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Turkey and European Union Relations: Concept of Customs Union

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ABSTRACT

Turkey is the only pluralist secular democracy in the Moslem world and has always targeted herself as being part of the western world and values. Turkey started to establish close economic relations with Europe by the 1963 Ankara Agreement. By 1995, Turkey abolished most of the barriers in her trade through a customs union agreement with the European Union. Customs union is widely discussed in the sense that the terms of trade between the two sides have not evolved in favour of Turkey. However evidence shows that Turkey did not experience any extreme changes in its import figures as were feared before the beginning of the agreement. As a result of customs union, economically Turkey became more advantageous than many other candidate countries despite her unhealthy economic statistics especially in the area of inflation and per capita income. Turkey would have the chance to benefit more from the customs union after it completes its ongoing economic reforms, which would bring more stability and power to the Turkish economy.

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1. Introduction

Economic integration is concerned with the discriminatory removal of all trade impediments between at least two participating nations and the establishment of certain elements of co-ordination and co-operation between them (El-Agraa, 2001). Efforts for establishing western values in Turkey were intensified after the establishment of Turkish Republic in 1923. Turkey closely aligned itself with the West and has become a founding member of the United Nations, a member of NATO, the Council of Europe, OECD and an associate member of the Western European Union. But the success in the political cooperation was not repeated in the economic relations. Turkey began to establish economic relations with the European continent by applying to the European Economic Community (EEC) in May 1959. The EEC's response to Turkey's application in 1959 was to suggest the establishment of an association until Turkey's circumstances permitted its accession. Resulting negotiations resulted in an agreement creating an association between the Republic of Turkey and the European Economic Community (the "Ankara Agreement") on 12 September 1963. This agreement, which entered into force on 1 December 1964, aimed at securing Turkey's full membership in the EEC through the establishment in three phases of a customs union, which would serve as an instrument to bring about integration between the EEC and Turkey. In the meantime, the EEC would offer financial assistance to Turkey under various Financial Protocols. Turkey benefited from three successive financial protocols between 1963 and 1981 for a total value of €680 million (www.europtr.org.tr-"overview"). Since then, a considerable amount is still being planned to grant to Turkey under the fourth financial protocol but it is not being implemented due to the veto of Greece.

On 24 January 1980, Turkey radically shifted its economic policy to an open economic model and established its economy on the operation of market forces. Following this development in the economic area, the relations between Turkey and the Community, which had come to a virtual freeze following the military intervention in September 1980 in Turkey, began returning to normality. In the light of these positive developments and the influence of possible benefits that would arise by membership (Karluk, 1998), Turkey applied for full membership in 1987. The council sent the application to the Commission for its opinion. The Commission presented its opinion in 1989, which basically underlined Turkey's eligibility for membership but mentioned that great economic and social differences still exist between the two sides. The commission also concluded that the conjunctural environment is not suitable for

the enlargement of the Community. Some of the positive economic points that were underlined in the commission's report regarding Turkey's application were (Gunugur, 1995):

- High growth of Turkish economy and a promising future
- A carefully planned privatisation program which started to be implemented by the second half of 1980;
- Considerable share of young generations within the whole population;
- Important positive influence of Turkish workers in various countries on Turkey's current account balance;
- Huge potential of tourism sector;
- Increasing measures in Turkish economy for ensuring the smooth operation of international trade between the Community and Turkey;
- Measures taken in Turkish economy for fully promoting the working of free market economy;

On the other hand, some of the negative points were the high rate of inflation, high growth rate of population, low level of national income and per capita income level which was only 10% of the EU average (Barnes & Barnes, 1999), share of agriculture within the economic activities, big share of agricultural employment within the total working force etc.

In the end, the report concluded by mentioning some of the political and democratic problems in Turkey such as the minorities' problems and the Cyprus dispute. The commission decided not to give any positive and negative answer to Turkey's application at that moment and asked for deepening the economic relations with Turkey within the content of "Matudes Report" which aimed at achieving the customs union with Turkey by the end of 1995. Consequently, efforts were intensified for the establishment of customs union. So even though the primary aim of Turkey was not fulfilled, the application gave a positive momentum for the completion of customs union between Turkey and the Community.

2. The Customs Union

A customs union is an area where all the trade barriers such as the tariffs and quotas on goods and services are abolished for all intra trade between customs union countries. It also includes a system of common tariff and quota system (Common External Tariff) for all external trade with other countries. Consequently a customs union is far more important and comprehensive than a “free-trade area model” of economic union since it guarantees that all the imports coming from other countries are treated in the same manner (McDonald & Dearden, 1999).

Efforts were intensified and an agreement for the customs union between Turkey and the European Union was signed on 6th March 1995 at the Turkey-EU Association Council. The agreement can be analysed under three basic headlines.

Technical aspects on the Free Movement of Goods: On 6th March, the Association Council adopted its decision 1/95 on the completion of the customs union between Turkey and the EU in industrial and processed agricultural goods. With the start of the customs union, Turkey abolished all duties and equivalent charges on imports of industrial goods from the EU. Furthermore, Turkey started to harmonise its tariffs and equivalent charges on the imports from third countries with the EU's Common External Tariff.

Resolution for Intensifying the Cooperation between Turkey and the EU: Apart from these rather technical provisions related to the establishment and the proper functioning of the customs union, the package also comprised an Association Council Resolution providing for the intensification of cooperation between Turkey and the EU in such areas not covered by the customs union as industrial cooperation, Trans-European networks, energy, transport, telecommunications, agriculture, environment, science, statistics, as well as matters relating to justice and home affairs, consumer protection, cultural cooperation, information etc. These provisions also aimed at ensuring that the higher degree of integration achieved between Turkey and the EU through the customs union was not limited solely to trade matters and that the customs union would serve its basic purpose which is to promote Turkey's accession to the EU.

Financial Cooperation: The third element of the customs union package was the statement on financial cooperation. This financial cooperation aimed at easing the burden which the opening up of the economy to EU competition would bring to Turkish producers. In addition,

it would improve Turkey's. So far, the transfers planned within this framework have so far failed to materialize due to the consistent veto of Greece.

On January 1st 1996 the customs union between the European Union and Turkey came into effect, thereby creating the closest economic and political relationship between the EU and any non-member country. Essentially, the customs union would bring many advantages to Turkey and the Union. Among the advantages for Turkey would be:

- The chance of Turkish producers to access to the group of countries which are among the richest countries on the continent and the world;
- Access to a market which has a huge trade potential and is among the most consistent markets in the world;
- The customs union will crown Turkey's process of integration with the World economy. It will help rationalize and modernize Turkey's economic structure. Increased competition will improve the efficiency of Turkish firms.
- Through increased competition, Turkish consumers will have the chance to reach to high quality products which would possibly be cheaper;
- Turkish consumers' consciousness would increase by the help of a competitive market area;
- Financial cooperation will contribute to Turkey's economic restructuring efforts and to the improvement of her infrastructure. It will also bring up the possibility of increased and more effective cooperation between EU and Turkish firms through joint Community programs.
- The customs union is expected to give rise to an increased inflow of foreign direct investment which will modernize production facilities and bring in crucial international know how.
- All of these will, in the medium and long term, would increase employment in Turkey, which will ease social tensions and improve the country's socio-economic situation.

Also there would be some political benefits such as:

- The customs union would strengthen the Western values in Turkey. Also it would encourage attempts at liberalizing the constitutional and legal system which would help Turkey to improve her democracy;
- It will set firmly Turkey on the course of integration with Western Europe. Such as, it will provide a concrete foreign policy objective and put off attempts that push Turkey away from this goal. By the same token, it will help to weaken the influence of those who support this policy;
- Increased economic interdependence with Western Europe will, through the strengthening of civil society, contribute to the development of a healthier democracy;
- Above all, it would be a significant step for Turkey in achieving its overall target, which is the full membership to the EU.

On the other hand, some of the economic and political benefits for the union would be:

- Turkey is among the countries where the union has the highest trade surplus (Allen, 2000). The customs union would further open and consolidate the Turkish market for Community producers. All tariff and non-tariff barriers will be eliminated. Community exporters will thus earn preferential and free access to this young and mostly non saturated market of nearly 70 million consumers;
- With the customs union, Turkey will harmonize her economic legislation with that of the Community. As a result, the conditions for making business in Turkey will become substantially similar to those existing in the Community. Thus Community firms operating in Turkey would experience a familiar economic and legal environment.
- Community firms will gain a new competitive edge provided that they take advantage of the investment and production opportunities offered by Turkey. They will also be able to use Turkey as an export base for the Middle East, the Black Sea region, and Central Asia. In addition, improved opportunities of cooperation with Turkish firms will enable them to break in and operate in those markets;

- Customs union will firmly link Turkey to the West and to the EU in particular;
- Customs union will increase the appeal of the Turkish model in a region full of economic difficulties and political instability. It will thus be a suitable model of development. By the same token, it will help those countries to move away from radical and extremist attitudes which would cause great political problems such as the one in former Yugoslavia;
- The Union will have the chance and potential to establish close links with the Islamic world and the Central Asian countries in addition to the Balkan countries.

3. Latest Developments:

In the political arena, things have not evolved as promising as the economic relations. In July 1997, Commission presented its agenda 2000 report, which confirmed Turkey's eligibility. But in the 1997 Luxembourg Summit, a number of pre-conditions were put forward for inviting Turkey to the London conference in March 1998. On the other hand, 10 Central and Eastern European Countries (CEEC's) were elected as candidates for full membership. In a statement issued right after the summit, Turkish government strongly criticized the EU's attitude and stated that the pre-conditions were totally unacceptable. So the relations entered to a difficult period in which the whole relations between the two sides had nearly frozen up.

This had continued for around two years until 1999. In preparation for the European Council to be held in Helsinki in 10-11 December 1999, the Commission issued its second regular Report on Turkey's progress towards accession. The Commission proposed that Turkey would be considered as a candidate and would face similar conditions as the other candidates. Turkey welcomed these proposals that would prepare her for full membership to the EU. In the Statement made by the Foreign Ministry of Turkey, Turkey's recognition as an official candidate, would initiate a new phase in Turkey-EU relations. So the Helsinki European Council held on 10-11 December 1999, produced a breakthrough in Turkey-EU relations. At Helsinki, Turkey was officially recognised without any precondition as a candidate state on an equal footing with other candidate states. While recognising Turkey's candidate status, the Presidency Conclusions of the Helsinki European Council approved the proposals of the Commission made on 13 October 1999. Thus, Turkey, like other candidate states, would acquire the possible benefits from a pre-accession strategy to motivate and support its

reforms. This will also include an Accession Partnership, which will be drawn up accordingly, combined with a National Program for the adoption of the *acquis*. The recognition of Turkey as a candidate for accession at the Helsinki Council started a new era in the relations between Turkey and the EU.

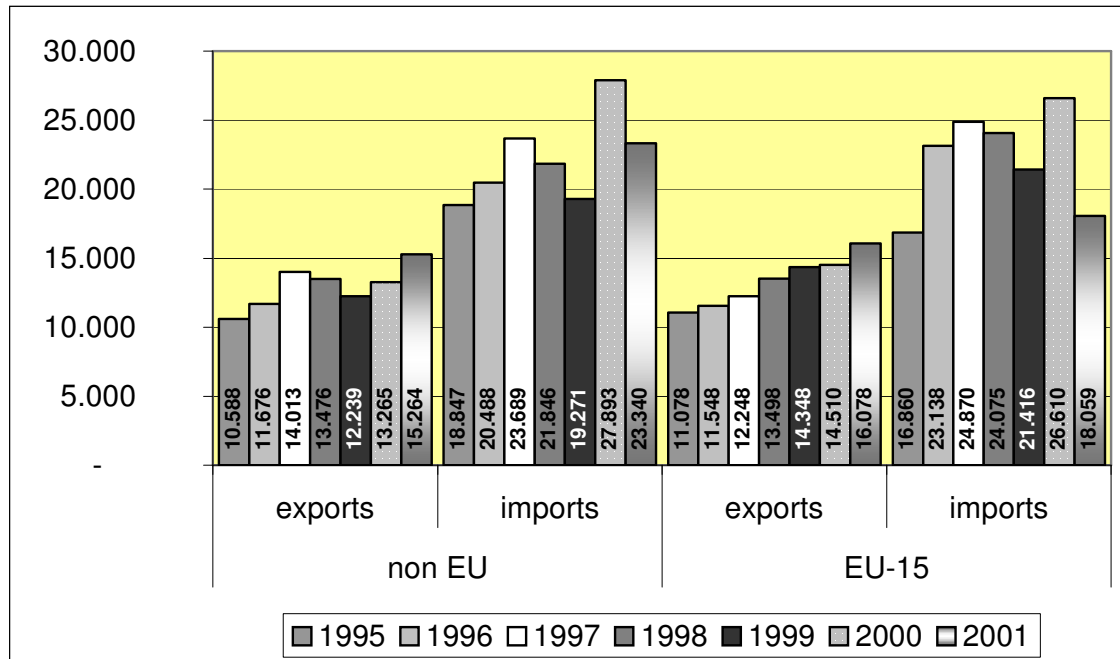
The National Program: As foreseen in the *Helsinki European Council conclusions*, the EU Commission prepared an Accession Partnership for Turkey. After the approval of the Accession Partnership by the Council the Turkish Government announced its own *National Program for the Adoption of the EU acquis* on March 19th, 2001. The National Program was submitted to the EU Commission on March 26th, 2001. The National Program includes short and medium term priorities of Turkey related with a wide range of issues, such as improving human rights, strengthening the rule of law and restructuring of democratic institutions. In November 2001, the Commission prepared its fourth annual Progress Report for candidate countries including Turkey. Progress Reports evaluate the candidates' progress towards membership for that specific year. In general, evaluations for Turkey were positive but also pointed out some weaknesses concerning fundamental rights and freedoms (Comm, 2001). Turkey accepted the assessment as constructive and encouraging for her ongoing reform processes. At present, Turkey continues to take the necessary steps in her constitution along the path set by the National Program. On the economic front, in line with the National Program and in response to the serious economic crisis that Turkey has been going since February 2001, numerous reform measures have been adopted. Therefore, considerable progress has been made in meeting the priorities envisaged in the National Program.

By the summer of 2002, Turkey came to a cornerstone for her political arena and EU membership. Some of the features that were mentioned in the National Program were not put into effect. These were the "abandonment of the death penalty" and the "right of education and broadcasting in other languages apart from Turkish". The Nationalist Party, which was the partner of the coalition government, did not accept to make the necessary constitutional changes. So the reform process took a break and political parties accepted to go to an early election by autumn 2002. Widely, this election is perceived as a referendum for the EU membership of Turkey by the Turkish people. Whether Turkey will choose to carry on its reforms for the EU or not will be clear by that time. Nevertheless latest developments showed that the internal problems of Turkey during the reform process were the political problems in addition to its unhealthy economic indicators. On the other hand, the union is in a position to

decide about its future enlargement in its December 2002 summit. Time will show whether its plans will include Turkey or not.

4. Brief Evaluation of Trade after the Customs Union

Figure 1: Turkey's trade with EU-15 and non-EU countries (bill US\$)

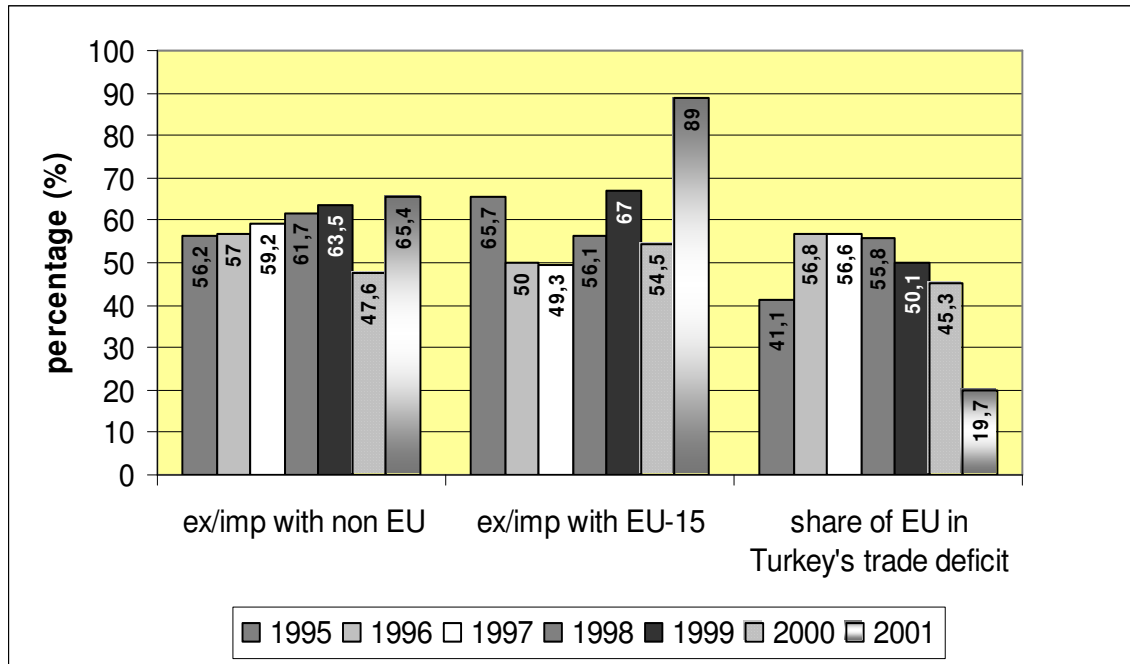


Sources: Undersecretariat of Foreign Trade, State Institute of Statistics, Eurostat.

Trade figures after the beginning of the customs union in 1996 show that (fig 1), Turkey's imports from the EU rose by 7.1% between 1995 and 2001. Imports rose from 16.860 billion US\$ to 18.059 billion US\$. On the other hand exports, amounting to 11.078 billion dollars in 1995, rose by 45.1% and reached to 16.078 billion US\$ by 2001. However, it is important to note here that the 2001 figures would not totally reflect the truth that Turkey's exports rose by around 45% and imports just improved by only 7.1%. Turkey experienced a serious economic crisis in 2001 and this had caused a significant increase in its exports and a big decline in its imports as a result of great devaluation of Turkish Lira. When the previous data is considered, it is clear that the changes in imports and exports are somewhat different. For instance, if the increase of imports is analyzed between 1995 and 2000, it could be seen that the increase in imports amounted to 58%. Conversely, Turkey's trade relation with other countries shows that, Turkey's imports from non-EU countries rose by 23.8% between 1995 and 2001.

Imports rose from 18.847 billion US\$ to 23.340 billion US\$. Conversely exports, amounting to 10.588 billion dollars in 1995, rose by 44.2% and reached to 15.264 billion US\$ by 2001. When these improvements are analyzed for 1995-2000 period, figures show that imports increased by a much greater amount of 48% and exports increased by 25.3%.

Figure 2: Turkey's 'exports/imports ratio' for EU & non-EU Countries.



Sources: Undersecretariat of Foreign Trade, State Institute of Statistics, Eurostat.

In general, when the Turkey's exports/imports ratio is analyzed (fig. 2), this figure for non-EU countries rose from 56.2% in 1995 to 65.4% in 2001. For the period between 1996 and 2000 the ratio changed between 47.6% and 63.5%. For the EU countries this data rose from 65.7% in 1995 to 89% in 2001. Naturally the data for 2001 is slightly swallowed. The same data for the period between 1995 and 2000 varied between 49.3% and 67%.

Table 1: Turkey's Trade in 1995 & 2001 by Main Partners.

Partners	1995					2001				
	Value of exp (mill. \$)	% Share	Value of imp (m. \$)	% Share	Trade balance	Value of exp (m. \$)	% Share	Value of imp (m. \$)	% Share	Trade balance
Total	21,637	100	35,709	100	-14,072	31,340	100	41,399	100	-10,059
EU-15	11,078	51.2	16,860	47.2	-5,782	16,078	51.3	18,059	43.6	-1,981
Germany	5,036	23.3	5,548	15.5	-512	5,367	17.1	5,335	12.9	32
USA	1,514	7.0	3,724	10.4	-2,210	3,134	10	3,261	7.9	-127
Italy	1,457	6.7	3,193	8.9	-1,736	2,342	7.5	3,484	8.4	-1,142
UK	1,136	5.3	1,830	5.1	-694	2,175	6.9	1,914	4.6	261
France	1,033	4.8	1,996	5.6	-963	1,895	6.1	2,284	5.5	-389
Russia	1,238	5.7	2,082	5.8	-844	924	3	3,436	8.3	-2,512
Japan	180	0.1	1,400	3.9	-1,220	124	0.4	1,307	3.2	-1,183

Sources: Undersecretariat of Foreign Trade, State Institute of Statistics, Eurostat.

The EU preserved its place as Turkey's biggest trading partner in 2001 with a 43.6% share in her imports and 51.3% in exports (table 1). This was more or less the same in 1995. Within the union, Germany has an apparent leading role among the members with a share of 17.1% in Turkey's exports. Also Italy, UK and France have significant shares in Turkey's international trade. Russia's share had significantly declined after it had experienced an economic crisis towards the end of the decade.

5. Concluding Remarks:

Customs union was widely discussed in the sense that the Turkish economy would not adapt itself very well to a new and highly competitive environment of Europe. At present, many more studies are still being made within the perspective of analyzing the customs union as a trade agreement without pointing out to its importance for the EU membership of Turkey. In addition they conclude by indicating that Turkey has not benefited from the customs union. Couple of points should be assessed as follows; since the EU had already abolished its tariffs for imports from Turkey since 1971, the customs union did not bring about a significant liberalisation for Turkey's exports to the EU. On the contrary, Turkey's gradual elimination of tariffs against EU caused slight increases on EU imports to Turkey. But as it can be seen from the statistics, changes in import figures were not as drastic as expected. The customs union constitutes a very important step towards Turkey's full integration with the EU. It has also

demonstrated that, despite predictions to the contrary, the Turkish economy was able to withstand EU competition; Turkey's efforts to align itself to the EU's commercial policy towards third countries produced the Free Trade Agreements with EFTA and many countries like Israel, Romania, the Czech and Slovak Republics etc. In the long run, these countries would bring new potential markets for Turkish exports; nearly all of the changes that Turkey adapted itself by the customs union coincide with Turkey's obligations arising from the World Trade Agreement (WTO) rules and procedures. WTO primarily aims at improving the principle of trade liberalisation (Pelkmans, 2001) and since Turkey is a member of the WTO, she would have to apply those rules and procedures anyhow. So customs union gave a momentum for Turkey's obligations in catching up the International Standards; customs union brought in many advantages for Turkish consumers as a result of high competition with European producers. Turkish consumers had the chance to obtain high quality products at lower prices. Turkish exports widely depends on a stable and rich European market which gives her a chance to experience less export shocks like she had experienced during the Russian crisis. Biggest handicap during the application of customs union is Greece's veto for the application of financial protocols between Turkey and the EU. It is still a great disability of the Union that it had not found a way to solve this problem and apply its financial obligations for Turkey. Also compared to other candidate countries, Turkey had benefited very little from foreign direct investments and technology transfer from the EU due to its unstable internal political arena (Carikci, 2001).

Overall it can be summarised that the customs union would not solely be evaluated as a trade agreement between two economies. Customs union is a very important milestone in Turkey's historical aim of being a part of Europe and its economic power. In addition, Turkey did not experience any extreme changes in its import figures as were feared before the beginning of the agreement. As a result of customs union, economically, Turkey is more advantageous than many other CEEC's despite her unhealthy economic statistics especially in the area of inflation and per capita income. Turkey would have the chance to benefit more from the customs union and foreign direct investments after it completes its economic reforms, which would bring more stability and power to Turkish economy.

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