects the potential of both sides.

CASE STUDY - Ford Otosan (Turkey)

Turkey's signing of the World Trade Organization (WTO) Agreement in 1995 and the establishment of the Customs Union (CU) with Association Council Decision 1/95 has facilitated the integration of Turkey's economy to international markets.

Undoubtedly, the most important step in this process has been the establishment of a CU between Turkey and the European Union (EU) in 1995. With the CU, Turkey has become a suitable manufacturing location for global markets, especially the EU. Thanks to the new competition law, new legislation on industry and property, and EU's technical regulations adopted as a result of this relationship, Turkey has attained a reliable and predictable legal and administrative framework for investments.

The export champion of Turkey for the last 5 consecutive years, Ford Otosan's success is a prime example that proves global competition is an opportunity for Turkish companies that manufacture high-quality products.

In brief, following the establishment of the CU, Ford Motor Company increased its shareholder equity in Otosan in 1997, and the company name was revised as "Ford Otosan" with Koç Holding and Ford Motor Company as equal partners. New investments along with projects implemented as a result of this partnership, Ford Otosan's;

- Annual production capacity, which was 47 thousand units in 1997, increased to 455 thousand units by 2019
- Exports of 667 units in 1997 increased to 334,455 units by 2019
- Export revenue of 16 million dollars in 1997 increased to 5.9 billion dollars by 2019
- The number of employees, which was 3,406 in 1997, increased to 10,899 by 2019.

Commenced with the establishment of the CU, Ford Otosan's transformation has not been limited to increases in production and export volumes. In 2019, Ford Otosan Kocaeli Factories became one of only four automotive factories in the world that was elected to the Global Lighthouse Network by the World Economic Forum (WEF) and McKinsey due to Kocaeli factories' compatibility with Industry 4.0 applications. In addition, Ford Otosan established the largest, privately-owned Research and Development (R&D) centre in Turkey, and has been the champion of Turkey's Exports in Engineering Services for the last 4 years.

By 2020, it has been deduced that the existing CU framework falls short of meeting the present needs that transpire from the complex trade relations between the EU and Turkey, and that it hinders the relationship from reaching its potential.

It can be seen that the EU has been signing new generation Free Trade Agreement (FTA) with many countries that can rival Turkey's current position. This may cause the relative advantage Turkey has thanks to the CU to disappear gradually.

Additionally, while the EU is able to carry out FTA negotiations with the country it wishes, Turkey cannot sign an FTA with any country before the EU signs an FTA according to its own priorities. Even then, Turkey is required to convince the third party which signed an FTA with the EU to its own priorities at the negotiation table for the FTA to be signed with Turkey. This relationship dynamic is owed to the asymmetric structure of the current CU. The most concrete example of this can be seen in the FTA negotiations with Turkey's second-largest export market, the United Kingdom (UK). Although both the UK and Turkey were willing, Turkey could not sign a separate FTA with the UK, before the EU and UK struck a deal. What is worse is that the EU was not even making the situation of Turkey privy to these FTA negotiations, and excluded from discussions issues such as rules of origin that are of high interest and priority for Turkey.

With a CU update, the hesitations of foreign investors that arise from geopolitical tensions will be eliminated, and a framework that will protect Turkey's interests in future FTA negotiations to be carried out by the EU will be established. As a result of progress in bottlenecks such as transport quotas, Turkey will become more attractive to global supply chains, and create a more favourable investment environment for the supply industry, also of vital importance for the EU.

CASE STUDY - MAN Turkey A.Ş. (Turkey)

The Customs Union (CU) agreement concluded between the European Union (EU) and Turkey in 1996 not only refers to the social development of modern standards but has also contributed to the acceleration of technology transfer and the development of the investment environment, in regard to trade and exports. It has also helped accelerate the internalization of global standards in both legal and financial transactions.

By accepting to be part of the EU CU agreement, Turkey has been able to internalize the technical regulations for industrial products in terms of customs and trade policy, as well as the policies and legislation regarding competition rights and intellectual and industrial property rights. Mutual customs duties on industrial products were abolished, and companies based in Turkey could export to the EU, which aided in the technology transfer to Turkey and was accelerated by the increase in international suppliers. This has allowed the CU agreement to have a positive impact on the adaptation of Turkey to the international competitive environment while simultaneously increasing the attraction of foreign capital investment in the manufacturing sector. Moreover, the change in technical legislation has provided the opportunity to sell products that are in line with international standards and available to international markets.

In this context, the automotive industry in Turkey has undergone significant structural changes as a result of the CU agreement and has aided Turkey in becoming more competitive on the international stage. The EU has become the primary export market for the Turkish automotive industry.

MAN Turkey has also benefited from the momentum provided by the CU agreement to the Turkish automotive sector. MAN Truck & Bus also sells trucks & vans to EU, which are produced in its plants in Turkey. In parallel with the growth of the Turkish automotive industry, it has continuously increased its production capacity in recent years and has become one of the largest integrated bus manufacturing factories in the world, including Europe. It has become the main production base of coach type buses within MAN Truck & Bus. While 45 percent of the parts used in production are procured from suppliers in the EU, it has been exporting more than 95 percent of its production in recent years, and EU countries, especially Germany, have received the biggest share of its exports. The contributions of the CU agreement to the Turkish automotive sector over the years can be clearly noticed. MAN Turkey has benefitted greatly from the CU agreement and captured many opportunities for new investments.

Further development of the current conditions of the CU agreement will contribute to the increase of mutual gains for the automotive sector in both Turkey and the EU.

CASE STUDY - Siemens Healthineers (Turkey)

In this case study, Siemens Healthineers Turkey has commented on the Customs Union (CU) agreement issue under 3 headings. In addition, since experiences of the Siemens Healthineers Turkey as a company is actually the common experiences of the industry, Siemens Healthineers Turkey is communicating their opinion jointly, not only as a company, but through associations in the health sector which Siemens Healthineers Turkey is a member of, to have this case study be more comprehensive and more effective.

The CU agreement facilitates the full commercial trade between Turkey and the European Union (EU) parties, as a foundational mechanism for Turkey's full EU membership accession. However, the CU agreement is insufficient in facilitating trade with the EU, as the membership process has been prolonged much more than expected. Moreover, Turkey's and the EU's Free Trade Agreements (FTAs) with third-party countries offer advantages over the CU agreement, which hinders the effectiveness of the agreement. This situation has led to the need of updating the CU agreement and the enlargement of its scope, in order to make trade freedom more effective. However, due to the current political conjuncture, the ability to move forward on the modernization of a CU agreement seems more and more difficult.

This case study reflects the perception of companies that have their headquarters in the EU but maintain active operations in Turkey. For Siemens Healthineers operating in Turkey, the biggest advantage that the CU agreement has provided, has been the right to benefit partially from taxes issued at customs and product safety inspections (TARESK - Risk-Based Trade Control System). Countries that manufacture more, stand to benefit more from the CU agreement, and most of the high-end medical machinery found in Turkey is manufactured and imported from other European countries. These partial tax abatements allow European manufactured medical devices to remain competitive in the market. Since there is no manufacturing of high-end technological medical devices in Turkey, it is unable to benefit from the CU agreement as much as other EU countries in this regard.

Currently, Siemens Healthineers is active in Turkey in several areas, including importation, distribution, and services of medical imaging devices. Operations consist of distributing medical machinery (in-vivo), the spare parts of these devices, and the laboratory side analysers and test kits for use in these devices (in-vitro). Under the CU agreement, most of the products that fall under these categories do not benefit from the current agreement in place.

On the other hand, Turkey benefits from the advantages of the CU in terms of the health sector, such as the national medical device legislation ((Medical Device Regulation (93/42 / EEC, 90/385 / EEC, 98/79 / EC)) and the current Medical Device legislation of the EU. The advantage of the CU agreement in the Turkish health industry is the focus on the use and management of medical machinery to be in line with the same set of standardized protocols for both the EU and Turkey. However, in the event of the cancellation of the CU agreement, such regulations compatible with standardized EU protocols, may be reviewed, and different applications and processes may be required. (For example, additional licensing and certification may be requested for non-EU products to be sold in EU countries.)

Siemens Healthineers is able to enjoy some tax benefits from the CU agreement regarding diagnostic medical machinery and medical machinery spare parts. On the other hand, some of the medical machinery and its parts are subject to additional taxes as well. In some cases, Turkey adds additional taxes to these product groups as a reciprocal response to EU taxation on these product groups. At times, the EU circumvents customs taxes by using its FTA's with third-party countries to import products into Turkey. As a result, the dynamics of this process make it very difficult for the health industry to benefit from the protocols in place (such as tax abatements) from the CU agreement while having a very negative effect on the importer.

Through the CU agreement, product safety inspections should be carried out with standardized protocols similar to how it is done in EU countries; however, this is one area, which there is a large discrepancy. The mechanisms for product safety inspection are nearly non-existent once the product passes through customs. The process of product safety inspections would be much more efficient if they could be carried out at the point of customs. Siemens Healthineers in Turkey made a unique proposal that safety inspections, if not done at the point of customs, could be done at local headquarters, as opposed to being conducted once products had already been distributed into the market. This suggestion would be beneficial in being considered for an upgrade to the CU agreement, as there is a loss of 7-10 days on average for safety inspections on products at customs.

CASE STUDY - Siemens Healthcare GmbH (Germany)

The basic benefit of the Customs Union (CU) established in 1996 through the European Union (EU)-Turkey Association Council Decision 1/95 is the free movement of industrial goods, i.e., the abolition of tariffs and quotas on CU-goods circulating between the parties and the alignment of a common customs tariff. All goods that were wholly obtained or manufactured in one of the parties or that were already put into free circulation after their importation from third countries in one of the parties can be imported with 0 percent duty to the other party. This means CU goods can circulate anywhere in the territory in the CU as long as they are accompanied by an A.TR movement certificate (official proof of CU status). Please note that agricultural and fishery products and coal and steel products are not covered by the CU but by separate EU-Turkey Free Trade Agreements (FTAs). Having said this, both EU and Turkey businesses in many industries surely highly benefit from the CU as immense duty savings can be generated (compared to imports from other third countries), which eases market access for EU business in Turkey and vice versa and which made Turkey an interesting location of production for many industries.

Many industries will be able to report interesting figures of duty savings due to CU. However, in the healthcare sector, it is hard to generate significant savings in the EU-Turkey trade as the vast majority of healthcare products are free of import duty according to the common customs tariff. For instance, there is no difference in duty if the healthcare product is sourced from a CU partner or from another third partner supplier because the Most Favoured Nation (MFN) rate is already 0 percent.

There is a recent topic that is linked to EU-Turkey trade and indirectly to the CU that if addressed in the modernization of the CU agreement, could result in a favourable outcome from a business perspective for all parties. Since 2018 Turkey is rising additional duties and taxes for many imported goods that have an Asian country as the country of origin. That means that EU exporters also have to issue official Certificates of Origin for every export to Turkey (besides the A.TR movement certificate) to avoid these additional duties and taxes for all goods that do demonstrably not originate in one of these Asian countries.

This means extra bureaucratic effort and costs in export processing operations, and this basically contradicts the CU agreement where all shipments of CU goods (regardless of their country of origin as described above) should be free of any duty. If this was to be resolved in the modernization of the CU agreement, it would drastically simplify the process regarding imports and exports.

Input from the Austrian Trade Commission in Turkey (Advantage Austria)

The majority of the Austrian business community in Turkey is in favour of an update of the Customs Union (CU) according to the Austrian Trade Commission surveys, which are conducted annually. To further develop trade and investments, the Austrian Trade Commission in Turkey (Advantage Austria) organizes a wide variety of events in both Turkey and in Austria for the business community, including all Turkish and Austrian companies interested in enhancing their businesses in either countries.

In more general terms, the main problems, which most of the companies included in the Austrian-Turkish Chamber of Commerce are facing, can be summarized as follows:

- The Certificate of Origin has to be provided for each shipment despite A.TR certificate.
- In case a Certificate of Origin is missing, additional duties have to be paid.
- Inspections requested by TAREKS (Risk-Based Trade Control System) are time-consuming and costly.
- Products which are already certified according to European Union (EU) standards still need to be inspected and at times tested again by TSE.
- Resource Utilization Support Fund at a rate of 6 percent is applied to imports realized under acceptance credits, deferred payment letter of credit, and on a cash-against-goods basis.

Input from the Dutch Business Association Turkey (DBA Turkey)

E-COO

- Status: Only applicable for Italy and Spain shipments. Especially from Poland, as we have high volume business, the e-COO is not fully applicable
- Request: Within the EU, E-COO usage coverage should increase

E-A.TR

- Status: Receiving original A.TR as shipping documents
- Instead of the original A.TR, we need E-A.TR within in EU. Also, E-A.TR should include E-COO, which means A.TR should meet the E-COO requirements.

Logistics

- Request: Usage of Ro-Ro should increase, railway lines to increase and usage of railways to increase by proposing benefits.

Free movement in the EU

- Status: The shipments that are under free movement from the EU have another customs control when entering Turkey (like TSE, etc.)
- Request: EU shipments should directly release for free movement in Turkey like the EU applies.
- On the Turkish site, risk criteria are periodically applied, but EU origin goods must have full exemption.

Additional customs tax (Additional financial liability tax)

- Request: Should consider removing the additional taxes (under additional financial liability tax) for the goods from EU which are originally shipped from other countries

Market inspection implementation vs. regular customs inspection

- Request: Currently, products are controlled at the customs stage. Manufacturer responsibility area should increase comparing to importer responsibility. If market inspections will take place, then manufacturer liability should

Product release

- Request: Repetitive inspections for the same products. Should receive approvals once for the products

Import process simplifications for EU imports

- Request: Instead of complexity, the process should have a more lean & simple process for EU goods

Guarantee

- Request: Different rate guarantee cost application for the goods from the EU which will bring the advantage of guarantee cost

Additional customs taxes

- Request: Additional tax is applicable where there are no customs for the third category countries

There are several restrictive measures applied by Turkey under the existing Customs Union (CU) Agreement in terms of access to the Turkish market and equality of treatment, as well as many measures that make it difficult to access the public procurement market. Markets are closed to French products (such as sheep and goats). There are also several administrative barriers/hurdles, such as difficulties in obtaining investment permits and in the renewal of operating licenses, localization requirements (in the medical sector, for instance), and local sourcing restrictions in public tenders (such as in the transportation of energy products) and prohibitive customs tariff (in the agri-food industry for instance).

French companies are particularly concerned by restrictive measures applied by Turkey under the existing CU Agreement:

- Certification and testing requirements of imported goods: importers need to register on the TAREKS (Risk-Based Trade Control System) electronic control system and carry out their applications via this system. The system generates a risk analysis and determines if the product subject to import requires a conformity check. Normally products in free circulation in the European Union (EU), hence with nomenclature A.TR, are not subject to checks and have direct access to the Turkish market. In the case of the identified risk profile, products with A.TR certificates may also be directed to conformity checks. French exporters complain with regard to products that have to bear CE marking, particularly in the machinery sector and with regard to lighting products. The products are often diverted to conformity assessment checks - based merely on documentation incorrectness - even if there seem to be no risks of product safety.
- Additional duties on a wide and expanding range of products, customs implementation issues: In 2011, Turkey started to introduce tariff increases or so-called 'additional duties' above the Common Customs Tariff that the EU-Turkey CU agreement obliges Turkey to apply. Since then, Turkey has expanded the scope of these additional duties to an ever-increasing number of products, from initially certain textile and garments products to cover, i.e., footwear, cosmetics, household appliances, certain machinery, and motorcycles. Turkey has made numerous individual decisions, in some cases amending previous ones, covering a new set of products designated by Harmonized System (HS) codes to be subject to such duties at a rate varying anywhere from 2.5 percent up to 50 percent. In April and May 2020, the process has sharply accelerated with a number of newly adopted decisions expanding the scope by several hundred additional product lines, apparently motivated by the growing trade deficit in the context of the COVID-19 pandemic. Products originating in the EU or Free Trade Agreement (FTA) partners of Turkey are not subject to these additional duties. However, products originating from third countries are subject to additional duties even when imported via the EU and in free circulation in the EU after completing import procedures in a member state. The concurrent problem is, therefore, the requirement for proof of origin document. The application of such duties is in breach of the EU-Turkey CU. However, Turkey is staying below its World Trade Organization (WTO) bound rates in the tariff lines it has committed to. These additional duties lead to a need for the Turkish customs to establish the origin of goods that fall under these tariff lines, and therefore a requirement for a non-preferential certificate of origin even when exporting goods in free circulation to Turkey with an A.TR movement certificate as provided for in the CU agreement.

More specifically for health, cosmetic, textile, apparel, and footwear industries:

- Persistent problems in the health and cosmetic sectors: There are four types of barriers to access the market of pharmaceutical products: registration time frames (since 2010, Good Manufacturing Practice (GMP) certifications issued by EU member states are not accepted by Turkish authorities), the price of reimbursed medicine (the calculation method of which results in the exclusion of certain medicines from the Turkish market especially new generation or small-volume medicine), data exclusivity and "forced" localization. As for cosmetics, there are two types of discriminatory barriers: the unjustified registration process and the publication on the public website of detailed information about cosmetic products. There are some urgent concerns regarding confidential information requested during the registration process and public access to confidential information.
- Registration procedures in the textile, apparel, and footwear industries: as of 31 January 2019, all exporters from the EU to Turkey are required to be registered at the Istanbul Textile and Apparel Exporters Association (İTKİB). Furthermore, more and more products with an A.TR certificate is covered by the Risk-Based Trade Control System (TAREKS), which is an electronic system that is in contradiction with the free movement policy of the CU. In addition, a requirement imposing additional documentation on apparel and footwear from third countries entered into force on 31 January 2019. This requirement imposes burdensome and far-reaching requirements on EU operators purchasing from Asia (initially China only, later added Bangladesh, Vietnam, Indonesia, India, Cambodia, Pakistan, Sri Lanka, Myanmar, and Thailand) in an exporter/producer information form. The submission of detailed commercial information poses a serious concern for exporters.

Input from the German - Turkish Chamber of Industry and Commerce (AHK Turkey)

The German - Turkish Chamber of Industry and Commerce (AHK Turkey) perspective on modernizing the Customs Union (CU) agreement is favourable. AHK Turkey views the outlook of the German - Turkish trade relationship very positively and identifies great potential between businesses and industries in both countries. AHK Turkey is an integral component of the Bilateral European Chambers in Turkey. Through its network of resources and services, it has continually fostered the growth of trade relations and investments between Turkey and Germany. Germany, serving as Turkey's largest European trade partner, stands to benefit greatly from the modernization of the CU agreement. The Chamber's perspective is that trade facilitation between both countries could be strengthened greatly through a modernized CU agreement and would benefit commercial activity from both countries, by continuing to strengthen the long-term sustainability and prosperity of their relationships.

AHK Turkey not only views the modernization of the CU agreement favourably, but as a necessity. With the Chamber on the front lines of commercial activity in both countries, the step towards modernizing the CU agreement is viewed as long overdue. Issues revolving around Certificates of Origin even with the recent legislation change (on 10th of January,2021), updated policies on e-commerce, visa restrictions, and third-party Free Trade Agreements (FTAs) are in need of urgent revision and modernization, with current policies serving more to hinder the commercial activity between both countries. As AHK Turkey, the urgent modernization of the CU agreement is viewed as vital to the long-term trade growth between the European Union (EU) and Turkey.

The Chamber views the creation of the EU Customs Union agreement as a pivotal turning point in EU-Turkey trade relations. It also views the agreement as outdated and non-responsive to many of today's commercial demands. An agreement that was originally created to serve as a catalyst for trade growth and stronger relations has lost some its luster. The scope of the agreement must be catered to look through the lens of the 21st century. AHK Turkey not only hears the calls of businesses at home and abroad but understands the value it will bring to the long-term health of the EU-Turkey relationship and fully supports any measures that will take place to modernize and revitalize the EU CU agreement.

Input from the Italian Chamber of Commerce and Industry in Turkey (CCIIST)

The current Customs Union (CU) Agreement has had a profound, transformative effect on the Turkish economy as well as the legal infrastructure of the country. Turkey has gone through a significant modernization and integration process with the European Union (EU) to the effect that most of the *Acquis Communautaire* is now enshrined into law. In turn this has given confidence to EU based economic actors to increase their exposure to the Turkish market, both in terms of trade and investments. There have been winners and losers but, in aggregate, all this has resulted in a major increase in bilateral economic ties between Italy and Turkey (among others). The CU agreement was supposed to be a temporary step on the road to full membership, but this has yet to materialize and the prospects on that score do not look very favourable at the moment. At the same time, the Turkish private sector has proved its resilience and competitiveness and could play a bigger role in the single market for the benefits of both sides. The current agreement has probably run its course in terms of its value creation potential and its shortcomings are becoming all too obvious. On one hand, we believe that it is essential to defend the spirit and letter of the current agreement as more and more protectionist measures and non-tariff barriers are being put up by all parties involved. On the other hand, it is time to modernize the CU agreement with a more comprehensive Free Trade Agreement (FTA) in order to boost bilateral trade and investment. The CCIIST estimates that under the right circumstances, the bilateral trade between Italy and Turkey could reach 30 billion dollars in a period of 5 years from the current (pre COVID-19) trade of 20 billion dollars.

Input from the Swiss Chamber of Commerce in Turkey (SCCT)

The Swiss Chamber of Commerce in Turkey (SCCT) has been part of the Bilateral European Chambers initiative since the very beginning and is a strong supporter of improvements in the investment and trade relationships between Turkish and European countries. Switzerland is a landlocked nation surrounded by four European Union (EU) members, including three of its largest economies: Germany, France, and Italy. The EU plays a preponderant role in Swiss trade flows and policy. For the same reason, Swiss - EU trade relations will continue to occupy a central role. Switzerland is in fact closely integrated with the EU. In economic terms, the EU is Switzerland's most important trading partner, accounting for more than 60 percent of total Swiss exports and almost 80 percent of its imports. In this context, modernizing the EU-Turkey Customs Union (CU) agreement would lead to greater legal certainty and have a positive effect on Switzerland-Turkey trade relations. Close and sustainable relationships between Turkey and the EU are of significant importance for the economic relations between Switzerland and Turkey, which ranks 20th among the most important Swiss trading partners. Accordingly, alignment of the trade frameworks would help avoiding triangulation issues with third countries such as Turkey.

Switzerland, together with the other European Free Trade Area (EFTA) countries, has modernized the 1991 Free Trade Agreement (FTA) with Turkey. The new agreement which was signed in Iceland in June 2018 has been approved respectively by the Swiss and Turkish parliaments and is now pending ratification by the President of the Republic of Turkey. The modernized EFTA agreement includes new provisions on mutual recognition of conformity tests, reference to the rules of origin of the Pan-Euro-Mediterranean (PEM) Convention, protection of intellectual property, trade in services, and trade and sustainable development. These areas are also expected to be covered within the scope of the CU modernization talks. In regard of the revision of the rules of origin of the PEM Convention, Turkey did not vote for the revised rules at the last PEM meeting in November 2019 regarding the abolition of the duty drawback rule. Reaching of a bilateral solution in the Turkey-EU discussion in this respect could allow Turkey to agree on the revised PEM Convention in the near future.

Brief information on contributor chambers

Austrian Trade Commission in Turkey (Advantage Austria)

The Austrian Trade Commission in Turkey (Advantage Austria) has offices in Istanbul and Ankara and is part of the Austrian Federal Economic Chamber in Austria. As all 300,000 Austrian companies are members of the Austrian Chamber, the Austrian Trade Commission in Turkey represents the whole of the Austrian Business Community in Turkey.

Turkey is an important business partner for Austrian businesses. According to the Turkish Statistics, Austria is with a total trade volume of approximately 10 billion dollars, which makes it one of the most important investors in Turkey. 150 Austrian companies with subsidiaries are present in Turkey, and each year approximately 1.2 thousand Austrian companies are in touch with the Austrian Trade Commission to do business in Turkey. Foreign trade between Austria and Turkey, regarding goods and services is around 3.8 billion euro annually and in Turkey's favour.

Belgian - Luxembourg Chamber of Commerce in Turkey (BLCCT)

The Belgian Chamber of Commerce in Turkey was founded in 1926 with the aim of supporting economic, commercial, social, and cultural relations. At the Ordinary General Assembly held at the Consulate General of Belgium in Istanbul on 16 April 2009, after receiving the power of attorney of the Luxembourg Chamber of Commerce from the Federation of Belgian Chambers of Commerce, the name of the Chamber was changed to the Belgian - Luxembourg Chamber of Commerce in Turkey (BLCCT).

The BLCCT supports Belgian and Luxembourgish companies established in Turkey or aiming to develop trade and industrial relations with Turkey. The BLCCT also supports Turkish companies wishing to operate in Belgium and Luxembourg. The BLCCT provides business matchmaking, practical support, and knowledge sharing services for its members. Among other services, Connects Network, an online business matchmaking platform, has a wide range of usage among the BLCCT members.

The platform allows companies to survive and leverage their business activities during and beyond the COVID-19 crisis by helping them to continue buying, selling, and connecting digitally. The BLCCT is an accredited member of the Federation of Belgian Chambers of Commerce (cci.be), headquartered in Brussels and organized in 32 countries.

British Chamber of Commerce in Turkey (BCCT)

The British Chamber of Commerce in Turkey (BCCT) has over 400 members consisting of both United Kingdom (UK) and Turkish enterprises and is the second oldest British Chamber abroad in the world. The BCCT is a strategic partner of the Department for International Trade (DIT) in Turkey and is responsible for delivering services to the British firms who are looking to export and invest in Turkey.

The BCCT is the British Chambers of Commerce International Affiliates, which works in close cooperation within a strategic partnership with the DIT (formerly UK Trade & Investment) and other chambers in Turkey and the UK, BCCT delivers information, support and networking services to companies and organisations in both the UK and Turkey. The BCCT serves British companies with one integrated offer to seize business and export opportunities in Turkey and acts as a matchmaker between the UK and Turkish companies and generates over 2 million Turkish Lira (TL) in annual revenue with 10 employees.

Increasing FDI is one of our targets that BCCT has been actively trying to promote over the years. Together with the DIT and its member network, the BCCT is able to effectively deliver events and business clinics for UK investors looking to expand into the Turkish market. Since 2013, the BCCT has delivered several investment events in the UK. The BCCT routinely provides matchmaking services to the UK firms that are looking to invest in Turkey through various partnership options.

The BCCT has been delivering commercial services to both UK and Turkish business for decades. Having a strong presence in Turkey over the years has given the BCCT a unique advantage of generating a very large and diversified network incorporating various sectors. The BCCT works closely with its stakeholders and is capable of delivering and representing commercial activities both in Turkey and in the UK. As part of being the overseas delivery partner of the UK government, the BCCT is engaged with the UK policy makers and the trade department of the British missions in Turkey. Together with the DIT UK network, the BCCT is capable of stimulating bilateral trade activities in the UK and vice versa through their partnerships with the local chambers in Turkey.

Dutch Business Association Turkey (DBA Turkey)

The Dutch Business Association Turkey (DBA Turkey) is a non-profit association, founded in 2014, with the objective to promote, enhance and support business and investments between the Netherlands and Turkey. The association is responsible for connecting the professionals of Dutch and Turkish corporate members and Small and Medium-Sized Enterprises (SMEs) through high-level forums, presentations, webinars and networking events to exchange information, knowledge and best practices across different industries. The ultimate objective of the DBA is to promote bilateral business. The DBA currently has about 75 members, mostly corporate, but also SMEs.

The DBA works in close cooperation with the Dutch Consulate-General in Istanbul and the Dutch Embassy in Ankara and is part of NLinBusiness, a strong network of business hubs around the world that help Dutch entrepreneurs to grow internationally. DBA Turkey generally supports trade improvements between the Netherlands and Turkey and therefore also supports the initiative to have a balanced improvement of the Customs Union (CU) on both sides.

Brief information on contributor chambers

French - Turkish Chamber of Commerce

The French - Turkish Chamber of Commerce is a fully independent and self-financed association under Turkish law, created in 1885, it is one of the main French institutional players involved in the development of bilateral economic relations between France and Turkey due to its seniority and its role and position as a gateway to the Turkish market. It is the second oldest bilateral chamber in Turkey and is one of the five oldest French Chambers abroad, as well as a founding member of the CCI France International. The French - Turkish Chamber of Commerce brings together French and local companies to form a business community through a network of contacts and information and serves as the spokesperson for the Franco-Turkish business communities in Turkey. Serving as a business facilitator, the French - Turkish Chamber of Commerce conducts its actions around connecting businessmen and providing information and supporting businesses through its own services, such as its business centre and its members and partner services. The French Chamber of Commerce brings together the vast majority of the biggest French companies in Turkey, which aims to serve as one of the main contributors to Franco-Turkish bilateral trade.

According to French statistics, nearly 450 French companies are present in Turkey, which are responsible for over 150 thousand employees in the country (Foreign Direct Investment (FDI)'s shares in Turkey accumulate of 5 percent). More than 400 companies, many of whom are members of the French - Turkish Chamber of Commerce, are operational in key sectors of the Turkish economy, including over 150 French companies that were established in Turkey, which represent more than 2/3rd of the total French FDI in Turkey. The French - Turkish Chamber of Commerce has 6 full-time employees.

The French - Turkish Chamber of Commerce encourages and integrates many methods to capture, influence, and increase foreign investment. The Chamber promotes the attractiveness of the Turkish market to French companies and their contacts in France (CCI, professional federations, etc.) and enjoys great operational flexibility to provide tailor-made services to businesses, thus providing the Chamber the ability to leverage and stimulate economic activity and trade.

German - Turkish Chamber of Industry and Commerce (AHK Turkey)

The German - Turkish Chamber of Industry and Commerce (AHK Turkey) was established in 1994 and is part of a network of 140 AHKs (German Foreign Chambers) found in 92 countries. AHKs are the main actors in the development of German foreign trade on behalf of the Federal Republic of Germany. They represent the German business in host countries. They provide information and promote Germany as a field of economic activity.

AHK Turkey has almost 1000 active members from all sectors and in all sizes representing Turkey's largest trade partner. The Chamber's main objective is to support German companies in establishing and developing economic relations in Turkey. In Turkey, it is the only Bilateral Chamber that is legally recognized as an official chamber of commerce. It has been founded by a joint agreement between the Union of Chambers and Commodity Exchanges of Turkey (TOBB) and the Association of German Chambers of Industry and Commerce (DIHK) and the 94/5592 numbered Cabinet Decree in İstanbul. AHK Turkey is the first point of contact for German companies looking to pursue their commercial interests in Turkey.

AHK Turkey consistently works with all size businesses operating in both Germany and Turkey in various industries. Consisting of almost 30 employees spread out over 3 branches in Istanbul, Izmir, and Ankara, the Chamber branches provide support and resources to business on a wide range of topics. The Chamber has been a critical component of fostering business growth, investment, and overall trade relations between Germany and Turkey and business operations for companies in both countries. Recently, German Chancellor Angela Merkel's visit to the AHK Turkey in December of last year, has highlighted the importance and magnitude of the role the Chamber plays in business relations between Germany and Turkey. As of 2019, the Chamber also has a designated branch in Turkey's capital city, Ankara. This branch was established specifically to work on government engagement and relations on pursuing and realizing the interest of AHK members. The branch has been instrumental in creating direct dialogue channels with bureaucratic officials and streamlining member interests and concerns.

AHK Turkey plays a pivotal role in representing the trade relation activity between German and Turkish businesses. Because of its long-standing reputation as a viable asset for assisting German businesses abroad, its track record of established dialogue channels with bureaucratic officials, and its capability to deliver positive results, the Chamber possesses a unique ability to influence commercial activity. The Chamber's capabilities have served as a catalyst in terms of capturing and influencing the foreign investment. The Chamber has continually served as a trustable mechanism for intervening and resolving issues and concerns from German businesses and thus plays an increasingly active role in serving as a consulting mechanism regarding investments, economic trends, market research, and business models.

Brief information on contributor chambers

Italian Chamber of Commerce and Industry in Turkey (CCIIST)

The Italian Chamber of Commerce and Industry in Turkey (CCIIST) was founded in 1885 in Istanbul with the aim of promoting and contributing to the development of commercial activity, especially for Small and Medium-Sized Enterprises (SMEs), between Italy and Turkey. Since Italy has been historically one of the first five largest commercial partners of Turkey and the second European Union (EU) one, the CCIIST plays an important role in many different areas in order to meet her mission. Currently, the CCIIST has 615 members with a total turnover of about 400,000 euro. The CCIIST has 8 full-time staff, with two additional representative offices in Ankara and Kocaeli. The Chamber not only gives a direct and daily service to its members, but also contributes to their internationalization, organizing B2B meetings, fair activities, and institutional delegations for both countries. It has recently started being more active in providing support and advice to companies of each country wishing to invest in the other one.

In terms of economic strength, the board of CCIIST has representatives from and very close cooperation with all the main Italian investments in Turkey, such as Fiat, Pirelli, Ferrero, Barilla, Prysmian, Banca Intesa, and more. The CCIIST is part of a closely-knit network of 70 Italian chambers in the world spanning all continents and is recognized and supported by the Italian authorities.

The CCIIST is in favour of an upgrade of the CU and is actively promoting this project to and has the active support of the network of Italian Chambers of Commerce, the Italian Union of Chambers Unioncamere and the Employers Association Confindustria. The Italian Embassy and ICE trade promotion office are also supportive and are in close cooperation to coordinate efforts on this matter. The CCIIST board is made up of representatives from the Italian companies with the largest investments in Turkey. With its long experience (135 years) it is also the preferred gateway for Italian companies seeking to do business or invest in Turkey.

Swiss Chamber of Commerce in Turkey (SCCT)

The Swiss Chamber of Commerce in Turkey (SCCT) is structured in the form of a Turkish non-profit association, carrying out the mission of being a trade connection between business communities in Switzerland and in Turkey. As a 150-member strong organization with a budget approaching 1 million Turkish Lira (TL), the SCCT represents both Swiss and Turkish individuals and corporations, including industrial groups, services and trading companies, scholars, advisors and independent entrepreneurs. The SCCT team consists of two full-time professionals, supported by voluntary board members involved on specific matters relating to their respective areas of expertise.

The SCCT plays an important role in the ability to influence and represent commercial activity. Relying on the deeply-rooted Swiss investments made in Turkey across decades (some of them dating back to early 1900s) and on a strong cooperation with Swiss public institutions and Non-Governmental Organizations (NGOs), the SCCT is capable of reaching out to key contacts both in Switzerland and in Turkey that could help creating public opinion support on the initiatives of the Bilateral European Chambers. The SCCT also has capacity to convey key issues in the scope of the yearly Joint Economic Meetings addressing bilateral challenges.

Regular actions are being taken by the SCCT in cooperation with the Switzerland Global Enterprise and business associations in Switzerland to improve the visibility of Turkey as a land of opportunities for international investors. Focus is put on changing the perception of foreign investors and public opinion regarding Turkey in the scope of an objective assessment. The close cooperation of the SCCT with Switzerland Global Enterprise brings the advantage of being able to benefit from the strong networking capacity of this organization in Switzerland and to leverage on its commercial and public affairs capabilities to access influential public and private sector representatives.

Union of Chambers and Commodity Exchanges of Turkey (TOBB)

The Union of Chambers and Commodity Exchanges of Turkey (TOBB) is Turkey's largest business organisation representing the interest of more than 1.5 million businesses of all sizes, sectors, and regions.

Being part of the Continental Chamber system, all commercial companies in Turkey are members of chamber network through 365 local chambers and commodity exchanges. TOBB therefore is the apex organization of the whole business community. Over 1.5 million members of TOBB provide 60 percent of employment, 75 percent of Gross Domestic Product (GDP), 80 percent investment and 100 percent of export.

With its wide international network and strong international relations services, TOBB also represents the interest of the business community abroad, promote global business relationships and provide support for investments in Turkey.

Appendix

Appendix Table 1 - Timeline for the EU-Turkey relations

Relationship base	Initiation Date and Milestones	Details
Association	1963 Association Agreement (Ankara Agreement)	Establishes association between the European Economic Community (EEC) and Turkey, with the aim to continuously strengthen trade and economic relations, in particular through the progressive establishment of a customs union in three stages: preparatory, transitional and final, with protocols laying down the rules of the preparatory stage.
	1970 Additional Protocol	Lays down the rules for implementing the transitional stage of creating the customs union, including the progressive abolition of customs duties between the EEC and Turkey over twenty-two years.
Current bilateral preferential trade framework (BPTF) including CU for industrial goods	1995 Customs Union Decision	Establishes the customs union for industrial goods by the final stage which ensures that Turkey aligns its external tariffs to those of the EU. Also requires that Turkey aligns its customs and technical legislation to the EU as well as its commercial policy vis-à-vis third countries in the CU context.
	1996 Coal and Steel FTA	FTA on coal and steel products (including rules on competition).
	1998 Agriculture and Fisheries 'FTA'	Bilateral preferential concessions in agricultural and fisheries products.
Accession process	1999 Turkey candidate for EU accession	Turkey takes political commitment to progressively harmonise its national legislation with the EU acquis.
	2005 start of accession negotiations	Up to now, 16 out of the total 35 chapters have been opened.

Source: 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."

Appendix Table 2 – The timeline of the European Customs Union

1968	1973	1981	1986	1995	2004	2007	2013	2021	EU-27
				Austria					Austria
Belgium									Belgium
						Bulgaria			Bulgaria
							Croatia		Croatia
					Cyprus				Cyprus
					Czechia				Czechia
	Denmark								Denmark
					Estonia				Estonia
				Finland					Finland
France									France
Germany									Germany
		Greece							Greece
					Hungary				Hungary
	Ireland								Ireland
Italy									Italy
					Latvia				Latvia
					Lithuania				Lithuania
Luxembourg									Luxembourg
					Malta				Malta
Netherlands									Netherlands
					Poland				Poland
		Portugal							Portugal
						Romania			Romania
					Slovakia				Slovakia
					Slovenia				Slovenia
		Spain							Spain
				Sweden					Sweden
UK								- (UK)	

Source: European Commission⁶⁸, CIIE⁶⁹, WTO RTA Database, TEPAV visualizations

⁶⁸ “History of the EU Customs Union,” European Commission.

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