

**Büşra Özyüksel<sup>1</sup>**

## **Free Trade Between Turkey and the EU in the Frame of Customs Union**

### **Introduction**

The concept of free trade often known as laissez-faire, is a government policy in which it does not discriminate against imports or interfere with exports by imposing taxes, on imports, or subsidies, to exports. A free-trade policy, on the other hand, does not always entail that a country abandons all regulations and taxes of imports and exports.<sup>2</sup> Free trade agreements do more than just lower and eliminate tariffs; they also help address behind-the-border barriers that would otherwise impede the flow of goods and services; encourage investment; and improve rules governing issues such as intellectual property, e-commerce, and government procurement.<sup>3</sup>

In today's globalizing world, free trade covers a wide area from political cooperation between countries to cultural cooperation. In such an important field of cooperation, Turkey is also in favour of developing free trade with the European Union (EU), which is the closest and richest community to its geography, and accordingly, it has taken some steps throughout history. The problematic of this study is how the trade relations between the EU and Turkey in the frame of the Customs Union (CU) have developed. The reason of this – since Turkey is not a member state of the EU – the Ankara Agreement, a special status agreement, was signed to regulate trade between the Union and the country. In this agreement, it was decided to establish a customs union with Turkey in order to make trade more liberal. Therefore, this study examines the “free trade” between Turkey and the EU within the framework of the CU from back to the present.

The importance of this study is to analyse Turkey's relations with the EU from the economic perspective and to add to the literature an abstract study. To do this, this paper first explains the historical background of the bilateral relations in the frame of economic aspect. Later, the process of the CU comprehends the essence of the study, after the explanation of the relations' improvements current situation consists of an outlook from today, and with the conclusion part the study comes to an end. The study uses the analytical and chronological literature review as the method.

### **Historical Background**

Free trade policies refer to the movement of goods, services, labour, and capital between countries without any barriers. Although its sustainability is debatable, ensuring the free movement of goods is the first step of the initial phase of international economic integration.<sup>4</sup> Free movement of goods is one of the success stories of the EU and is one of the four fundamental freedoms of the EU (the others are persons, services, and capitals). Therefore, the first chapter titles of the EU Acquis (*acquis communautaire*) are harmonization with the principle of free movement of goods.<sup>5</sup> As a near neighbour of the EU, Turkey is also utilising

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<sup>1</sup> 2<sup>nd</sup> year Ph.D. Student, University of Szeged, Faculty of Law and Political Sciences, Doctoral School.

<sup>2</sup> “Free trade”, access date 11 April 2022, <https://www.britannica.com/topic/free-trade>

<sup>3</sup> “The benefits of free trade agreements”, Australian Governments Department of Foreign Affairs and Trade, Access date 11 April 2022, <https://www.dfat.gov.au/trade/about-ftas/Pages/the-benefits-of-free-trade-agreements#:~:text=Free%20trade%20agreements%20don't,e%2Dcommerce%20and%20government%20procurement>

<sup>4</sup> Mangır Fatih and Hakan Acet, “Serbest Ticaret ve Korumacılık, Avrupa Birliği'nde Malların Serbest Dolaşımı ve Türkiye'nin Uyumunu”, *Selçuk University Journal of Institute of Social Sciences Dr. Mehmet YILDIZ Special Edition*, 93/108, (2014).

<sup>5</sup> Mangır and Acet, “Serbest Ticaret”, p. 95

this integration area. Trade relations between Turkey and the EU is provided by mutual agreements. The 1963 Ankara Agreement, the 1971 Additional Protocol and the CU signed in 1996 are three important milestones in determining the provisions regarding the free movement of goods between Turkey and the EU.

Turkey's EU integration process has been going on for more than 60 years. Turkey applied to the as it was then known European Economic Community (EEC) in 1959, and this application established a partnership relationship with the Union in 1963 with the Ankara Agreement. In this period, when membership was targeted but no definite date was given, integration with the Union was decided to be carried out in three stages.<sup>6</sup> At the preparation stage, Turkey has not made any commitment, the procedures and principles of the transition period had been determined, and the Community had decided to help Turkey to undertake tariff facilitation commitment for certain goods and to undertake the obligations that will fall on itself in the future. The second phase is the transition phase, which started with the 1973 Additional Protocol signed with the Community, and with this agreement, it was decided to zero the customs duties of industrial goods subject to 12 and 22-year periods in Turkey. On the other hand, the EU abolished taxes on most industrial goods, and a preferential trade regime was applied on agricultural products. The last phase ended in 1996 by signing a partnership agreement with the Union. The CU covers mutually removing tax and quantity restrictions on industrial goods and processed agricultural products, and the free movement of these goods has been ensured. Thus, nearly 90% of the goods were subject to free trade between the two countries. Turkey, which was not accepted as a member of the Union in 1982 and 1997, was accepted as full membership in 1999 with the Helsinki Summit and in 2002 the EU agreed to start accession negotiations; scanning for the accession started in 2006.<sup>7</sup> Turkey has committed itself to comply with 35 chapters that the EU put forward for the candidate countries. The first of these chapters is the free movement of goods, and today it is one of the chapters that the Cyprus has vetoed.

Turkey had faced serious difficulties in fulfilling its obligations to the European Community (EC) with the Additional Protocol Agreement. The main reason for this was that the Turkish economy was dragged towards an economic crisis due to inadequate and wrong economic policies. As it is known, the world economy entered the first oil crisis in 1974. Oil prices increased four times in an instant and the price of oil per barrel rose from 3 dollars to 12 dollars. Considering this development, Turkey could not make the necessary arrangements in monetary, fiscal, exchange rate and incentive policies.<sup>8</sup> As a result, inflation started to accelerate in the Turkish economy and a foreign currency bottleneck began to emerge. Another mistake Turkey made was that it did not perceive in time that the industrialization policy based on import substitution was gradually reaching its limits. Turkey started to follow an industrial policy based on import substitution, with the implementation of its five-year development plans as of the beginning of 1963. This policy was successful and the industrial sector in Turkey showed a rapid development. However, by 1975, the limits of industrialization based on import substitution were reached its limits and bottlenecks began to emerge in the industrial sector. The oil crisis that emerged in 1974 accelerated this process. Despite this, Turkey had started to implement an export-oriented industrial policy.<sup>9</sup>

As a result of the political instability added to all these economic developments, Turkey had begun to struggle to fulfil its obligations under the Additional Protocol Agreement and instead of implementing the economic policies that would overcome these difficulties, Turkey made a historical mistake and demanded the freezing of its obligations to the EC between 1979-1983

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<sup>6</sup> Morgil Orhan, "Türkiye-Avrupa Birliği Ekonomik İlişkileri", *G.Ü. İ.İ.B.F. Dergisi*, 1/2003, 103-116, (2003).

<sup>7</sup> Togan Sübidey, *Economic Liberalization and Turkey*, USA: Routledge, 2010.

<sup>8</sup> Morgil, "Türkiye-Avrupa Birliği Ekonomik İlişkileri", p. 104.

<sup>9</sup> Morgil, "Türkiye-Avrupa Birliği Ekonomik İlişkileri", p. 105.

and the economic relations between Turkey and the EC envisaged in the Additional Protocol Agreement at the beginning of 1979 were frozen. That mistake made by the Ecevit government<sup>10</sup> was reversed on February 4, 1980, with the Demirel Government's<sup>11</sup> decision to freeze the obligations of the Additional Protocol Agreement; with this agreement Turkey put into practice a stabilization program on January 24, 1980, which included monetary, fiscal, exchange rate and structural adjustment measures to get out of the crisis in which its economy fell. In this framework, the industrial policy was changed, and the industrial policy based on import substitution was switched to an open and export based industrial policy. Depending on all these developments, the decision to freeze economic relations with the EC was lifted. With the implementation of these decisions, the improvement and developments in the Turkish economy enabled Turkey to gradually fulfil its commitments to the EU.<sup>12</sup>

Another historical mistake Turkey made during this period was that although Greece applied for full membership to the EC, Turkey did not apply for full membership despite the EC's request. Since Turkey's application for full membership would have been handled together with Greece, it can be said that it would have seriously affected the full membership process of Greece. Greece's full membership to the EC in 1981 adversely affected Turkey-EC relations. Due to the negative attitude of Greece, the EC had not provided financial aid to Turkey since 1981.

Besides of those mistakes that Turkey had done, liberal foreign trade policy, flexible exchange rate policy, gradually liberalizing foreign exchange system and structural regulation measures put into practice in Turkey since the beginning of 1980, on the way to the Additional Protocol, have brought about serious improvement and positive developments in the Turkish economy. Economic growth accelerated, inflation was controlled to a certain extent, and the foreign exchange balance was achieved to a large extent. These positive developments in the Turkish economy enabled Turkey to fulfil its obligations under the Additional Protocol Agreement. Thus, the economic relations between Turkey and the EC were on track and started to develop in a positive way. Despite the rapid opening of the Turkish economy to foreign competition, the development of its exports and the balance of payments strengthened the view that the Turkish economy had gained competitiveness and could compete in the EC markets. As a result of these developments, Turkey applied to be accepted as a full member of the EC on 14 April 1987. The European Community Commission (ECC) examined Turkey's request for full membership for 2.5 years and announced the report on 18 December 1989; the conclusion that Turkey could not become a full member due to economic and political reasons. The EC Council accepted this report prepared by the ECC and decided not to start full membership negotiations with Turkey.<sup>13</sup>

After the ECC rejected the full membership in its report dated 18 December 1989, it recommended that Turkey's relations with the EC be developed in the form of establishing a customs union within the framework of Ankara and Additional Protocol Agreements. The Council of the EU, meeting in Lisbon on 26-27 June 1992, reiterated this proposal. Thus, negotiations for the establishment of a customs union between Turkey and the EU began.

Negotiations for the establishment of a customs union between Turkey and the EU were carried out within the framework of Ankara and Additional Protocol agreements as has been

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<sup>10</sup> 57th Government of Turkey, the V. Ecevit Government or the ANASOL-M Government served between 28 May 1999 - 18 November 2002. "Türkiye Cumhuriyeti hükümetleri". hurriyet.com.tr. Hürriyet. 17 Mart 2003, <https://www.hurriyet.com.tr/gundem/turkiye-cumhuriyeti-hukumetleri-134271> access date 12 April 2022.

<sup>11</sup> 43rd Turkish Government, VI. Demirel Government, the government established under the chairmanship of Justice Party Chairman Süleyman Demirel served between 12 November 1979 - 12 September 1980. "Türkiye Cumhuriyeti hükümetleri". hurriyet.com.tr. Hürriyet. 17 Mart 2003 <https://www.hurriyet.com.tr/gundem/turkiye-cumhuriyeti-hukumetleri-134271> access date 12 April 2022.

<sup>12</sup> Morgil, "Türkiye-Avrupa Birliği Ekonomik İlişkileri", p. 106.

<sup>13</sup> Morgil, "Türkiye-Avrupa Birliği Ekonomik İlişkileri", p. 107.

indicated before, and a customs union decision was signed by the Association Council on 6 March 1995. This agreement entered into force on 1 January 1996, after being ratified by the European Parliament.

## Customs Union

The CU has a wide scope based on Single Market that has been established since 1992 with 282 directives and regulations issued through the Single European Act agreement, which entered into force on 1 July 1987 in the EU. The EU's becoming a Single Market with the European Single Act has expanded the scope of the CU established between Turkey and the EU. In particular, Turkey has undertaken the obligation to fully comply with the competition policy implemented by the EU within the framework of the CU.

Through the CU, duty-free trade of industrial and processed agricultural products between the EU and Turkey has become possible. In this way, Turkey has become a part of the EU's common market by making free trade with the EU in the areas covered by the CU. Therefore, Turkey has made the necessary legal arrangements to comply with the EU acquis within the scope of the CU.<sup>14</sup> The Additional Protocol envisaged the existence of agricultural products within the scope of the CU and the free movement of these products between the two parties. However, only industrial products and processed agricultural products were included in the Association Council Decision numbered 1/95. Accordingly, customs protections corresponding to the industrial processing of the finished product in the import of processed agricultural products such as some types of yoghurt containing cocoa or other fruit, and spreadable oils other than butter, flour, biscuits, chocolate, confectionery, pastry, etc., have been reset; however, taxes on basic agricultural products included in the finished product continued to be applied.<sup>15</sup>

The CU has brought some obligations for Turkey to undertake some regimes of the EU.<sup>16</sup> From the perspective of Turkey, in accordance with the CU Agreement; Turkey has an obligation to undertake the EU's Common Trade Policy, and accordingly, the EU's preferential trade system for countries outside the Union, which is called the third country, is assumed. In this context, Turkey can negotiate similar agreements based on mutual benefit with the countries with which the EU has negotiated Free Trade Agreements (FTA), in other words, Turkey can only sign FTAs with the countries with which the EU conducts FTA negotiations. In this regard, Turkey is not obliged to accept the same content of FTAs signed by the EU.<sup>17</sup> In sum, the CU established between Turkey and the EU, apart from providing free trade opportunities in the trade of industrial goods and processed agricultural products, requires Turkey's harmonization with the EU's common trade policy and the removal of all mechanisms that may cause unfair competition. The upcoming section of the study will elaborate this unfair competition widely.

## Current Situation and the Renewal of Customs Union

The CU has a central position in the field of economic and commercial relations, which is one of the most important issues in Turkey-EU relations. The CU, which envisages the abolition

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<sup>14</sup> Özşümer, Sıla. "Türkiye-Avrupa Birliği Gümrük Birliği Anlaşması ve Yeni Düzenlemeler." *İzmir Ticaret Odası* (2016).

<sup>15</sup> Tezel, T., "AB Türkiye Gümrük Birliği'nin Güncellenmesi", *Süt Dünyası Süt Ürünleri Gıda Tarım ve Hayvancılık Dergisi*, 12(64), 30-31, (2017).

<sup>16</sup> Kalaycı Cemalettin and Cem Küçükali, "Türkiye Avrupa Birliği İlişkilerinin Geleceği: Gümrük Birliği'nin Güncellenmesi", *İşletme ve İktisat Çalışmaları Dergisi*, 6(3), 13-23, (2018).

<sup>17</sup> Koçtürk, Murat O. and Aslıhan, Kocaefe, "Serbest Ticaret Anlaşmalarının Türk Dış Ticareti Üzerine Etkileri". *Tarım Ekonomisi Dergisi*, 20(2), 65-77, (2014).

of customs duties, quantity restrictions and all kinds of measures with equivalent effect in the trade of industrial products, and Turkey's harmonization with the EU Common Customs Tariff and foreign trade policy, as well as the harmonization of legislation on issues such as competition, intellectual property and consumer rights related to the market order, is quite advanced economic integration method.<sup>18</sup> Turkey became the only country other than city-states such as Andorra and San Marino that formed a customs union with the EU without becoming a member. However, in an environment where membership was not yet on the horizon, it was adopted as an important tool for improving relations with the EU and gaining international confidence by joining Turkey, which was going through political and economic difficulties. The main argument presented to the public by the leaders who accepted the CU decision at that time was that the CU was the last stage before full membership to the EU and that Turkey would complete this integration by entering the EU in 4-5 years.<sup>19</sup>

With the Association Council's decision numbered 1/95 in 1995, it was aimed to start the CU process in 1996, and it was thought that full membership to the EU would be realized in the very near future. However, contrary to expectations, the prolongation of this process and the fact that it has become increasingly uncertain has brought along some problems for Turkey arising from entering the CU without being a full member of the EU.<sup>20</sup> Due to some missing points regarding the CU, serious asymmetrical situations have arisen in the decision-making process between Turkey and the EU. While the member states are represented in the EU institutions and take part in the decision process, one of the most important examples in this context is that although Turkey has responsibilities towards the EU within the scope of the CU, it has no authority over the EU and is not represented. Wherefore EU has signed an FTA with different countries and the negotiation process is carried out by the EU Commission on behalf of the member states, Turkey's interests in these negotiations are not represented by the Commission because it is not a full member. At this point, within the scope of the CU, Turkey must sign similar agreements with the countries with which the EU has signed an FTA, in order not to experience disadvantages both legally and commercially. This situation weakens Turkey's position in FTA negotiations with these countries.<sup>21</sup> Turkey has signed FTAs with many countries with which the EU has reached an agreement in order not to be disadvantaged.<sup>22</sup>

Another asymmetrical structure example for Turkey is while the goods within the scope of free trade belonging to the countries that have signed an FTA with the EU can come to Turkey duty-free, the fact that the goods belonging to Turkey can go to these countries duty-free depends on Turkey's FTA with those countries. In this context, some countries, aware of the fact that they can send their goods to Turkey duty-free when they come to an agreement with the EU, are not willing to sign an FTA with Turkey. Thus, Turkey falls into a disadvantageous position in bilateral trade against countries that have signed an FTA with the EU but do not want to sign an FTA with Turkey.<sup>23</sup>

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<sup>18</sup> Nas, Çiğdem, "Gümrük Birliği Neden Güncellenmeli?". PERSPEKTİF (2020). <https://www.perspektif.online/gumruk-birligi-neden-guncellenmeli/#:~:text=G%C3%BCmr%C3%BCk%20Birli%C4%9Fi'nin%20g%C3%BCncellenmesi%20durumunda,bir%20g%C3%BCven%20ortam%C4%B1n%C4%B1n%20olu%C5%9Fturulabilmesi%20gerekiyor,> Access date: 12 April 2022.

<sup>19</sup> Nas, "Gümrük Birliği Neden Güncellenmeli".

<sup>20</sup> Kalaycı Cemalettin and Cem Küçükali, "Türkiye Avrupa Birliği İlişkilerinin Geleceği: Gümrük Birliği'nin Güncellenmesi", p. 16.

<sup>21</sup> Özşümer, Sıla, "Türkiye-Avrupa Birliği Gümrük Birliği Anlaşması ve Yeni Düzenlemeler".

<sup>22</sup> Kalaycı Cemalettin and Cem Küçükali, "Türkiye Avrupa Birliği İlişkilerinin Geleceği: Gümrük Birliği'nin Güncellenmesi", p. 17.

<sup>23</sup> Kalaycı Cemalettin, "Serbest Ticaret Anlaşmalarının Türkiye'nin Dış Ticaretine Etkileri: Açıklanmış Karşılaştırmalı Üstünlükler Endeksi Uygulaması", *Uluslararası Ekonomi ve Yenilik Dergisi*, 3 (2), 133-147, (2017).

When comes to the present, the process for updating the CU was blocked after 2016. Based on the impact analysis it had commissioned, the European Commission requested the EU Council of Ministers to start negotiations with Turkey on modernisation of the CU. However, restrictions on rights and freedoms within the scope of the state of emergency declared after the coup attempt of 15 July 2016 in Turkey, especially the transition to the Presidency executive system as a result of the Constitutional referendum on 16 April 2017, and the problems regarding the independence of the judiciary and legal procedures prevented the granting of this authority. Member states, especially Austria and Germany, blocked the way of authorization in the Council. Even after the lifting of the state of emergency in Turkey, the lack of progress on the issues criticized by the EU resulted in the Council's position being recorded in writing.<sup>24</sup> The conclusion document of the General Affairs Council convened on 26 June 2018 included the following statement: "The Council notes that Turkey has been moving further away from the EU. Turkey's accession negotiations have therefore effectively come to a standstill and no further chapters can be considered for opening or closing and no further work towards the modernisation of the EU-Turkey CU is foreseen."<sup>25</sup>

## Conclusion

Turkey and the EU has a long history and bilateral relations. Turkey started its journey with the expectations to become one of the member states of the Union, however, during the time both because of Turkey's mistakes and EU's changing conditions to become a member, Turkey gradually lost its hopes to become a full member. Yet, economic and trade relations have significant place for developing and globalising countries and not having a full membership to any union is not an obstacle for building these sorts of relations. From the point of this, at least as a step before the full membership, Turkey could get established a customs union with the EU.

Although the CU established between the EU and Turkey does not provide any prospect for Turkey to join the EU, it has opened a very important trade area for the country. Turkey on the other hand is also an important trade partner for the EU. Unfortunately, the CU also has its shortcomings. As mentioned throughout the study, it leaves Turkey in a disadvantageous position. The issue of the renewal of the CU, which came to the fore in 2016, is of utmost importance in order for Turkey to get rid of its disadvantaged position and to establish a more just competition environment.

In the light of all these evaluations, it can be said that the most ideal solution in the short term is to update the CU in order to eliminate the problems that Turkey has experienced due to the CU, since it is not a full member of the EU, and to continue the EU membership process, which started in 1959. Therefore, Turkey should devote its full attention to the negotiations to update the CU, which has already begun, and should endeavour to ensure that the scope of the CU is expanded to the desired extent. In this context, legal steps should be accelerated in order to minimize Turkey's losses arising from the current asymmetrical situation.

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<sup>24</sup> Nas, "Gümrük Birliği Neden Güncellenmeli".

<sup>25</sup> "General Affairs Council, 26 June 2018". Consilium.Europa.Eu. <https://www.consilium.europa.eu/en/meetings/gac/2018/06/26/>. <https://www.consilium.europa.eu/media/35863/st10555-en18.pdf> p. 13, section 35, Access date 15 April 2022.



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