

MODERNISING THE EU-TURKEY CUSTOMS UNION AS AN INTEREST-DRIVEN INITIATIVE

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Abstract

The customs union (CU) established in 1996 between the EU and Turkey has always been regarded by the Turkish side as the main device for eventually achieving full EU membership as envisaged by the Association Agreement of 1963. Currently, in the absence of a well-defined and strong membership prospect, continued structural deficiencies of the CU and global pressures force both parties to modernise the CU to meet their shared economic interests and high level of interdependence. This paper explains why and how the parties need to modernise the CU and discusses political difficulties before the modernisation process. The paper reveals that the parties' preferences regarding modernisation and the specific parameters that negotiations may depend on are mainly generated by the domestic interests of societal actors.

Keywords: Customs Union, modernisation of the Customs Union, liberal intergovernmentalism, EU-Turkey relations

Çıkar Odaklı Bir İnisiyatif Olarak AB-Türkiye Gümrük Birliği'nin Modernizasyonu

Öz

Türkiye ile AB arasında Ocak 1996'da kurulan Gümrük Birliği, 1963 Ortaklık Anlaşması'nın da öngördüğü üzere, Türkiye tarafından AB üyeliği için hep önemli bir araç olarak görülmüştür. Ancak uzun bir gümrük birliği ilişkisine rağmen üyeliğin orta vadede beklenmediği düşünüldüğünde, mevcut yapısal sorunları ve güncellenme ihtiyacı Gümrük Birliği'nin reformunu ortak ekonomik çıkarlara sahip ve yüksek derecede karşılıklı bağımlı taraflar için acil bir ihtiyaç haline getirmiştir. Nitekim taraflar Mayıs 2015'te Gümrük Birliği'nin modernizasyonu sürecini

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Makalenin Gönderilme Tarihi: 25/09/2019 Kabul Edilme Tarihi: 03/04/2020

başlatmışlardır. Bu çalışma tarafların neden ve ne şekilde bu sürece angaje olduklarını açıklamayı hedeflemekte ve bu sürecin başarıya ulaşmasını zora sokan mevcut siyasi zorlukları tartışmaktadır. Çalışma, genelde Gümrük Birliği'nin modernisasyonu açısından, özelde de modernisasyon müzakerelerine konu olabilecek meseleler açısından tarafların tercihlerinin, Liberal Hükümetlerarası kuramın öne sürdüğü üzere, ağırlıklı olarak toplumsal aktörlerin çıkarlarının etkisi altında oluştuğunu göstermektedir.

***Anahtar kelimeler:** Gümrük Birliği, Gümrük Birliği'nin modernisasyonu, Liberal Hükümetlerarasıcılık, AB-Türkiye ilişkileri*

Introduction

Since the Ankara Agreement was signed in 1963, Turkey's main objective has been its gradual integration into the EU's internal market. The agreement envisaged that a customs union (CU) would be achieved by 1995 as an integration device, and it has indeed enabled Turkey's integration into the EU in CU-related areas. Since 1999, when Turkey was declared a candidate for full membership, relations have proceeded within both the CU and accession frameworks. Turkey's alignment with the EU's *acquis* has furthered after accession negotiations were launched in 2005. In short, these parallel processes have been mutually supporting and complementary.

However, after accession negotiations stalled due to the Cyprus issue, Turkey's performance on EU membership reforms has steadily worsened. Meanwhile, the CU relationship started to suffer structural and conjunctural challenges because so much time had passed without achieving EU membership. In the absence of membership on the medium-term agenda the parties agreed in May 2015 to revise and update the CU to meet their shared economic interests and high level of interdependence. This process could deal with the CU's structural deficiencies and conjunctural challenges. By examining the basic parameters of the CU reform process, this paper aims to show why and how the two parties needed to engage in the modernisation of the agreement. Theoretically, the analysis draws on Andrew Moravcsik's liberal intergovernmentalism. The paper argues that since Turkey seems unlikely to gain EU membership in the foreseeable future, national preferences generated by domestic economic interests have pushed both parties to consider modernising the CU. These preferences have shaped their likely negotiating positions in accordance with the need for reform. The paper also discusses how political difficulties are challenging the agreement's relevance for the future of relations. It concludes that it is in the economic and political interest of both parties to reform the CU because it

has a rules-based functional character rather than being purely transactional. This gives it the potential to be used by the EU to push Turkey to revitalize its democratic reforms, which also contributes to the EU's normative identity construction.

I. The EU-Turkey Customs Union and an Interest-driven Approach to Its Modernisation

The CU was established on 1 January 1996 in accordance with the Association Agreement of 1963, known as the Ankara Agreement, and the Additional Protocol of 1970, which together form the contractual basis of bilateral economic relations. The agreement, which ultimately aimed at Turkey's full EU membership, planned that the CU would advance in three stages to gradually integrate Turkey's economy with the EU's. Since the Ankara Agreement only laid down general rules and principles for the association relationship rather than specify clear commitments for both parties,¹ the Additional Protocol, which was annexed to the Ankara Agreement, stipulated all the conditions, detailed rules, and timetables necessary for establishing the CU. Specifically, over 12-22 years, tariffs and non-tariff barriers on industrial goods in bilateral trade would be gradually removed. However, Turkey's weak performance in this respect resulting from economic inadequacies and political instability in 1970s and 1980s forced the parties to take further actions to complete and implement the CU. Indeed, the rules for implementing the final phase of the CU were laid down with the Decision of the Association Council on 6 March 1995.²

The CU decision initially envisaged various measures and a timetable regarding the remaining obligations for the implementation of the CU. Accordingly, the parties removed bilateral trade barriers on imports and exports of industrial goods³ while Turkey had to adopt the EU's Common Customs Tariff (CCT) on industrial imports from third countries by 1 January 1996. The CU decision also required Turkey to adapt its legislation

¹ Hacı Can and Çınar Özen, *Türkiye-Avrupa Topluluğu Ortaklık Hukuku* (Turkey-European Community Association Law), (Ankara: Gazi Kitabevi, 2005): 24-25.

² For Decision No 1/95 of the EC-Turkey Association Council on implementing the final phase of the Customs Union see Official Journal of the EC, *Decision No 1/95 of the EC-Turkey Association Council of 22 December 1995 on implementing the final phase of the Customs Union* (96/142/EC), L 035, (February 13, 1996), Accessed: February 2017, [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21996D0213\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21996D0213(01):EN:HTML)

³ These are customs tariffs and charges having equivalent effect as well as quantitative restrictions and measures having equivalent effect.

to match the EU's trade and competition policies to ensure that the CU would function properly once it was implemented. This involved aligning Turkey's national legislation with the related EU *acquis*, such as the Common Commercial Policy (CCP), competition rules, protection of intellectual and industrial property rights, and protection of consumer rights, in accordance with developments in these policies as well as the EU's technical legislation in areas covered by the CU. In other words, the CU not only provided Turkey with market access facilitation in bilateral trade but also powerful instruments to modernise the structure, standards, and legislative framework of its economy.

In establishing the CU, Turkey aimed to integrate its economy into the EU's internal market in industrial goods, both for economic reasons and to achieve its ultimate goal of EU membership. That is, Turkey regarded the CU as a stepping-stone towards membership rather than an end itself in accordance with the Ankara agreement. For this reason, a CU, which also requires full alignment in trade policy with third countries, instead of an FTA,⁴ was adopted as the model to integrate with the EU's internal market in industrial goods. Indeed, Turkey has become the most integrated non-member country on the European periphery more than 20 years after first establishing the CU. The CU has encouraged deeper trade and investment linkages between the EU and Turkey, with value of the bilateral trade in goods increasing more than four fold between the period 1996-2015 to reach \$140 billion. This makes Turkey the EU's fifth largest trading partner with a share of 4% of total EU foreign trade in 2015 while the EU is Turkey's biggest partner with a share of 40.6% of Turkey's global trade in 2015.⁵ The member states with the largest imports from and exports to Turkey are Germany, the United Kingdom, Italy, France, and Spain. Regarding investment relations, the EU is Turkey's largest foreign investor, accounting for 57.6% of total foreign direct investment inflows in manufacturing and services in 2015.⁶ With many European companies operating in Turkey, the economic integration of Turkey's economy with Europe's has brought the

⁴ While the parties follow their own trade policies with third countries in the case of an FTA, they need to implement common rules and policies in their trade with those countries in the case of a CU. Therefore, a CU provides a deeper integration between the parties than an FTA.

⁵ Krisztina Binder, *Reinvigorating EU-Turkey bilateral trade: Upgrading the customs union*, Briefing, International Agreements in Progress, (Brussels: European Parliamentary Research Service, March 2017): 3, Accessed: January 2018, [http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/599319/EPRS_BRI\(2017\)599319_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/599319/EPRS_BRI(2017)599319_EN.pdf)

⁶ *Ibid.*

economic interests of the industrial sectors of both sides into alignment. Obviously, integrating the two economies further is in their interests.⁷

In recent years, however, Turkish prospects for full EU membership have radically diminished after accession negotiations stalled at the end of 2006. This was due both to the Cyprus issue and mutual estrangement following Turkey's worsening performance in its EU reforms and current challenges to European integration. Since Turkey's full economic integration through membership seems farther away than ever, the above-mentioned interdependence and strongly shared economic interests have urged both parties to start modernising the CU in accordance with the urgent need for reform.

The accession process is plagued by the politicization in some member states of Turkey's candidacy. This has created new obstacles like the technical suspension of accession negotiations, the threat to suspend them officially, EU member states' reserving the right to hold referenda on Turkey's accession following the conclusion of the negotiations, and discussions of offering new forms of integration below full membership. These developments demonstrate how national preferences (or interests) affect EU's relationship with Turkey. Given their decision-making powers, member states are the leading actors in European integration regarding enlargement and bilateral cooperation with non-members. Their decisions depend on assessing the political and economic costs and benefits for themselves. States base their cost and benefit analyses on their own domestic interests to generate their national preferences.

Andrew Moravcsik's theory of liberal intergovernmentalism (LI) offers a salient explanation of why Turkey and EU member states need to modernise the CU. The main arguments of LI are as follows.⁸ Firstly, geopolitical interests are outweighed by national preferences driven by the issue-specific (generally economic) interests of powerful domestic actors. Secondly, the relative power of EU member states stemming from asymmetrical interdependence determines their intergovernmental bargaining ability. Thirdly, states have an instrumental understanding of

⁷ Kamil Yılmaz, *TTIP and EU-Turkish Economic Relations: Deepening the Customs Union*, Global Turkey in Europe (21), (Rome: Istituto Affari Internazionali, March 2015): 6, Accessed: March 2017, http://www.iai.it/sites/default/files/gte_pb_21.pdf

⁸ Andrew Moravcsik, "Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach", *Journal of Common Market Studies*, 31, No: 4 (1993): 473-524; Andrew Moravcsik and Frank Schimmelfennig, "Liberal Intergovernmentalism" in *European Integration Theory*, eds. Antje Wiener and Thomas Diez, (Oxford: Oxford University Press, 2009): 68-69.

creating and empowering institutions that are considered to strengthen the credibility of mutual inter-state commitments. Moravcsik's explanation reflects intergovernmental ways of doing business and the importance of the parties' domestic economic interests in deciding whether and how to modernise the CU. According to LI,⁹ the preferences of the parties to modernise the CU, particularly the parameters governing modernisation negotiations, are mainly generated by the domestic interests of societal forces, such as economic actors, lobby groups, and political parties. As rational actors, Turkey and EU member states have interdependent preferences that determine their behaviour while modernising the CU.

After exploratory discussions, Turkey and the EU agreed to start modernisation on 12 May 2015. On 21 December 2016, the European Commission formally asked the EU Council and the Parliament for a mandate to launch formal negotiations with Turkey. It also published its impact assessment report providing the main reasons for CU modernisation and the possible impacts of different options.¹⁰ Negotiations can start after the Council gives its authorization, which also includes the EU's common negotiation position, to the Commission to negotiate on behalf of the EU while the European Parliament delivers its positive decision on the issue. However, this is unlikely to happen soon considering the current state of Turkey-EU political relations.

The impact assessment, prepared to define the EU's own negotiation position, was significantly supported and guided by an online public consultation targeting all relevant stakeholders conducted by the Commission between 16 March and 9 June 2016. This public consultation, which received 169 eligible responses, gathered detailed views regarding the future trade and economic relationship between the EU and Turkey. The responses were mainly (158) submitted by companies and business associations representing the economic interests of a comprehensive range of sectors, which were mainly based in the EU (74% of all respondents). The rest of the responses were mainly from Turkey (13%) and China (9%).¹¹ The results, which generally reflected the economic interests of EU industries,

⁹ Moravcsik, "Preferences and Power in the European Community", 480-485; Andrew Moravcsik, "Taking Preferences Seriously: A Liberal Theory of International Politics", *International Organization*, 51, No: 4 (1997): 516-524.

¹⁰ The Impact Assessment of the European Commission compares three possible options: 'no policy change', 'CU modernization and FTA in additional areas', and 'Deep and Comprehensive Free Trade Agreement'.

¹¹ European Commission, *Impact Assessment*, Commission Staff Working Document SWD(2016) 475 final, (Brussels, December 21, 2016): 60, Accessed: July 2017, http://trade.ec.europa.eu/doclib/docs/2017/january/tradoc_155238.pdf

were fed into the impact assessment.¹² In its report, the Commission frequently referred to responses received in the consultation while presenting the main reasons for CU modernisation and the impacts of different policy options. This shows how the parameters around which the parties may negotiate were mainly generated by the domestic interests of societal actors, as LI suggests. Turkey's Ministry of Economy also commissioned an impact analysis based on four scenarios on possible effects of CU modernisation.¹³ Its findings, which were generally compatible with the Commission's, were summarized in a press release.¹⁴

II. Main Parameters of CU Modernisation

Although the CU has benefitted both parties overall, its structural insufficiencies and conjunctural developments in the global trading system have urged the parties to modernise the design and scope of bilateral trade and economic relations. In its impact assessment report, the Commission identifies three main drivers of the CU's problems that require reform: its design (structure), its narrow scope, and Turkey's non-compliance with certain basic provisions.¹⁵ To address these problems, the Commission supports a CU+FTA formula. This would modernise the CU for industrial goods by tackling its structural shortcomings while extending trade preferences to cover agriculture, services, and public procurement through a new FTA. The other two options, according to the impact assessment, are maintaining the current framework with no substantial change or replacing the CU for industrial goods with a new deep and comprehensive FTA (DCFTA). According to the studies carried out by the Commission,¹⁶ the

¹² The results of the public consultation were attached to the Commission's Impact Assessment on CU modernization with Turkey as Annex 2.

¹³ For these scenarios, see Çiğdem Nas, "Turkey-EU Customs Union: Its Modernization and Potential for Turkey-EU Relations", *Insight Turkey*, 20, No: 3 (2018): 49.

¹⁴ See Ministry of Economy of the Republic of Turkey, *Gümrük Birliği Güncellenmesi Etki Analizi Basın Bildirisi (Impact Assessment on the Upgrading of the Customs Union Press Release)*, (Ankara, January 18, 2017), Accessed: July 2017, https://www.ekonomi.gov.tr/portal/faces/blog/newsDetail?news_id=EK-235432&_afLoop=24411758882176668&_afWindowMode=0&_afWindowId=new&_adf.ctrl-state=80ahc5vbf_1#!%40%40%3F_afWindowId%3Dnew%26_afLoop%3D24411758882176668%26news_id%3DEK-235432%26_afWindowMode%3D0%26_adf.ctrl-state%3D80ahc5vbf_5

¹⁵ European Commission, *Impact Assessment*.

¹⁶ European Commission, *Study of the EU-Turkey Bilateral Preferential Trade Framework, Including the Customs Union, an Assessment of Its Possible Enhancement*, Final Report,

World Bank,¹⁷ and Bertelsmann Stiftung,¹⁸ revising the CU in line with a CU+FTA formula would generate significant economic gains for both sides. About three quarters of respondents in the online public consultation find the current state of bilateral trade and economic relations only partly satisfactory or not satisfactory.¹⁹ Respondents considered both the CU+FTA option and the DCFTA as having potential. However, considering the different economic impacts, they regarded the former as more beneficial than the latter.²⁰

In its own impact assessment, Turkey's Ministry of Economy concluded that the most beneficial scenario for both parties was the one that resolved the CU's structural problems and included reciprocal opening of services, public procurement, and agricultural markets.²¹ It therefore suggested an identical option to the Commission's CU+FTA formula.

The influential pressure group, the Turkish Industry and Business Organization (TUSIAD), which represents domestic industrial interests, agreed that modernising the CU offered an important opportunity for Turkey's economy. A TUSIAD study published in October 2015 concluded it would improve Turkey's economic governance, help consolidate Turkey's independent regulatory institutions, and raise economic productivity by increasing competition in the service sector and public procurement.²² In comments on Turkey's EU integration process, published online on 28 February 2019, TUSIAD noted that European companies, both from the EU and Turkey, had clearly prioritized CU modernisation while carefully preserving Turkey's EU integration. As a Business Europe member,

(Brussels, October 2016), Accessed: April 2017, http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2016/turkey_anx6_en.pdf

¹⁷ World Bank, *Evaluation of the EU-Turkey Customs Union*, Report No. 85830-TR, (March 28, 2014), Accessed: August 2015, <http://www.worldbank.org/content/dam/Worldbank/document/eca/turkey/tr-eu-customs-union-eng.pdf>

¹⁸For this study, see Erdal Yalçın, Rahel Aichele and Gabriel Felbermayr, *Turkey's EU Integration at a crossroads*, (Gütersloh: Bertelsmann Stiftung, April 2016), Accessed: July 2017, https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Publikationen/GrauePublikationen/NW_Policy_Brief_Turkey_s_EU_integration.pdf

¹⁹European Commission, *Impact Assessment*, 8.

²⁰Binder, *Reinvigorating EU-Turkey bilateral trade*, 11.

²¹Nas, "Turkey-EU Customs Union", 49.

²²Sinan Ülgen and Pelin Yenigün-Dilek, *Gümrük Birliği'nde Yeni Dönem ve İş Dünyası (New Period in the Customs Union and the Business World)*, (Istanbul: TUSIAD, October 2015), Accessed: April 2017, file:///C:/Users/vista/Downloads/Gumruk-Birliginde-Yeni-Donem-ve-Is-Dunyasi_1.pdf

TUSIAD also stated that it supported efforts to make Europe more competitive globally. It also agreed that CU modernisation was a win-win formula for both parties by including services, agriculture, and public procurement, and creating an effective dispute settlement mechanism and a mechanism for correcting decision-making asymmetries.²³

While Turkey agreed with the Commission on the best option by particularly emphasizing the problems arising from the CU's asymmetric nature, it is also strongly interested in transport quotas and visa requirement as obstacles to free movement of Turkish goods due to the influence of relevant economic actors.²⁴

A. Remediating the CU's Design Deficiencies

Structural insufficiencies, or design deficiencies in the Commission's terms,²⁵ are firstly related to what Turkey regards as the CU's asymmetric nature. That is, Turkey is required to adopt the EU's legislation and policies in areas directly related to correct functioning of the CU while it cannot be involved in their formulation as a non-member state. Because Turkey is bound to adopt EU policies and rules related to the CU while lacking any voting rights, the CU has a democratic deficit.²⁶ This poses important long-term challenges. While Turkey initially successfully aligned its CU-related rules and policies with those of the EU, it has faced more difficulty in adapting to the evolving EU *acquis*, particularly regarding trade policy, and technical rules and regulations.²⁷ This situation has upset market uniformity between the parties, leading to market access problems and trade irritants.

Harmonization with the EU's trade policy covers not only adopting EU trade measures and instruments with third countries but also aligning with the EU's preferential trade regime with those countries. Turkey has therefore concluded mutually advantageous bilateral agreements with all third

²³For TUSIAD views on Turkey's EU integration process, see TUSIAD, *TUSIAD views on Turkey's European Union integration process*, (February 28, 2019), Accessed: April 2019, <https://tusiad.org/en/press-releases/item/10251-tusiad-views-on-turkey-s-european-union-integration-process>

²⁴Binder, *Reinvigorating EU-Turkey bilateral trade*, 8.

²⁵European Commission, *Impact Assessment*.

²⁶Sieglinde Gstöhl, "Models of external differentiation in the EU's neighbourhood: an expanding economic community?" *Journal of European Public Policy*, 22, No: 6 (2015): 859.

²⁷European Commission, *Impact Assessment*, 15.

countries that had preferential trade agreements with the EU up to 2001. Its performance was significant as it largely aligned its preferential trade regime with the EU's. Since then, however, the EU's bilateral trade relations have evolved significantly through numerous extensive FTAs, particularly following the introduction of a new trade policy in 2006 in response to the stalemate in multilateral World Trade Organisation (WTO) trade negotiations. The CU's insufficiencies became apparent with the increasing number of comprehensive FTAs that the EU concluded with third countries.

The EU has been negotiating and concluding such agreements with third countries without allowing Turkey any effective pre-negotiation involvement, for example as an observer, in Council meetings that include trade negotiations, or in determining the EU's common negotiation position in its Trade Policy Committee. Obviously, it is far from being a real CU with a co-decided commercial policy regarding third countries. Turkey can neither negotiate with third countries jointly with the EU nor conduct parallel negotiations with a generally common position, which would be reached through increased consultation and greater information sharing with the EU. Thus, it needs to conclude its own FTAs with these countries on their own terms and usually after a time lapse following the EU's own agreement. This situation has made it quite difficult for Turkey to obtain trade privileges from third countries as beneficial as the EU's. Additionally, it disadvantages Turkish exporters as EU exporters can penetrate these third country markets ahead of their Turkish rivals.

Prompted by the interests of its exporters, Turkey has become increasingly concerned as this situation provides no legally binding mechanisms to force the EU's new FTA partners to conclude parallel FTAs with Turkey either simultaneously or within a set time. This became even more worrying after the EU started to negotiate its Transatlantic Trade and Investment Partnership (TTIP) with the USA in July 2013 as its major trade partner. Indeed, in all its bilateral trade discussions with the EU, Turkey frequently expressed its expectation of involvement in these negotiations or at least to conclude a parallel FTA,²⁸ and repeatedly stated its concerns about the risks associated with such FTA asymmetry.²⁹ These concerns have pushed the Turkish government to highlight particularly the FTA issue with reference to the CU's asymmetric nature while arguing for the need for CU reform.

²⁸The TTIP negotiations were frozen under the Trump presidency and their revival seems unlikely since the Trump administration is preoccupied with other priorities, particularly China and NAFTA.

²⁹European Commission, *Impact Assessment*, 14.

Insufficient involvement in EU committees, limited exchange of information, and inefficient consultation have also led to difficulties for Turkey in aligning its legislation with the EU regarding technical rules and regulations, as acknowledged by the European Commission.³⁰ Indeed, in the public consultation for the impact assessment, European participants from various sectors, including footwear, sporting goods, pharmaceuticals, cars, agricultural machines, alcoholic beverages, and cosmetics, expressed serious concerns that trade with Turkey was significantly impeded by technical barriers, increasing costs for European exporters, and delays in goods deliveries.³¹ These barriers are generally due to technical regulations and conformity assessment procedures that Turkey has not harmonized with EU standards. The economic concerns of these sectors led the Commission to strongly emphasize in its impact assessment that this issue reflected Turkey's lack of compliance and needed to be resolved. Accordingly, the EU intends to prioritize it in the CU modernisation negotiations.³²

Harmonisation in areas directly related to the proper functioning of the CU is an important step towards achieving free movement of goods between the parties since it would secure market uniformity or 'market homogeneity' in Gstöhl's terms.³³ Therefore, Turkey's non-compliance regarding free movement of goods with the EU is directly linked to the CU's design deficiencies according to the European Commission.³⁴ Due to these harmonisation problems and domestic industrial policy considerations, Turkey has introduced protective measures that constitute technical barriers to bilateral trade and caused trade irritants and market access problems for the EU. Asymmetry in the development of the EU's trade policy, particularly its unfair competition effects, have forced Turkey to impose surveillance and safeguard measures that increase costs for EU exporters while hindering the CU's proper functioning. Effectively addressing the structural problems would improve Turkey's perception of the overall CU relationship, and would make it more legitimate for both partners to insist on full compliance with the rules of a modernised CU.³⁵ This is thus a major motivating factor for both parties to modernise the CU. For Turkey, sufficiently tackling the

³⁰*Ibid.*, 15.

³¹*Ibid.*, 13.

³²Beken Saatçioğlu, *et al.*, *The Future of EU-Turkey Relations: A Dynamic Association Framework amidst Conflictual Cooperation*, Feuture Synthesis Paper, (March 2019): 28, Accessed: April 2019, https://www.feuture.uni-koeln.de/sites/monteus/user_upload/FEUTURE_Synthesis_Paper.pdf

³³Gstöhl, "Models of external differentiation in the EU's neighbourhood", 855.

³⁴European Commission, *Impact Assessment*, 16.

³⁵*Ibid.*

CU's participatory deficiencies constitutes a major national preference generated by domestic economic interests arguing more effective representation in formulating relevant policies. For the EU, it is important to resolve these structural problems to push for Turkey's full adoption and uniform implementation of the evolving *acquis*. In turn, this would ensure market homogeneity to maintain the competitiveness of EU industries while solving market access problems. In short, the preferences of both parties for modernising the CU are driven by the interests of influential domestic economic actors.

The EU has also underlined the lack of an effective and operational dispute settlement mechanism in CU relations as another design problem that needs resolution to better manage growing trade irritants and address unresolved trade issues.³⁶ That is, the CU lacks an effective mechanism for judicial enforcement of adopted rules and policies, which is equally important for ensuring market homogeneity. The Commission's impact assessment report shows clearly that the EU will prioritize this issue in the negotiations. Indeed, the Commission has proposed an effective dispute settlement mechanism with technical arbitration by independent courts to avoid political stalemate. This would address the trade irritants that are causing important market access problems for EU economic players while also helping to prevent the introduction of such measures if they breach CU rules.³⁷ This also supports one of the main arguments of LI: that states have an instrumental understanding of creating and empowering institutions that are believed to strengthen the credibility of mutual inter-state commitments.

B. Extending the Scope of Economic Relations

The CU between Turkey and the EU only covers free movement of industrial goods and processed agricultural goods whereas the EU's FTA's with third countries, whether concluded or under negotiation, include trade liberalisation in areas like agriculture, foreign direct investment, services, and government procurement. Thus, the CU's narrow scope contradicts the prevailing trend in international trade relations, which leads to important challenges for the parties.

Although the Ankara Agreement and the Additional Protocol envisaged that trade in agricultural products would also be included, the CU did not deliver free movement because Turkey was unable to harmonize its agricultural policy with the EU's as required by the protocol. Although the

³⁶*Ibid.*, 15-16.

³⁷*Ibid.*

parties agreed on preferential concessions in some agricultural and fishery products,³⁸ the CU still lacks full liberalisation in agriculture. While tariff quotas and non-tariff barriers are imposed on certain Turkish agricultural products, EU agricultural and fishery exports are restricted, either by high tariffs or highly protective non-tariff barriers as EU participants in the public consultation highlighted.³⁹

Liberalising highly protective agricultural trade with the EU would significantly increase EU agricultural exports to Turkey by US\$2.5 billion, which would please European agricultural exporters the most. An EU-Turkey FTA in agriculture would also increase Turkish agricultural exports to the EU by US\$1.5 billion.⁴⁰ Including the agricultural sector in free movement between the parties would obviously increase potential for economic gains from bilateral trade, thereby improving welfare and real incomes for both parties.⁴¹ The challenge for Turkey, however, would be to open its highly protected agricultural markets to the EU as this would require full compliance with the EU's agricultural *acquis*.⁴² Based on the impact analysis commissioned by Turkey, the Economy Minister, Nihat Zeybekçi, regarded agriculture, which accounted for 8% of Turkey's GDP in 2014, as the most challenging sector for modernising the CU since it needs a significant transformation.⁴³ Moreover, an FTA in agricultural sector could reduce Turkey's farm employment by 0.5%.⁴⁴ Clearly then, the short to medium-term economic and social costs of agricultural adjustment would be high for Turkey. To counter balance these adverse effects, Turkey should liberalise its agricultural sector gradually rather than drastically,⁴⁵ with EU financial support.

Similarly, including services and public procurement in the CU can create real economic gains for the EU and Turkey since they are key areas for economic development, accounting for two thirds of both parties'

³⁸Binder, *Reinvigorating EU-Turkey bilateral trade*, 2.

³⁹European Commission, *Impact Assessment*, 10.

⁴⁰World Bank, *Evaluation of the EU-Turkey Customs Union*, 67.

⁴¹*Ibid.*, 64-65.

⁴²Sübidey Togan, *Modernizing the EU-Turkey customs union*, The Forum, Economic Research Forum (ERF) Policy Portal, (March 6, 2018): 2, Accessed: September 2018, <https://theforum.erf.org.eg/2018/03/01/modernising-eu-turkey-customs-union/>

Sübidey Togan, "Trade Policy Alternatives for Turkey", in *Turkey in the North Atlantic Marketplace*, eds. Daniel S. Hamilton, Aylin Ünver-Noi and Serdar Altay, (Washington, DC: Center for Transatlantic Relations, 2018): 123.

⁴³Binder, *Reinvigorating EU-Turkey bilateral trade*, 8.

⁴⁴World Bank, *Evaluation of the EU-Turkey Customs Union*, 65.

⁴⁵Yılmaz, *TTIP and EU-Turkish Economic Relations*, 6-7.

economies.⁴⁶ Bilateral liberalisation of these markets would further economic relations by addressing the problems of barriers to trade in services and obstacles for EU companies' access to Turkish public procurement markets. Regarding services, since the parties do not export to each other at full capacity, trade liberalisation may stimulate further bilateral trade in services and thus economic welfare gains for the parties.⁴⁷ Trade liberalisation in this sector would facilitate the functioning of cross-border value chains and production networks that have already emerged under the CU, which enhance bilateral economic relations.⁴⁸

As to public procurement, while the EU's market is largely open, Turkey implements restrictive measures that deny EU companies access to the Turkish market, as almost all respondents noted in the online public consultation. EU companies have also recently complained more fervently that Turkish public procurements are not transparent and that they are not allowed to participate in these markets due to highly restrictive and discriminatory measures.⁴⁹ This means there is unfulfilled trade potential for both goods and services.⁵⁰ However, since the party that is concerned more about the restrictive measures of the other party is the EU, the issue of liberalising public procurement markets will be one of the EU's main priorities in the CU modernisation negotiations.⁵¹ Moreover, while negotiating, Turkey may demand transitional measures to open up its procurement markets incrementally until they reach a level comparable with the EU, as suggested by Dawar and Togan.⁵²

The European Commission has suggested dealing with the narrow scope of the CU and its resulting difficulties by establishing an additional FTA in agriculture, services, and public procurement. Both parties support this as a way to avoid extending the asymmetry problem regarding the severely limited collective commercial policy-making of the CU to these areas. The economic benefits of this option are expected to be proportionate to the level of trade liberalisation and the degree of market access agreed in

⁴⁶European Commission, *Impact Assessment*, 9.

⁴⁷World Bank, *Evaluation of the EU-Turkey Customs Union*, 73.

⁴⁸European Commission, *Impact Assessment*, 11.

⁴⁹*Ibid.*, 65.

⁵⁰*Ibid.*, 11.

⁵¹Saatçioğlu, *et al.*, *The Future of EU-Turkey Relations*, 28.

⁵² Kamala Dawar and Sübidey Togan, *Bringing EU-Turkey Trade and Investment Relations up to date?* European Parliament, Directorate General for External Policies, Policy Department, (Belgium, May 2016): 39, Accessed: January 2018, http://www.europarl.europa.eu/RegData/etudes/STUD/2016/535014/EXPO_STU%282016%29535014_EN.pdf

these areas. This is particularly true considering Turkey's high level of protection in agriculture, the limited access to Turkey's public procurement markets, and regulatory and market access restrictions on services. Improved preferential access to public procurement and services markets will increase trade in goods. Together with agricultural liberalization, this will then deepen economic integration and spur economic growth for both parties.⁵³ For example, Turkey's then Economy Minister, Nihat Zeybekçi, stated in 2016 that expanding the scope of bilateral trade liberalisation to include services, public procurement, and agricultural products could increase Turkey's share of exports to the EU from 48.5% to 60%.⁵⁴ Moreover, given that Turkey is obliged to conclude similar FTAs with the EU's FTA partners, an FTA in these additional areas would also address the risk whereby either the EU or Turkey provides trade preferences to the EU's FTA partners in services, public procurement, or agriculture while not providing the same level of preferences to its CU partner in these sectors.⁵⁵ This is a particularly important risk for Turkey as it could reduce its competitiveness in the EU's market. Accordingly, Turkey agrees with the Commission on establishing an additional FTA in agriculture, public procurement, and services even though this would constrain its financial and structural capabilities, particularly regarding the first two sectors as mentioned above.

C. Eliminating Restrictions in Goods Transportation and Visa Requirements

In addition to the CU's structural insufficiencies, Turkey also frequently raises concerns about the restrictive impact of the insufficient and slow allocation of quotas for the road transport of goods. This constitutes an important barrier to the free movement of goods between Turkey and EU member states as they directly restrict the volume of goods exported from Turkey. The limited number of transit permit quotas has an equivalent effect to quantitative restrictions. It also forces road vehicles carrying export goods to use longer indirect routes or train transportation, which increases costs. Moreover, the transit fees and taxes applied to Turkish trucks carrying goods to EU countries are considered to have a restrictive effect equivalent to tariffs. Turkish authorities argue that these barriers, coupled with visa requirements for Turkish truck drivers, contradict Articles 4 and 5 of the CU

⁵³European Commission, *Inception Impact Assessment: Enhancement of EU-Turkey bilateral trade relations and modernisation of the EU-Turkey Customs Union*, (Brussels, August 2015): 5, Accessed: July 2018, http://ec.europa.eu/smart-regulation/roadmaps/docs/2015_trade_035_turkey_en.pdf

⁵⁴Binder, *Reinvigorating EU-Turkey bilateral trade*, 8.

⁵⁵European Commission, *Impact Assessment*, 10.

decision and reflect the EU's non-compliance with the requirement of removing all the barriers on free movement of goods.

The issue of transit road fees and taxes collected by the Hungarian authorities from Turkish trucks was submitted to the ECJ through the preliminary ruling procedure. The Court ruled in 2017⁵⁶ that such fees and taxes constituted charges having equivalent effects to tariffs, which were prohibited under Article 4 of the CU decision.⁵⁷ The ruling has justified Turkey's arguments. Another case against Austria regarding transport quotas imposed on Turkish trucks was also referred to the ECJ for a preliminary ruling.⁵⁸ The Turkish side expects this case, which had not been yet finalized at the time of writing, to confirm its claims that transport quotas should be considered as measures having equivalent effect to quantitative restrictions.

The EU's approach to the issue of restrictions in goods transport conflicts with Turkey's since it considers it a matter of free movement of services instead of free movement of goods. The EU claims that the issue has nothing to do with the CU because it excludes free movement of services. This difference in approach is the most important obstructing factor preventing the parties from resolving the issue. Including free movement of services in bilateral trade relations through an additional FTA would also enable this controversial issue to be addressed since it would destroy the basis of the EU's argument, and therefore would contribute to full implementation of the free movement of goods.

Another important concern for Turkey regarding the CU is the visa requirement that the EU imposes on Turkish citizens, including business people, industrialists, service providers, and market analysts. Turkish economic actors currently need to obtain an entry visa to undertake normal economic activities in EU countries while their EU counterparts can travel without visas to Turkey or, at worst, obtain a visa at the point of entry. This situation disadvantages Turkish economic actors and also contradicts the logic of the CU because, while goods are allowed to move freely between the parties, Turkish citizens trying to market, sell, or transport these goods are disqualified, restricted or, at best, hindered by visa procedures. To get visas, Turkish producers and traders suffer an onerous and lengthy procedure requiring redundant official documents and unreasonably high visa fees.

⁵⁶C-65/16, Judgment of the Court (Second Chamber) of 19 October 2017, *Istanbul Lojistik Ltd v Nemzeti Adó- és Vámhivatal Fellebbvitelilgazgatóság*, <http://curia.europa.eu/juris/liste.jsf?num=C-65/16>

⁵⁷Nas, "Turkey-EU Customs Union", 51.

⁵⁸*Ibid.*

Because this is quite costly in business terms, it constitutes an important setback for the functioning of the CU.

A seemingly positive development in this regard began when the two sides signed an agreement on a visa liberalisation dialogue, together with the Readmission Agreement of 16 December 2013. This was followed by the refugee deal on 18 March 2016, which included visa liberalisation among its provisions. However, the visa liberalisation roadmap included 72 criteria for Turkey to meet to qualify for visa-free travel, five of which remain unmet. One of these, which requires Turkey to revise its anti-terror legislation to narrow its application, is controversial given the fight against the PKK in the south-east of the country and several ISIS terror attacks in major Turkish cities. Therefore, the visa liberalisation issue has remained unresolved after the target date of June 2016 and then the October 2016 deadline for lifting the Schengen visa for Turkish citizens could not be met. To date, technical negotiations on measures to perform the remaining criteria continue. Visa liberalisation is important not only for a successful implementation of the refugee deal between the parties since Turkey linked them closely to each other but also to ensure that the CU functions fairly. Visa liberalisation will therefore have renewed urgency when negotiations start on liberalising services between Turkey and the EU.⁵⁹

III. The Current Outlook for Modernising the CU and Its Continuing Relevance to the Future of Turkey-EU Relations

According to Arısan-Eralp, when the parties first discussed the need to reform the CU around 2015-2016, the motivation was technical and economic.⁶⁰ However, the process has since become politicized due to the EU's policy of conditionality, following bilateral strains between Turkey and some member states. The degradation of democratic norms and the rule of law in Turkey drove some countries, particularly Austria and Germany, to refer officially to tying political conditionality to launching the modernisation negotiations. Moreover, some EU political and official figures informally stated their concerns launching the negotiations could be seen as a gift for a democratically regressive regime (which would most probably fail to meet its commitments arising from a modernised CU) to regain the

⁵⁹*Ibid.*, 52.

⁶⁰Nilgün Arısan-Eralp, "The Unique Nature of Modernizing the Customs Union", *Turkish Policy Quarterly*, 17, No: 2 (September 28, 2018): 2, Accessed: May 2019, <http://turkishpolicy.com/article/920/the-unique-nature-of-modernizing-the-customs-union>

confidence of international finance and investor sectors. Consequently, conditionality has been under consideration ever since the Commission forwarded its communication to the Council asking for a mandate to launch formal negotiations with Turkey. However, blocking the launch of negotiations is more likely to impede the parties' economic and political engagement and discourage domestic reforms in Turkey due to increasing despair regarding the fate of CU modernisation in particular and EU-Turkey relations in general. Moreover, as Arisan-Eralp rightly points out,⁶¹ the mandate will be just to start the negotiations, not to conclude them. Therefore, all conditionalities can be imposed during the negotiations and/or at the end since a probable agreement on the revamped CU will also need the European Parliament's consent. In its Resolution of March 13, 2019, the parliament established a strong link between revision of the CU and the revival of democratisation reforms in Turkey.

Another important point is that the EU has not objectified or defined the substance of its political conditionality; instead, it has so far only generally referred to it generally in terms of the rule of law and fundamental freedoms.⁶² These references have been made under the influence of bilaterally-stressed relations without offering a technical and credible road map. Only a technically well-defined, strong and credible EU conditionality may constitute a true incentive for Turkey to realize democratic reforms in return for benefits of a modernised CU. Modernisation of the CU could revitalise EU political conditionality regarding Turkey, which has been ineffective for some time following the *de facto* suspension of accession negotiations.⁶³ However, the EU would need to officially formulate *a priori* benchmarks following the launch of the negotiations. This would allow the EU to also put weight on the benchmarks previously put forward for opening Chapters 23 and 24 of the accession negotiations on Judiciary and Fundamental Rights, and Justice, Freedom, and Security respectively. This would force Turkey to adopt certain democratic reforms under the pressure of its main economic interests to gain the much needed trade and economic gains of a modernised CU.⁶⁴ The greater power of EU member states due to the asymmetrical interdependence between Turkey and the EU would increase their intergovernmental bargaining ability. As the European Parliament made clear in its Resolution of March 13, 2019, CU

⁶¹*Ibid.*, 4.

⁶²Saatçioğlu, *et al.*, *The Future of EU-Turkey Relations*, 28.

⁶³Ebru Turhan, *Thinking out of the Accession Box: The Potential and Limitations of Internal and External Differentiated Integration between Turkey and the EU*, CIFE Policy Paper (58), (Nice: CIFE, July 3, 2017): 6.

⁶⁴Saatçioğlu, *et al.*, *The Future of EU-Turkey Relations*, 28.

modernisation constitutes a valuable opportunity and positive leverage for democratic conditionality. It could proceed alongside concrete improvements by Turkey on democratic reforms. This would be the only way to ensure that normative goals and interest-based objectives can coexist in the EU's relations with Turkey.⁶⁵

On the other hand, considering the decision-making powers of member states arising from the intergovernmental nature of the EU in bilateral cooperation, CU modernisation could also be politicised to take advantage of bilateral political disputes like the Cyprus dispute. Cyprus is expected to constitute another impediment to starting negotiations if conditions are imposed regarding Turkey's refusal to extend the current CU to Cyprus since the latter gained EU membership in 2004. It seems unlikely that Turkey will apply the CU equally to all member states, including Cyprus, until the EU ends its economic isolation of the Turkish Cypriots. In addition, suspending the Cyprus-related chapters of the accession negotiations failed to impose any pressure on Turkey. Therefore, Cyprus would be unwise to use this bilateral political dispute as to block a modernised CU as it will damage long-standing and mutually beneficial economic relations.

In addition to its economic and commercial benefits, an overhauled CU appears to be the only way left to maintain a synergic and cooperative relationship between Turkey and the EU given the stalemate in accession negotiations and the aggravating mutual estrangement. As Nasnotes, it may help promote 'functional integration' since liberalisation of additional sectors of the economy and a more rules-based framework would enable Turkey to harmonise with the EU's norms and standards. This could then spread to the political area regarding democratic norms, human rights, and the rule of law.⁶⁶ Moreover, it may generate a social learning process so that EU norms and values are internalised by Turkey's institutions and people. This would certainly contribute to Turkey's accession process while countering the arguments of those who oppose Turkey's EU membership. In short, CU reform provides a proper foundation for longer-term accession.

Conclusion

Given the current state of relations due to Turkey's ever-declining performance on EU reforms, the technically frozen accession negotiations

⁶⁵Senem Aydın-Düzgit, *Turkey and the EU: Perpetual Crisis or Restricted Cooperation?* GMF Strengthening Transatlantic Cooperation, (June 16, 2017), Accessed: February 2018, <http://www.gmfus.org/publications/turkey-and-eu-perpetual-crisis-or-restricted-cooperation>

⁶⁶Nas, "Turkey-EU Customs Union", 57.

due to the Cyprus issue, and recent problems challenging European integration, Turkey's EU membership hopes currently seem farther away than ever. In the absence of membership on the medium-term agenda, strong interdependence and mutual economic interests have forced the parties to increase economic integration by dealing with structural problems and conjunctural challenges facing the CU.

It is questionable whether the EU is still a voice for normative values in a time of crises that strongly constrain it and its member states. In particular, modernising the CU as a pragmatic, interest-driven initiative challenges the EU's adherence to its norms and values in its external relations. It is certainly quite complex for the EU to preserve a normative perspective in the face of daily challenges to meet the practical needs of bilateral cooperation whereby member states, as the leading actors of European integration with their decision-making power, determine their preferences under the influence of domestic interests. CU modernisation does not seem exceptional in this respect considering the pressure of domestic economic interests on member states' preferences. Indeed, as outlined above, the parties have primarily been driven by economic interests in considering CU reform.

However, as Arısan-Eralp suggests, reform will also provide a rules-based functional relationship rather than a purely transactional one, as in migration, energy, and counter-terrorism.⁶⁷ In such a relationship, the EU can improve the rule of law and governance in Turkey's economic sphere and transform its economic structure in key sectors like services, public procurement, and dispute settlement through greater transparency, competitiveness, and respect for universal laws and regulations. More importantly, the EU may also push Turkey to revitalise its democratic reforms. This would give it transformative power in political sphere through CU modernisation if the EU devises *ex ante* objectification of democratic conditionality to prevent individual member states politically manipulating conditionality. This could contribute to the EU's normative identity construction. Ultimately, therefore, reforming the CU is both economically and politically in the interests of both parties.

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