

# Services: A Key Element in Upgrading the EU-Turkey Customs Union?

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## ABSTRACT

The Global Turkey in Europe (GTE) project established a platform to discuss and analyse the rapid transformation of Turkey in a European and global context. In its fifth year, GTE focuses on the multiple dimensions of EU–Turkey relations, ranging from economy, energy, conflicts and security to migration and the role of civil society. The first event of the fifth GTE programme, held in Paris on 15 December 2017, discussed the issue of economic partnership between the EU and Turkey, with a particular attention to the upgrading of the customs union and its possible economic and political effects on Brussels–Ankara relations.

*Turkey | European Union | External trade | Services*

**keywords**

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### Introduction

The Global Turkey in Europe (GTE) project established a platform to discuss and analyse the rapid transformation of Turkey in a European and global context. Launched in 2012 by the Istituto Affari Internazionali (IAI) in collaboration with the Istanbul Policy Centre (IPC) and Stiftung Mercator, the project team was joined in its fourth year by the Foundation for European Progressive Studies (FEPS).<sup>1</sup>

While over the last four years GTE has been focusing on specific aspects of EU–Turkey relations, covering migration, security, economics and energy, the fifth cycle looks comprehensively at all dimensions of the relationship. It is precisely thanks to the multidimensional nature of EU–Turkey relations that, notwithstanding its current low point, the relationship is so fundamental to both sides, and it is therefore unrealistic for it to fall under a certain threshold.

The first event of the fifth GTE programme, held in Paris on 15 December 2017, discussed the issue of economic partnership between the EU and Turkey, with a particular attention to the upgrading of the customs union and its possible economic and political effects on Brussels–Ankara relations. The economic and trade dimension can be conceived as the most important section of the relationship, as it is the only one having the potential to be genuinely rules-based. Upgrading the customs union could indeed deepen the relationship by integrating it in a broader contractual framework.

<sup>1</sup> For more details, see the IAI website: <http://www.iai.it/en/node/504>.

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· Report of the seminar “Modernizing the Customs Union: A Key to Reinvigorate a Rules-Based EU-Turkey Relationship?”, organized in Paris on 15 December 2017 by the Istituto Affari Internazionali (IAI), the European Union Institute for Security Studies (EUISS), the Istanbul Policy Center (IPC) and Stiftung Mercator within the framework of the project “Turkey, Europe and the World: Political, Economic and Foreign Policy Dimensions of Turkey’s Evolving Relationship with the EU” (Global Turkey in Europe, GTE).

As discussed at the first GTE workshop, in a reality of rising tensions between the EU and Turkey and increasing doubts concerning Turkey's accession to the Union, the economic front could become even more central in reinforcing the future relationship. The EU is Turkey's first trade partner and Turkey ranks among the EU's first five import and export markets. The entry into force of the customs union in 1996 not only boosted Turkey's economic



power, but also paved the way for its democratization and Europeanization in the late 1990s and early 2000s. On the economic front, the debate surrounds both the risk of an economic crisis in Turkey, and the prospect of opening negotiations on a modernized customs union. Whether or not an upgraded customs union could serve as a pillar in a novel rules-based institutional frame between the two parties therefore stands as a question urging debate.

### 1. The role of services in upgrading the customs union

The discussion was based on the findings of a paper<sup>2</sup> presented by Jacques Pelkmans, Senior Research Fellow at the Centre for European Policy Studies (CEPS), and was kicked off by responding to the question of why services could represent a key element in upgrading EU–Turkey economic relations. Pelkmans reminded that the paper takes the political situation as given and looks exclusively at the economic dimension of the relationship. From this point of view, while overall EU–Turkey relations are currently at a low point, the customs union represents a great success: there is a deep integration in the industrial goods sector, foreign direct investment (FDI) has gone up and market relations are blossoming. Overall, EU–Turkey economic relations are very good, although there are some shortcomings. If there were a more functional approach towards this issue, for example through opening up the services and agriculture sectors, the opportunities in the long run could be excellent. A major obstacle is nonetheless represented by the politicization of economic and trade relations, which make it complicated to move towards progress, particularly in light of the current impasse in the political relationship. There are indeed many dysfunctional aspects in the customs union as it is today, first of all its lack of comprehensiveness, with significant policy areas that remain uncovered.

<sup>2</sup> CEPS, *Strengthening EU-Turkey Economic Relations: Can Services (in a Wider Sense) Complement the Customs Union?*, to be published by the end of January 2018. The paper was commissioned by IPC and prepared by a CEPS research team in the context of a Mercator-funded project.

Focusing on the possibility of complementing free goods trade with the services sector, the paper starts by assessing the role of services in the broader economic spectrum. While many free trade agreements (FTAs) in the world include services from the moment of their creation, this is not the case with Turkey. According to many, liberalizing services would have a positive effect not only on Turkey's economy, but on the EU's economy also. Further, the incorporation of services not only affects the trade of services themselves, but also has fundamental impact on the overall economy and trade of goods, as higher quality services fuel greater competitiveness. Lastly, the services sector also provides key inputs to FDI, which represents one of Turkey's success stories.

Nevertheless, when looking at figures it can be observed that Turkey has seen a decrease in the services share in its economy – by contrast to the global trend of increase in the relative importance of services, and not visible in any other emerging economy. Further, Turkey has mainly specialized in medium- to low-technology services such as transport and tourism, and has only a small share in high value-added services. This is strongly linked to the lack of a well-educated work force. While in this regard some progresses have been made over the last years, as there has been an increase among the highly skilled and a decrease among the low-skilled, unchanged figures for the middle-skilled are worrying.

After discussing in small groups, participants brought numerous comments and ideas to the table, where they engaged in open debate. Some observed that while the upgrade of the customs union has long been pictured as the best option to save the relationship between the EU and Turkey, the paper outlines a different scenario, where not only is the upgrade very costly for Turkey, but there would also not be a significant economic gain in the short term. Others recalled that ex ante projections do not always turn out to precisely predict the future. In this regard, the case of the automotive industry was raised: this industry was underdeveloped in 1995 when the customs union came into force, and was obliged to adapt to the new regulations and market conditions – a development which has strengthened the industry and produced growth in the longer term. Similarly, the transport, telecommunication and financial service sectors could become more competitive and improve if pushed to adapt to new conditions. Looking merely at the current shares in added-value trade might therefore not be sufficient to come to a conclusion regarding the future growth of these sectors.

Another raised point concerned legal aspects that have to be taken into consideration if Turkey wants to upgrade the customs union and modernize its economy. One example in this regard is that procurement laws can merely open up markets that are already open. This reinforces the fundamental importance of services, which are indeed connected not only economically but also from the legal point of view to many other market sectors. It was further mentioned that education also represents a service, and that Turkey could consider upgrading its education system by opening it up, although this might pose critical issues in cultural terms. The importance of the Trade in Services Agreement (TiSA) and its potential for being more interesting than the upgrading of the customs union was brought

forward during the discussion as well. It was further recalled that trade in services represents a very delicate and not well-defined topic: indeed, due to data collection and analysis on this topic having started late, it is neither well qualified nor quantified, and available data might not be reliable.



Finally, the political setting was discussed. If initially upgrading the customs union was presented as a package, today the comprehensive approach which foresees the upgrading of the industrial goods section as well as the extension to new areas such as services, regulation and public procurement, looks quite ambitious in light of the draft mandate still pending in the Council. While promoting dialogue on certain trade-related areas (e.g. services liberalization) is possible, other sectors, such as public procurement, touch upon more delicate balances. A question that the EU has to pose itself is which sectors could possibly be harmonized and which sectors can be pushed towards liberalization, as this also depends on the level of harmonization among EU member states. So far, the customs union has worked as a regulatory anchor in certain areas: updating it might have the same effect on other areas, too. Lastly, the question was raised if in practice pre-accession is being promoted under another heading. It was concluded that for sure there is a mutual interest in moving closer on these topics, and that Turkey is interested in getting more involved in trade discussions.

## 2. Negotiation possibilities and obstacles

The second section of the paper presented by Pelkmans dealt with what an upgraded customs union arrangement with Turkey could look like. Two possible models were analysed: the EU–Canada Comprehensive Economic and Trade Agreement (CETA) model and the Deep and Comprehensive Free Trade Area (DCFTA) Ukraine model. The CETA model is organized in different sub-sectors, and based (for the first time in EU history) on the negative listing principle, which foresees liberalization as guiding principle and the listing in annexes of those sectors not included in such liberalization. While annex I lists already existing reservations with a so-called lock-in effect, meaning that no restrictions can be added or extended, annex II provides a “policy space”, i.e., the possibility to modify the restrictions with only an obligation to notify the other party. The real innovative nature of the negative listing lies in the transparency it carries, making market access less costly particularly for small and medium enterprises (SMEs). Lastly, it was pointed out that some elements of the CETA might be found in contrast with the Services Directive; in this regard, the example of the economic interest clause was made. The DCFTA Ukraine model is similar to CETA in many aspects, except for a few major differences: first, a

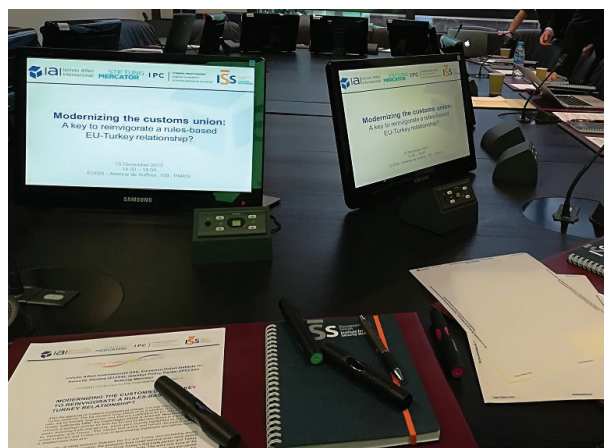
transition period, and second, the ultimate goal of integration in the EU market for certain sectors. Also, while the DCFTA Ukraine can be taken into consideration as an example, it has to be kept in mind that Ukraine is mainly a service market.

Following the discussion in small groups, participants again joined in a roundtable debating what the possible arrangement between the EU and Turkey could look like. It was observed that the core of the question lies indeed in the modalities – harmonization or liberalization – and in the approach to take. In that regard, the great advantages of the negative listing approach were highlighted. Most agreed on the ambitious nature of the proposal to add public procurement and regulation to the overall “package”, as this would require significant political reform. There were different views on the best approach to take. According to some, the upgrading of the customs union could be seen as the first step towards reinforced political relations. Others expressed the need to first re-establish political dialogue in order to build trust and nurture the relationship, in order to then allow the EU and Turkey to come together and work on the various dimensions of their relationship. In this regard, the option of upgrading the association agreement was mentioned, as this had originally kicked off the customs union process and would make it possible to look beyond the economic aspects to include other dimensions. It was countered that updating the accession agreement is impossible both politically and legally speaking, being a founding agreement. Rather, the reading should focus on the customs union being a step towards possible accession. Also, it might not be a good idea to update the association agreement as currently the political situation is at a low level and the outcome could be even more challenging.

Regarding the positive and negative listing approaches, the experience of the “liberalization list” before the 1980s and the “quota list” after the 1980s was recalled: under the former, imports were not liberalized except for those listed, while under the latter it was the other way around. This experience might be taken as an example, starting off with a positive list which details the service sectors to include, and, once the tipping point is reached, it could be converted to a negative list. A transitional period could also be envisaged in the Turkish case, in order to allow a longer adaptation period for the politically sensitive dimensions. Further ideas included access for Turkey to the EU Stabilization Fund, an underused instrument that has the potential of representing an incentive for Turkey to balance some of the costly changes it will have to take up.

By agreeing on the importance of upgrading the customs union, participants debated how to promote this issue in the political discourse. Indeed, the topic has been long framed under the economic rationale for Turkey, while little has been done to convince reluctant EU member states. This approach, which focuses on how to make an upgraded customs union more interesting for Turkey, is nevertheless disconnected from reality, as it is the EU that is currently blocking the process. A number of member states are hampering progress in the Council due to domestic situations directly linked to political reasons and bilateral relations with Turkey. These countries have applied leverage to not move forward discussions in the Council, because they are concerned about rule of law and democratization

issues in Turkey and in its relations with the EU. For this reason there is a need to first build trust, making the case about the win-win aspect of upgrading the customs union. Notwithstanding the different factual reality, until today the perception of the customs union representing a big gift to Erdoğan has been promoted in certain member states. Nevertheless, evidence demonstrates that there would be a significant gain for both sides, as well as there being an underestimation of the possible impact on the EU's gross domestic product (GDP). According to some, another issue lies in the existing political sensitivity on both sides: while certain services such as road transport are delicate for transit EU member states, topics such as public procurement are controversial in Turkey. Others believe that the lack of progress is not so much about specific sensitivities, but because of the broader political agenda. Participants agreed that hampering the customs union upgrade is against the EU's own interests and that there is a wrong perception which should be addressed. The roundtable was closed with the proposal of engaging in promoting a research-informed discourse on the benefits of the modernization of the customs union.



*Updated 26 January 2018*

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### Istituto Affari Internazionali (IAI)

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