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The Modernization of the European Union's Customs Union with Turkey

Turkey's Pro-Customs Union Rhetoric and Recent Approach of Turkish Political and Business Decision-Makers

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The project

The future of the EU's Customs Union with Turkey

Still a candidate for membership in the European Union, Turkey has outgrown the status of one-sided dependency on the EU. Ankara developed a more independent foreign policy that entails both areas for cooperation with Brussels but also for conflicts with the EU and its member states. Cases in point are the cooperation on migration on the one hand side and tensions with Greece and Cyprus in the eastern Mediterranean on the other. The EU needs working channels for communication and cooperation with Turkey. However, membership negotiations stall, talk on visa liberalization stuck, and the European Council blocks the opening of talks to re-negotiate the Customs Union.

To look for ways to overcome the deadlock, CATS and think tanks from five EU member states are looking into the respective nation debates on the economic and political pros and cons of re-negotiating the Customs Union. We find an overall interest in the deepening of economic cooperation and a variety of political issues to be addressed once working relations with Turkey are established.

This report is part of this joint endeavour in which the Centre for Applied Turkey Studies (CATS) cooperates with Institut français des relations internationales (IFRI), Paris; Elcano Royal Institute (Elcano), Madrid; The Polish Institute of International Affairs (PISM), Warsaw; Istituto Affari Internazionali (IAI), Rome and Hellenic Foundation for European and Foreign Policy (ELIAMEP), Athens.

The Turkish government has been very vocal about the modernization of Turkey's Customs Union with the EU. However within the context of the Customs Union there are some execution points which the Turkish government has to complete and it has been criticized heavily for not having done this in the last several years. For instance, the government has been taking heat about drifting away from a rule-oriented economic environment. State intervention in the markets via "independent" institutions or state-owned enterprises, state aids, constantly changing pricing mechanism in some industries, and non-merit-based promotions have been a concern for both the EU and institutional investors around the globe.

Summary

The need for a modernized Customs Union seems obvious based on the fact that it has been almost 25 years since the European Union (EU) and Turkey were linked by the Customs Union which came into force in 1996. Since then the world economy and trade have become more globalized and interlinked, the EU has grown from 15 member states to the current 27, and Turkey has radically changed in terms of civil society, economics and political landscape. There are also specific flaws stemming from the implementation and nature of the Customs Union agreement, such as Free Trade Agreements (FTAs) of the EU with third countries. For instance, when the EU signs an FTA agreement with a third country, by definition that country can also sell its products to Turkey with the conditions set by the Customs Union agreement and access to the Turkish market. However, Turkey cannot sell its products to that same country under the Customs Union conditions. Such is the nature of the Customs Union Agreement, and Turkey is dissatisfied about this situation. If the Customs Union is modernized it will likely be by liberalizing agriculture, services and public procurement and by improving the implementation of the agreement. We have witnessed impact assessments from both the EU and Turkey as well as independent opinion papers which roughly state that both parties would benefit from the modernization of the Customs Union, to a degree. Specifically, it is safe to underline that Turkey may possibly see more benefit from a modernized Customs Union not only in terms of higher GDP per capita but also, increased institutionalization, better regulatory framework and higher convergence to the EU in many areas. Even though these are powerful reasons for Turkey to pursue the modernization process, Turkey and the EU have not been able to drive the process further due to impediments such as the heavy election agenda of Turkey, the coup attempt and the breakdown of Turkey's EU membership talks between parties. It appears that much of the work related to the modernization of the Customs Union was completed between 2014 and 2017 and since then the status of the modernization has been in "stand-by" mode.

Current Status and Approach of Turkish Political and Business Decision-Makers

- Turkey is keen on starting the negotiations although political conditions attached as pre-conditions to the modernization of the Customs Union create disappointment and demotivation
- The recent pandemic period and world supply chain disruptions could create an opportunity for re-energizing the focus for the modernization
- Some implementations and policy actions of the Turkish government, related to the major headlines (public procurement, state aid, etc.), create discrepancy between Turkey's intentions and real actions
- Both Turkish and European business decision-makers seem to be more eager than politicians concerning the modernization

- As years pass and no concrete steps are seen for the modernization of the Customs Union, the possibility of a deal is becoming more challenging and the modernization seems less attractive

Still, under the current tense status of relations between the EU and Turkey, the modernization seems to be a more realistic policy option than either visa liberalization or Turkey's membership to the EU. Customs Union modernization could even serve as an opportunity for a better future conjuncture of EU-Turkey relations. In this context, the aim of this paper is to examine how the discussion of the modernization of the Custom Union came into being and to present the current perspectives of Turkish political and business decision-makers regarding this discussion.

A Brief Recap of the Customs Union and Transformation

The Customs Union is based on the Ankara Agreement between Turkey and which was then the European Economic Community (EEC). Ankara Agreement was signed between parties in September 1963 and came into force in December 1964. An additional protocol was also signed giving Turkey a 'transition phase' of 22 years¹. On 6 March 1995, European Community–Turkey Association Council adopted a 'Customs Union Decision (Decision No 1/95)' to implement a new phase of association between Turkey and the European Community (as the EEC was renamed in 1993). In this way, the 22-year transition phase envisaged in the Additional Protocol was completed as of 1 January 1996 and the Customs Unions process started.

The Customs Union agreement covers only industrial and processed agricultural products. For coal and steel products, a preferential agreement is applied. On the other hand, industries like raw agriculture, services and public procurement are outside the Customs Union context.

Turkey undertook various alignments and regulation changes in order to adapt to the Customs Union framework. For instance, it aligned its trade policy and preferential trade agreements with third countries². Under the import regime the protection rate for third countries decreased to 5.4% in 2019 from 16% just before the Customs Union agreement³. With obligations stemming from the agreement related to competition policy and intellectual property, Turkey first introduced a Competition Law in 1994 and then established the Competition Authority in 1997. Within the same context also a Patent Institute was established in 1994 to align with the Customs Union. Turkey liberalized its economy and made its currency convertible in the late 1980s with the reforms undertaken by its eighth President Turgut Ozal. In the 1990s the Turkish economy struggled to apply Ozal's reforms during an era of political instability in the country. Obviously, establishment of the institutions mentioned above and regulatory alignment with the EU *acquis* aided Turkey in forming a more rule-oriented commercial environment and introduced transparency in State functions. Of course, these did not happen overnight and the Customs Union was not the only factor.

¹ Council of European Communities, *EEC–Turkey Association Agreement and Protocols and Other Basic Texts* (1992), https://www.ab.gov.tr/files/ardb/evt/EEC_Turkey_association_agreements_and_protocols_and_other_basic_texts.pdf (accessed 15 June 2020).

² According to the Turkish Ministry of Trade, since the inception of the Customs Union Turkey has signed 37 FTAs of which 20 remain effective today.

³ Turkish Ministry of Trade figures, <https://ticaret.gov.tr/dis-iliskiler/avrupa-birligi/gumruk-birligi> (accessed 16 June 2020).

During the economic crises of 2001 in Turkey the International Monetary Fund (IMF) and the World Bank designed other sets of reforms, and the following were adopted by Turkey: Telecommunications Authority⁴ (established in 2000), Energy Market Regulatory Authority (established in 2001), Public Procurement Authority (established in 2002), Banking Regulatory and Supervision Agency (established in 1999 but commenced operations in late 2000) and Tobacco, Tobacco Products and Alcoholic Beverages Market Regulation Authority⁵ (established in 2002).

Both the IMF/World Bank–designed reforms in 2000–2001 and the Customs Union–related regulatory alignment with the EU supported Turkey to go through a significant reform process in the business and economic area, whereas being a candidate member for the EU very much positively affected and transformed Turkish political and civil society. According to Acemoglu and Ucer,

*on the political side the EU shouldered a role similar to the one that the IMF and the World Bank played on the economic side in the aftermath of the 2001 financial crisis, providing both pressure for reform and a template for best-practice legislation in the areas of civil and political rights, civilian-military relations and judicial reform.*⁶

As Turkey benefitted from the transformation mentioned above especially between the years 2002–2006, the Turkish economy reached its fastest per capita growth since the 1960s during this period and performed above most of its peers.⁷

In 2005 Turkey officially started negotiations for membership with the EU and principles governing the negotiations were published.⁸

In May 2015, the EU Commission (Commission) and Turkey announced that they agreed on the modernization of the 20-year-old Custom Union⁹. Both parties welcomed the ongoing work on the upgrading of the Customs Union in March 2016 with the so-called -18 March reconciliation'.¹⁰ The coup attempt in July 2016 pushed the relations between parties into a rough patch as the Turkish government constantly expressed its disappointment towards the EU about their perceived hesitant response to the failed coup. In turn, the EU Council (Council) criticized the post-coup executions of the Turkish government and the declaration of state of emergency along with some policy actions of the Turkish administration under this mode. Although in December 2016 the Commission published a proposed impact assessment to modernize the Customs Union and to further extend the bilateral trade relations to areas such as services, public procurement and agriculture,¹¹ the Council has not yet given the mandate to the Commission to venture into negotiations with Turkey to update the Customs Union. In 2018 the Council stated that no

⁴The Electronic Communication Law (Law No: 5809) was introduced in 2008 and the name was changed to Information Communication and Telecommunications Authority.

⁵This Authority was shut down in December 2017, and all of its assets and human resources were transferred to the Ministry of Agriculture. As of today it operates under the Ministry of Agriculture. *Official Gazette, Article 76*, 24 December 2017, <https://www.resmigazete.gov.tr/eskiler/2017/12/20171224-22.htm> (accessed 14 June 2020).

⁶Daron Acemoglu and Murat Ucer, "The Ups and Downs of Turkish Growth 2002-2015 Political Dynamics, European Union and Institutional Slide," *NBER Working Paper Series*, October 2015, 20.

⁷*Ibid.*, 3.

⁸"Negotiation Framework EU-Turkey", Luxembourg, 3 October 2005, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/turkey/st20002_05_tr_framedoc_en.pdf (accessed 9 June 2020).

⁹European Commission, "EU and Turkey Announce Modernization of Custom Union", Brussels, 12 May 2015, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1307> (accessed 5 June 2020).

¹⁰European Council, "EU-Turkey Statement", Brussels, action point 7, 18 March 2016, <https://www.consilium.europa.eu/en/press/press-releases/2016/03/18/eu-turkey-statement/> (accessed 8 June 2020).

¹¹EU Commission, "Impact Assessment on Modernization of the Customs Union", Staff Working Document, 21 December 2016, https://trade.ec.europa.eu/doclib/docs/2017/january/tradoc_155238.pdf (accessed 22 June 2020).

further work towards the modernization of the Customs Union was foreseen¹² until Turkey moves on the matter of democratization and rule of law, and finally in June 2019 a very similar announcement was adopted by the Council.

Even though the relations between two sides were undulating in 2019 and 2020, Turkey is the EU's 5th largest trading partner and the EU is Turkey's number one trading partner, as well as source of investments¹³. Turkey and the EU are also allies in issues related to security, counter-terrorism, immigration, etc.

¹² General Affairs Council, "Conclusion on Enlargement and Stabilization and Association Process", 26 June 2018, <https://www.consilium.europa.eu/en/press/press-releases/2018/06/26/council-conclusions-on-enlargement-and-stabilisation-and-association-process/> (accessed 21 June 2020).

¹³ European Commission 2019 figures,

Origins of Motivation for a Modernized Customs Union

It would be fair to say both parties started the modernization talks with high motivation. The EU Commissioner for Trade and the Turkish Minister of Economy decided to set up a senior Official Working Group (SOWG) in February 2014.¹⁴ The reason for this was to explore the possibilities to resolve current concerns regarding the structure and the functioning of the Customs Union as well as to further deepen and widen bilateral preferential trade relations. After several meetings, in April 2015 the SOWG announced that both parties agreed to work on three headlines¹⁵:

1. Better implementation and amendment of the Customs Union Agreement – Decision 1/95
2. Liberalization of agricultural products, services and public procurement
3. Better institutional structure

These three headlines also very well define what a ‘modernized’ or an ‘upgraded’ Customs Union would represent.¹⁶

In 2014 the World Bank,¹⁷ and in 2016 the Commission¹⁸ and the Turkish Minister of Economy¹⁹ adopted different impact assessments regarding the modernization. All three assessments showed both parties would benefit from the modernization albeit Turkey to a greater extent than the EU.

And finally in December 2016, the Commission requested a mandate from the Council to start the negotiations from the Council based on the impact assessment the Commission had conducted. That mandate was not given, and since then no further concrete steps have been observed.

¹⁴ Report of the Senior Official Working Group on the Customs Union, 27 April 2015, https://trade.ec.europa.eu/doclib/docs/2016/march/tradoc_154367.pdf (accessed 18 June 2020).

¹⁵ *Ibid.*

¹⁶ In almost all the documents that have been produced by the European Commission about this issue, the term ‘modernisation’ is used. On the other hand, in the documents produced by Turkish officials the term ‘up-grade’ is mostly used.

¹⁷ World Bank, “Evaluation of the EU-Turkey Customs Union”, report no. 85830-TR, 28 March 2014.

¹⁸ BKP, Panteia, AESA, “Study of EU-Turkey Bilateral Trade Framework, Including the Customs Union and an Assessment of Its Possible Enhancement”, 26 October 2016, https://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2016/turkey_anx6_en.pdf (accessed 17 June 2020).

¹⁹ Turkish Ministry of Trade, “Impact Analysis of the Update of the Customs Union Agreement”, Press Release, <https://ticaret.gov.tr/data/5b87239113b8761450e18ee6/Etki%20Analizi%20-%20Bas%C4%B1n%20Bildirisi.pdf> (accessed 29 June 2020).

Current Stance of the Turkish Administration, Political Parties and Business Organizations towards Modernization of the Customs Union

Government and the Administration

Most of the technical work (impact assessments, establishment of working groups, etc.) regarding the modernization was completed between 2014 and 2017. It can be stated that by 2018, with further deterioration of relations between Turkey and the EU, the modernization of the Custom Union talks had also halted. Despite this, the Turkish government has been and is very vocal, constantly asserting its motivation concerning the modernization. However, while political prerequisites to the modernization create demotivation for the Turkish government, on the other hand the recent pandemic era can create a window of opportunity.

Some recent and diversified policy actions are examined below to find a clue regarding the current approach of Turkey's political decision-makers (the President, the Turkish government, related ministries) to the modernization.

Recent Policy Actions of Turkish Administration on Customs and Imports

With several different presidential decrees, the Turkish government introduced higher import tariffs on a wide range of close to five thousand different items in April, May and June 2020.²⁰ The official approach to this policy action was that Turkey would make it harder to import goods, except for strategic products and those that cannot be produced domestically. Accordingly, it was also noted that the action had been taken in order to

²⁰ *Official Gazette*, 28 June 2020, 20 May 2020, and 11 April 2020, <https://www.resmigazete.gov.tr/eskiler/2020/06/20200628-20.pdf>
<https://www.resmigazete.gov.tr/eskiler/2020/05/20200520-10.pdf>
<https://www.resmigazete.gov.tr/eskiler/2020/04/20200418-9.pdf>
(all accessed 1 July 2020).

protect local producers. More importantly, in talking to the media the Minister of Finance implicitly stated that 'importing goods will not be easy'.²¹

However, according to the impact assessment conducted by the Commission in 2016, with the modernization of the Customs Union Turkey's imports from the EU will significantly rise.²² According to the assessment, in the most desirable scenario for Turkey, its imports from the EU will increase by 28.4 billion euros whereas the increase in exports is predicted to be limited to 4.9 billion. As a result, Turkey's foreign trade deficit to the EU is expected to increase by 23.5 billion euros. However, when FTAs are taken into account the overall trade deficit will come down to 10.4 billion euros. In short, one of the most desirable scenarios states that Turkey's imports will significantly increase under the modernization.

When this scenario is analysed alongside the Turkish government's recent protectionist actions in April, May and June 2020 and the Finance Minister's statements,²³ one cannot but wonder whether the Turkish government will reshape its foreign trade policy and abandon its modernization target, given that the Commission's impact assessment points to significant increases in imports.

However, there is another angle to this story. In 2018, Turkey faced a currency crisis with a huge sell-off on the Turkish lira (TRY) amid criticism regarding the independence of the Turkish Central Bank, less market-friendly implementations of the Turkish government as well as political tensions between Turkey and the United States. All of this fuelled a credibility loss for the Turkish government and as a result this caused the TRY to significantly lose value against other major currencies.²⁴ A sliding TRY means higher inflation, melting foreign currency reserves of the Turkish Central Bank and more political problems for the Turkish government. Based on this, the Turkish government had to impose diversified regulations and tighter controls on the TRY in order to prevent a further slide.

With the continued credibility loss of the government in 2019 and 2020, Turkish private and corporate investors moved their savings into foreign currencies rather than the TRY. As a result, Turkish local private and corporate deposit accounts totalled 202 billion United States Dollars (USD) as of June 2020. This amount is around 50% of all the cash/savings deposits in Turkey.²⁵ As a result, the Turkish government is working on trying to curb this 'dollarization'. However, rather than addressing how to restore credibility, the government is limiting imports by imposing higher taxes; as a natural consequence of declining imports, demand for foreign currencies will also be lower. In this way the Turkish government is seeking to stabilize the currency.

So, even though the imposition of higher tariffs and the pronouncements by the Minister of Finance could be evaluated as conflicting with modernizing the Customs Union agreement, it should be noted that these actions may be only short-term solutions to curb the surging foreign currency demand by Turkish corporate and private investors. Also it is

²¹ "'Importing Goods will not be easy' Turkish Finance Minister says", *Reuters*, 21 May 2020,

<https://uk.reuters.com/article/uk-turkey-economy/turkish-minister-says-importing-goods-will-not-be-easy-anaadolu-idUKKBN22W1V5> (accessed 3 July 2020).

²² BKP, Panteia, AESA [Footnote 18], 183.

²³ *Reuters* [Footnote 21].

²⁴ TRY was depreciated by 39.4%, 11.1% and 23.3% against the USD in 2018, 2019 and 2020 respectively.

Data of Turkish Central Bank, TRY hit all-time low against USD at 7.42 per USD on 24 Aug.

2020. <https://www.tcmb.gov.tr/wps/wcm/connect/tr/tcmb+tr/main+menu/istatistikler/doviz+kurlari/gosterge+niteligindeki+merkez+bankasi+kurlari> (accessed 24 June 2020).

²⁵ Weekly banking data of Turkish Central Bank, June 2020,

<https://www.tcmb.gov.tr/wps/wcm/connect/EN/TCMB+EN/Main+Menu/Statistics/Monetary+and+Financial+Statistics/Weekly+Money+and+Banking+Statistics/> (accessed 24 June 2020).

important to note that some of the recent taxes on imports will be valid until 30 September 2020 and others through year end. It is expected that the new taxes could be gradually lifted²⁶ and would thus be temporary.

It is too early to come to a conclusion on whether Turkey is going to make a radical shift in its trade and customs policy. The actions related to imports seem geared more towards stabilizing the TRY in the short term rather than a calculated shift in customs and trade policy.

As a result, if the Council turns on the green light for Turkey's Customs Union modernization process, it seems likely that Turkey will pursue this option albeit in a more detailed manner and possibly under the auspices of a new impact assessment and analysis.²⁷

Long-Term versus Short-Term Impacts of the Modernization

It is obvious that a government should calculate the impacts of any reform or large-scale policy issue that would deeply impact the country's economic and social life. Some of these impacts can be observed in the short term whereas others become evident in the long term.

Over the last several years, Turkey has witnessed a discretionary management style which has become significant especially with new presidential governance system. The Customs Union modernization entails reallocation of resources and funds, changes in regulations, and a more rule-based economic and civil society as opposed to a discretionary management style. There will be companies which will be positively impacted by the upgrade, whereas others will be impacted negatively. Less competitive and productive companies will experience challenges in keeping their footing, and some small and medium-scale enterprises (SMEs) might end up with complications in competing and reaching out to funds and resources in the short term. It could be argued that when the modernization of the Customs Union is implemented, initially Turkey could be expected to observe negative impacts in the short-term but with the increasing foreign direct investments (FDI) and productivity, positive impacts of modernizing the Customs Union will be observed in the longer term.²⁸

The Turkish business landscape is quite diversified. There are business groups (for instance the construction industry) that are close allies of the government and have expanded their business significantly during the last 15 years; and there are others (such as the Turkish Industry and Businessmen Association – TUSIAD) that stand in a relatively more distant position to the government. If as a result of the Customs Union modernization business groups that are close allies to the current government end up having challenges in competition and access to resources, possible conflicts might arise between such groups and the government. These conflicts could be social, economic and political.

As a result, in order to avoid such conflicts and negative impacts, especially during an election period, the Turkish government will revisit its priorities to accommodate the modernization to the election schedule. As a reminder, currently Turkey is officially set to

²⁶ Interview with an official familiar with the subject.

²⁷ Impact assessments conducted by both EU and Turkey are dated 2016. Probably new/updated analysis would be needed.

²⁸ Statement by the Chairman of IKV, "Strengthening EU and Turkey Relations Is Vital for Regional and Global Stability and Security", 3 June 2020, <http://www.eurochambres.eu/Content/Default.asp?PageID=1&DocID=8442> (accessed 22 June 2020).

execute both the presidential and parliamentary elections in 2023 unless there is an early or snap election.

On the other hand, there could be short-term positive impacts of the modernization. Throughout the last several years, the Turkish government has been taking a lot of heat for drifting away from the Western world.²⁹ If Turkey and the EU recommence discussion on modernization of the Customs Union, this will send a strong message to institutional investors around the globe. It will demonstrate that Turkey is still a part of Europe and is trying to achieve a good level of alignment with the EU *acquis*. This could in turn attract investors and funds into Turkey, which would help the TRY to stabilize and ease the currency problems. In addition, with the support of local media, it could generate a very positive atmosphere within the country. Even the news that ‘Turkey and the EU are starting to negotiate the modernization’ could create leverage for the Turkish government.

As a result, long-term versus short-term impacts could play a crucial role on the timing and public communication of the modernization. This would be a very important variable to assess the modernization strategy and roadmap of the Turkish government based on the election period.

The Modernization of the Customs Union Is Owned at the Presidential Level

Since 2014 the Turkish governments, all of which were formed by the Justice and Development Party (AKP), have been keen on starting the negotiations to modernize the Customs Union agreement. The public announcements made by the governments have always been supportive of the modernization, and this approach has for the most part been reflected and observed in the government programmes.

In November 2015, the newly elected 64th government was the first to adopt the modernization of the Customs Union into its programme.³⁰ Each subsequent government has also adopted it into their programmes as a policy action. Beyond the government programmes, also important is the Turkish State’s strategic document ‘medium term economic programme’ (MTEP). The MTEP stipulates a very detailed economic policy of the country and is prepared for the following two years. The MTEP for 2016–2018³¹ was prepared in 2015 and was the first to include the modernization of the Customs Union. Following all MTEPs have ranked modernization of the Customs Union agreement as an execution point. It is important to note that the MTEPs for the periods 2019–2021³² and 2020–2022³³ are the two that were prepared under the new presidential system of Turkey. The MTEPs are now prepared by the Strategy and Budget Directorate of the

²⁹ EU Commission, ‘Turkey Report 2019’, Staff Working Document, 29 May 2019, 105, <https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-turkey-report.pdf> (accessed 22 June 2020).

³⁰ 64th Government Programme of Turkey, 25 November 2015, 142, https://media-cdn.t24.com.tr/files/20151125175322_64.hukumet_programi.pdf (accessed 28 June 2020).

³¹ ‘2016-2018 Medium Term Economic Programme of Turkey’, 11 October 2015, article 207, p. 18, <http://www.sbb.gov.tr/wp-content/uploads/2018/11/Medium-Term-Programme-2016-2018.pdf> (accessed 28 June 2020).

³² ‘2019-2021 Medium Term Economic Programmes of Turkey’, Current Account Section, 20 September 2018, http://www.sbb.gov.tr/wp-content/uploads/2018/11/YeniEkonomiProgram%C4%B1_OVP_2019-2021.pdf (accessed 28 June 2020).

³³ ‘2020-2022 Medium Term Economic Programmes of Turkey’, Foreign Trade Section, 4 October 2019, http://www.sbb.gov.tr/wp-content/uploads/2019/10/YeniEkonomiProgrami_OVP_2020-2022.pdf (accessed 28 June 2020).

Presidency of the Republic of Turkey and the Ministry of Treasury and Finance. MTEPs are published in the Official Gazette with the approval and signature of the President of Turkey. Based on this, it could be argued that the modernization of the Customs Union is owned at the presidential level.

In parallel with this, Turkey has a Reform Monitoring Group (RMG) that was established in 2003 to screen actions and reforms for the EU membership. Under the new name Reform Action Group (RAG), its profile was upgraded in 2014. In August 2018, a RAG meeting was held with the participation of four high-profile ministers: the ministers for Foreign Affairs, Justice, Interior Affairs and Finance. This was the first RAG meeting in three years. In May 2019, the ninth meeting was held under the chairmanship of the President of Turkey and under the coordination of the Directorate for European Union Affairs. Other participants of the RAG meeting were the Minister of Justice, Minister of Foreign Affairs, Chief Negotiator, Minister of Finance and Minister of Interior Affairs. This was the first such meeting to be chaired by the President. The post-meeting public announcement included strong commitments both to political issues and to the modernization of the Customs Union.³⁴

While all these statements, meetings or references to the modernization in state documents could be deemed somewhat generic in nature (i.e., rhetorical rather than action-oriented), the RAG meeting under the President's chairmanship and declarations of strong commitment to Turkey's EU relationships and to the modernization of the Customs Unions could also be evaluated as strong messages to the EU leadership. After the coup attempt in 2016, the Turkish administration was heavily criticised by the Council for implementing anti-democratic policies, causing relations to further deteriorate. With the RAG meetings, constant public references to EU membership and to modernization of the Customs Union, the Turkish administration seems determined to show Turkey's willingness to mend ties with the EU.

The Ministry of Trade's Approach Shows Turkey's Technical Work Is Still Alive

One of the key stakeholders related to the modernization is the Ministry of Trade. The Ministry completed consultation reports with its public and private stakeholders in order to determine the positions of the Turkish government for each Customs Union headline that will be discussed with their EU counterparts.³⁵ In its strategic plan document the Ministry of Trade stated that the modernization of the Customs Union has become urgent due to the gridlock in the membership negotiations between Turkey and the EU.³⁶ For an official state document to define the modernization of the Customs Union as 'urgent' vis-à-vis suspension of membership negotiations is a very rare move on the part of the Turkish State, since it could raise the question whether the Customs Union is seen as an alternative to EU membership. This would not be exactly in line with the Turkish State's official policy, which continues to target EU membership. In this sense, this could be evaluated as an interesting point revealing the perception of the Ministry of Trade on the subject. In addition to this work, the Ministry established a consultation group that would coordinate the future consultations and execution points related to the modernization of

³⁴ Turkish Ministry of Foreign Affairs, "RAG Meeting Press Release, 9 May 2019, 5, https://www.ab.gov.tr/siteimages/birimler/sidb/press_release_of_rag_6th_meeting_.pdf (accessed 28 June 2020).

³⁵ Turkish Ministry of Trade [Footnote 19].

³⁶ Turkish Ministry of Trade, "Strategic Plan 2019-2023", 6 August 2019, 118, <https://ticaret.gov.tr/yayinlar/stratejik-plan> (accessed 29 June 2020).

the Customs Union and Brexit. This group was established in February 2019 and includes members from the Ministry of Foreign Affairs, the Ministry of Trade and members of non-governmental organisations (NGOs) from the business world such as the Economic Development Foundation (IKV) and the Economic Policy Research Foundation of Turkey (TEPAV).³⁷

Another notable work on the part of the Ministry of Trade was related to the compliance of the Turkish customs regulations to the EU *acquis*. According to the analysis completed by the Ministry of Trade, the Turkish customs regulations were 60% compliant with the *acquis* in 2019 and will be 70% compliant by 2020.³⁸

It is safe to underline that one of the key stakeholders is executing indispensable work and engaging both the public and the private sector within its own responsibilities and limitations concerning the modernization.

However, under the new presidential system of Turkey, most of the cabinet members are not politically influential figures since under the new system ministers cannot be selected from the parliament. Accordingly, most of the current cabinet members are either ex-bureaucrats or technocrats who are not even a member of the ruling party. The Minister of Trade is one of these technocrat ministers with no or very little political power. So even if the Ministry of Trade assesses the modernization as urgent, the Ministry holds limited power to trigger the Turkish government towards reforms or to convince their counterparts in the EU, given the reasons mentioned above and the nature of the complex political issues.

Pandemic Period: An Opportunity to Re-energize the Focus on the Customs Union and Germany's Presidency of the EU Council

With the recent pandemic, the Turkish government seems to be eager to use diplomatic tools to increase communication in the international arena. The window of opportunity lies in Turkey's relatively strong healthcare infrastructure, intensive-care unit capacity and experience in logistics and supply-chain capabilities.³⁹ The Turkish government launched emergency state hospitals with the aim of health tourism mainly addressing elderly COVID-19 patients in Europe,⁴⁰ and sent supplies of medical equipment to 80 countries.⁴¹ These moves can serve as diplomatic tools to establish better relations with world neighbours, and especially with the EU. In addition, the disruptions in China's supply-chain operations during the pandemic and the EU's dependence on Chinese supplies could create an opportunity for Turkey. Turkey could be an important player with its relatively skilled labour force, its experience in logistics and its geographic advantage. It could be expected that both the Turkish government and business NGOs

³⁷ Turkish Ministry of Trade, Document Related to "Consultations and Executive Meeting on Modernization Customs Union", 5, <https://ticaret.gov.tr/data/5b87239113b8761450e18ee6/Sivil%20Toplum%20Kurulu%C5%9Flar%C4%B1n%C4%B1%20Bilgilendirme%20Toplant%C4%B1lar%C4%B1.pdf> (accessed 29 June 2020).

³⁸ Turkish Ministry of Trade, "Strategic Plan 2019-2023", 6 September 2019, 117-18, <https://ticaret.gov.tr/yayinlar/stratejik-plan> (accessed 29 June 2020).

³⁹ "Why Is Turkey Better Equipped to Tackle the Coronavirus", *TRT World*, 16 March 2020, <https://www.trtworld.com/turkey/why-turkey-is-better-equipped-to-tackle-coronavirus-34610> (accessed 1 July 2020).

⁴⁰ "Istanbul Gets 2 More Pandemic Hospitals", *Daily Sabah*, 31 May 2020, <https://www.dailysabah.com/turkey/istanbul/istanbul-gets-2-more-pandemic-hospitals> (accessed 1 July 2020).

⁴¹ "Turkey Sent Aid to 80 Countries to Help Battle COVID-19, Vice President", *TRT World*, 15 May 2020, <https://www.trtworld.com/turkey/turkey-sent-aid-to-80-countries-to-help-battle-covid-19-vice-president-36336> (accessed 1 July 2020).

would implement a possible communication strategy with their counterparts promoting Turkey's relative health and supply-chain capabilities.

Also, back in 2016, the Syrian migration crisis gave Turkey an opportunity to sit down with the Council and lent impetus to relations. In 2016 as tensions between Turkey and the EU increased due to the illegal migration of Syrians from Turkey to Europe, this created an opportunity for the EU and Turkey to come to an understanding on this issue and to reconcile on many other issues. One of these was the modernization of the Customs Union. In the 18 March 2016 reconciliation⁴² between the Council and Turkey, it was stated that ongoing work regarding the Customs Union was very much welcomed. Even though the reconciliation was more directly related to the Syrian migration crisis, Turkey was successful in including the Customs Union modernization thereby demonstrating the importance of the modernization for Turkey. With the recent pandemic, the Turkish Ministry of Foreign Affairs believes there could be an opportunity similar to that provided by the Syrian migration crisis and the 18 March reconciliation, and this could pave way for the modernisation talks to reaccelerate.⁴³ In June 2020, the Deputy Minister of Foreign Affairs and Director for EU Affairs Ambassador Faruk Kaymakci participated in a meeting entitled 'Post COVID-19 Turkey-EU Relations' with Christian Berger, Head of the EU Delegation to Turkey. Apparently Mr Kaymakci underlined the importance of economic relations between Turkey and the EU in terms of reducing the negative impacts of the pandemic in Europe.⁴⁴ The president of Turkey's biggest business NGO, Union of Chambers and Commodity Exchanges of Turkey (TOBB), and the president of Eurochambres were also present at the meeting. Turkey seems to be making use of the pandemic crisis to bring trade-related issues forward as an agenda item.

It should also be noted that due to the pandemic both parties might need each other more than ever, at least economically. According to the IMF, the Turkish economy will shrink by 5% in 2020 with an unemployment rate of 17.2% whereas the EU's growth rate will be -7.5% with an unemployment rate of 10.5%.⁴⁵ With these forecasts, trade-related policy options might climb to higher steps in EU-Turkey relations.

Another important development for Turkey is the presidency term of Germany in the Council of the EU. Turkey and Germany have strong historic ties with millions of Turkish-originated individuals living in Germany. Almost 45 million tourists visited Turkey in 2019 and 11% of these belonged to Germany.⁴⁶ Germany also constitutes 9% of Turkey's overall foreign trade⁴⁷ and contributes 6% of foreign direct investments flowing to Turkey.⁴⁸ Although the relations at the top level seem to be tight, given the natural ties between Turkey and Germany, as well as Germany's leadership, power and ability to take action within the EU bodies, Turkey could have a better chance to re-energize the modernization talks under the presidency of Germany compared to the following two

⁴² European Council [Footnote 10].

⁴³ Webinar of IKV, "Turkey, EU Relations and Germany's EU Presidency", 28 May 2020, https://www.ikv.org.tr/ikv.asp?ust_id=3631&id=3817 (accessed 4 July 2020).

⁴⁴ Directorate of EU Affairs, Turkish Ministry of Foreign Affairs website, 11 June 2020, <https://www.ab.gov.tr/deputy-minister-of-foreign-affairs-and-director-for-eu-affairs-ambassador-faruk-kaymakci-participated-in-a-teleconferenc-52035-en.html> (accessed 12 June 2020).

⁴⁵ IMF data. According to the same data Germany's GDP will be -7.0% and unemployment 3.5% for 2020. See <https://www.imf.org/en/Publications/WEO> (accessed 9.6.2020).

⁴⁶ Turkish Ministry of Tourism, 2019 year-end data, <https://yigm.ktb.gov.tr/TR-249709/yillik-bultenler.html> (accessed 28 June 2020).

⁴⁷ Turkish Ministry of Trade, 2019 year-end data, [https://ticaret.gov.tr/istatistikler/dis-ticaret-istatistikleri-2019-2020-ocak-nisan-donemi-genel-ticaret-sis-temi%C3%9Ckelere%20G%C3%B6re%20D%C4%B1%C5%9F%20Ticaret](https://ticaret.gov.tr/istatistikler/dis-ticaret-istatistikleri/dis-ticaret-istatistikleri-2019-2020-ocak-nisan-donemi-genel-ticaret-sis-temi%C3%9Ckelere%20G%C3%B6re%20D%C4%B1%C5%9F%20Ticaret) (accessed 29 June 2020).

⁴⁸ Investment Office of the Presidency of Turkey, 2018 year-end data, <https://www.invest.gov.tr/en/whyturkey/pages/fdi-in-turkey.aspx> (accessed 29 June 2020).

term presidencies of the Council, Portugal and Slovenia, respectively. However, the Programme for Germany's Presidency of the Council does not incorporate a policy action related to Turkey and the modernization of the Customs Union.⁴⁹ It could be argued that Germany's presidency could have been an opportunity for Turkey several months ago but after the launch of the Programme for Germany's Presidency of the Council, the chances seem to be lower now.

Political Criteria as a Pre-condition for Modernization of the Customs Union

Many members of Turkish politics criticize the EU for assigning political pre-conditions⁵⁰ to Turkey for the modernization of the Customs Union. This is mostly considered as unfair to Turkey and the Turkish economy and is one of the most dominant perspectives among Turkish politicians. The Council requests Turkey to take actions especially on democratic rights and freedom of speech. Actions and new policies on these sorts of political items seem like criteria imposed on Turkey, tied to the modernisation. Without taking any steps on these issues it seems challenging for Turkey and the EU to commence modernization talks.

Even though Turkey claims these political issues should be detached from the modernization of the Customs Union, for the EU nothing is fully economic. There is a social and political aspect to every negotiation and deal.⁵¹ The impact assessment on the modernization of the Customs Union, which was adopted by the Commission back in 2016,⁵² was a fully technical and analytical report with various foreign trade policy options and calculations. However, even in that economic report there was quite a wide spectrum related to human rights and social effects. Still, at the highest level the Turkish government is very vocal in expressing concerns about political criteria being a pre-requisite for the modernization of the Customs Union. The government explicitly underlines the argument that political and commercial issues should be detached and should not block each other.⁵³ As political criteria block the way, each year without a further step towards an agreement increases demotivation.

On the other hand the Turkish governments have long seen the modernization of the Customs Union as a chapter to be discussed within the context of membership

⁴⁹ "‘Together for Europe’s Recovery’: The Programme for Germany’s Presidency of the Council of the EU”, <https://www.eu2020.de/blob/2360248/978a43ce17c65efa8f506c2a484c8f2c/pdf-programm-en-data.pdf> (accessed 6 July 2020)

⁵⁰ "Parliament Wants to Suspend EU Accession Negotiations with Turkey", *European Parliament News*, quote from Kati Piri, 13 March 2019, <https://www.europarl.europa.eu/news/en/press-room/20190307IPR30746/parliament-wants-to-suspend-eu-accession-negotiations-with-turkey> (accessed 3 July 2020).

⁵¹ "Economy Is EU’s Only Leverage Against Turkey, Customs Union Is Important" [AB'nin Türkiye'ye karşı tek kozu ekonomi, Gümrük Birliği önemli], *BBC News* [Turkish], interview with Kati Piri, 22 June 2017, <https://www.bbc.com/turkce/haberler-dunya-40362908> (accessed 30 June 2020).

⁵² EU Commission, "Impact Assessment on Modernization of Customs Union", Staff Working Document, 21 December 2016, https://trade.ec.europa.eu/doclib/docs/2017/january/tradoc_155238.pdf (accessed 22 June 2020).

⁵³ "Modernization of the Customs Union Is a Must", public presentation by Ruhsar Pekcan, Minister of Trade, Voice of America, 5 February 2020, <https://www.amerikaninsesi.com/a/gumruk-birliginin-guncellenmesi-bir-zorunluluk/5275259.html> (accessed 19 June 2020).

negotiations.⁵⁴ The main approach to the modernization of the Customs Union was that this should not be an alternative or a privileged partnership as opposed to being a member of the EU. However, the challenges that have been observed during the negotiation period of membership talks, the coup attempt, and so on have driven the relations to a very tough spot.

Under the current circumstances, the Turkish government should decide on a more accurate and rational strategy for its EU relations. For the time being, this strategy could be using the modernization of the Customs Union as an anchor, a very useful tool for both achieving economic benefits and re-energizing the overall relationships between parties. Yet the Turkish government appears indecisive in changing its vision about how to manage the EU relations under the current circumstances. This could be seen as a restriction point for the Turkish government to take action in order to move forward with the Custom Union modernization.

Some Executions of the Turkish Government Do Not Fit with the Quest to Modernize the Customs Union

The Turkish government has been very vocal about the modernization, however within the context of the Customs Union there are some execution points which the Turkish government has to complete and it has been criticized heavily for not having done this in the last several years. For instance, the government has been taking heat about drifting away from a rule-oriented economic environment. State intervention in the markets⁵⁵ via independent institutions or state-owned enterprises, state aids, constantly changing pricing mechanism in some industries, and non-merit-based promotions have been a concern for both the EU and institutional investors around the globe.⁵⁶ Within this context, there are two important headlines in the scope of the Customs Union requiring improvement over Turkey's recent performance.

State aid is one of the headlines that is expected to be incorporated with a modernized Customs Union agreement. The main aim of the state aid regulation and implementation is to empower competition law while auditing and screening the state aid as per the EU's vision. Turkey adopted law no: 6065, on Monitoring and Supervision of State Aid, back in 2010.⁵⁷ However, the secondary legislation and implementation did not follow the adoption.

The challenging angle about the state aid issue is the Turkish State's presence in almost every strategic industry from telecommunications to banking and energy, either through SOEs or the Turkish Wealth Fund (TWF). Turkey established the TWF back in 2016 with the root aim of funding large-scale infrastructure projects without increasing the public debt while protecting Turkish assets against global economic fluctuations.⁵⁸ The TWF has a portfolio of 20 companies from eight different sectors, two licenses (sports betting and

⁵⁴ Sinan Ülgen and Dilek Pelin Yenigün, "The New Era for Customs Union and Business World", October 2015, 29.

⁵⁵ "IMF Says Turkish Monetary Easing Went 'Too Far', Calls for Neutral Fiscal Policy in 2020", *CNBC*, 27 December 2019, <https://www.cnbc.com/2019/12/27/reuters-america-imf-says-turkish-monetary-easing-went-too-far-calls-for-neutral-fiscal-policy-in-2020.html> (accessed 24 June 2020).

⁵⁶ Izak Atiyas, Tamer Cetin and Gurcan Gulen, *Reforming Turkish Energy Markets: Political Economy, Regulation and Competition in Search for Energy Policy*, 163.

⁵⁷ Law No:6065, Monitoring and Supervision of State Aids, *Official Gazette*, 23 September 2010.

⁵⁸ "Varlık Fonu: Ne amaçlanıyor? Neden Eleştiriliyor?" [TWF: What's the purpose? Why has it been criticized?], *Euronews*, 14 September 2019, <https://tr.euronews.com/2018/09/14/varlik-fonu-ne-amaclaniyor-neden-elestiriliyor> (accessed 30 June 2020).

lottery games) and real estate (various lands and buildings).⁵⁹ In one salient example, TWF holds shares in both of Turkey's telecommunication giants, Turk Telekom and Turkcell,⁶⁰ which together represent around 69% of the mobile telecommunications market. Thus the Turkish State, as an active commercial player, is now managing almost 69% of the mobile telecommunication industry via its TWF, whereas Vodafone has the remaining 31%. The figures are even more spectacular for the broadband market. The combined market share of the two giants is 92% whereas Vodafone controls only 8% of the broadband market.⁶¹ These implementations may have possible negative impacts such as distorting the competition, allocating the revenues of one portfolio company of the TWF for another one, transparency and accountability.

Another disputable issue about state aid is the gigantic infrastructure projects in Turkey. The Turkish State has always been a financing source for big infrastructure projects, and public-private partnership or build-manage-transfer models have been very popular among almost all Turkish ruling parties for decades. Istanbul's third bridge (connecting Asia to Europe), the new Istanbul Airport and the Eurasia Tunnel (an underwater car tunnel connecting Asia to Europe in Istanbul) are some examples. There are positive aspects of these projects as well as negatives. On the positive side they increase investment and create employment, hence growth. Also these projects are seen as a chance to renew the country's infrastructure. On the other hand, they create confusion about the allocation of public funds and resources in a non-transparent manner. These projects require some revenue commitments from the government to the private company operating the related infrastructure. For example, for the Eurasia Tunnel, the Turkish State granted a volume of 25 million cars (one-way) per annum to the private company operating the Tunnel.⁶² If the car pass falls under the committed 25 million, then the variance in revenue between the realised number and the committed number will be paid by the Turkish Treasury.

Within this context, these examples raise questions about the competitive environment and transparency of the Turkish commercial life and public administration. If Turkey implements a more converged regulatory framework and implementation to the EU *acquis*, it will be a more transparent public administration and market-friendly environment for the Turkish economy, and the country will be more ready for a modernized Customs Union.

The second vital headline of the modernization is the liberalization of the **public procurement** markets bilaterally. Accordingly, it is expected that Turkey would converge its public procurement regulations and implementations to the EU *acquis*. The public procurement market of Turkey was 7.4% of its GDP in 2017, where the figure dropped to 5.4% and then to 3.3% in 2018 and 2019 respectively.⁶³ The decline in the share of public procurement is associated with struggling economy of Turkey where GDP growth rates

⁵⁹ Ali Babacan is the former economy tsar and Foreign Minister of Turkey between 2002 and 2015. In 2019 Babacan broke away from the ruling party and founded his own party DEVA. Babacan describes TWF as a black hole for the economy with no transparency and accountability. See <https://www.gazeteduvar.com.tr/ekonomi/2020/07/02/babacan-varlik-fonunu-5-yil-kurdurmadim-iktidara-gelince-kapatagiz/> (accessed 22 June 2020).

⁶⁰ Please see TWF website www.tvf.org.tr.

⁶¹ ICTA, "Market Data Report 2009 4th Quarter", 2, <https://www.btk.gov.tr/uploads/pages/pazar-verileri/4-ceyrekraporu-2019-final.pdf> (accessed 23 June 2020).

⁶² Ismail Sahin, "3 yıllık geçiş ücreti 1 yılda ödenecek" [3 years' worth of granted payments will be made in 1 year], *Sözcü*, 6 May 2020, <https://www.sozcü.com.tr/2020/ekonomi/3-yillik-garanti-ucret-1-yilda-odenecek-5796103/> (accessed 14 June 2020).

⁶³ Data based on Turkstat and Public Procurement Agency,

<https://www.ihale.gov.tr/ihale-istatistikleri-45-1.html>
<http://www.turkstat.gov.tr/UstMenu.do?metod=temelist> (both accessed 1 July 2020).

were 7.4% in 2017, 2.6% in 2018 and 0.9% in 2019. If Turkey achieves better economic performance and higher growth rates, it is very probable that its public procurement share within its GDP will significantly rise. On the other hand, the EU's public procurement share was around 14% of its GDP in 2018.⁶⁴ In the case of a liberalization regarding public procurement markets, there could be a significant opportunity for both parties. Currently Turkey has a public procurement law and public procurement agency.⁶⁵ Turkey's national public procurement legislation broadly reflects the principles of the EU yet the legislation has a number of inconsistencies with the *acquis*.⁶⁶ For instance, implementation of the compulsory domestic price advantage of up to 15%, and coverage of public procurement rules which were significantly reduced by a long and increasing list of exclusions of diversified items, appear to be the two important aspects related to the public procurement issue. Year by year the exemptions related to public procurement have been extended and there have been constant changes and amendments to the Public Procurement Law. According to the local media, between the years 2002 and 2018, 186 amendments to the Public Procurement Law were adopted in 187 months,⁶⁷ and the reason is very predictable.

Public procurement is actually another area which is very popular among Turkish politicians. For decades Turkish governments created close business allies via public procurement, and historically this has been an important source of political party funding. Basically, via public procurement, certain economic benefits are distributed to business allies, in turn causing a significant economic and social transformation of such allies. As a result, these business allies gain significant political power. So, even though the EU's public procurement market may seem very lucrative, because of the structure explained above, if Turkey liberalizes its public procurement market to the EU there could be resistance by some business groups that are close allies to the government and this could create political tension. Political parties that are benefitting from this public procurement structure could also resist the liberalization of the public procurement market; however, so far the ruling party in Turkey, for instance, has not expressed concern about this issue. One of the reasons for this is that Turkey's relatively well-structured and functioning construction industry could be quite competitive and gain a share in the EU's huge public procurement market. As a matter of fact, the Turkish government did include liberalisation of public procurement in its impact assessments.

Both public procurement and state aid have already been discussed in the Commission reports for Turkey and according to the assessments, Turkey has been backsliding in terms of both regulations and implementation. State aid and public procurement could be fundamental issues when modernization of the Customs Union is back on the table. Seen in this light, backsliding on issues like state aid and public procurement seems like a discrepancy from the aim of modernization for Turkey. Occasionally the Turkish government is quite vocal about modernization, but it is hesitant to act on these relatively sensitive issues. There could be two reasons for this. First, currently there are no ongoing negotiations about the modernization, and second it could be very challenging to poke an already established and powerful state aid and public procurement structure a la turca.

⁶⁴ European Commission, "Single Market Scorecard", 2018, https://ec.europa.eu/internal_market/score-board/performance_per_policy_area/public_procurement/index_en.htm (accessed 29 June 2020).

⁶⁵ The official website of the Public Procurement Agency. The Public Procurement Law is also available on the related website www.ihale.gov.tr

⁶⁶ European Commission, "Turkey Report 2019-EU", Staff Working Document, 29 May 2019, 66.

⁶⁷ "Public Procurement Law Was Changed 186 Times in 16 Years" [Kamu İhale Yasası 16 yılda 186 kez değişti, yasaya göre mi ihale, ihaleye göre mi yasa!], *T24*, 28 May 2018, <https://t24.com.tr/haber/kamu-ihale-yasasi-16-yilda-186-kez-degisti-yasaya-gore-mi-ihale-ihaleye-gore-mi-yasa.638392> (accessed 18 June 2020).

In this sense, converging its implementation and regulatory framework of state aid and public procurement to the EU *acquis* will give Turkey an opportunity to create a better competitive, more transparent and more governance-based commercial environment which in turn could contribute to sustainable growth of the country. Being vocal on many platforms about the modernization is not sufficient, decision-makers should also act in order to achieve a good level of alignment with the EU *acquis* and really reflect their intentions. Accordingly, apart from all political issues, it is difficult to state that Turkey is technically ready for the modernization of the Customs Union.

Brexit Issue: An Opportunity or a Threat for Turkey?

The United Kingdom (UK) is the second biggest export and sixth biggest import market for Turkey. Overall trade of Turkey with the UK reaches a magnitude of almost 18.5 billion USD⁶⁸ whereas Turkey is also a net exporter to the UK. The UK decided to leave the single market and the Customs Union in the process termed Brexit. There will be a transition period until December 31, 2020 during which the UK will remain in the Customs Union. After 2020, the UK will start planning its FTAs with third parties including the EU. Given this, Brexit could possibly present risks to Turkey's foreign trade. As per the Custom Union, the UK and the EU would initially sign a trade deal and it would then be possible for Turkey and the UK to have a separate trade deal of their own. However, following the UK's exit from the EU, until Turkey and the UK reach a potential FTA, higher tariffs will be applied to Turkey by the UK which will adversely affect Turkey's foreign trade. What is more, if the UK leaves the EU without a deal, Turkish exports to the UK will decline by almost 24%.⁶⁹ Accordingly, Turkey is one of the leading countries that will be affected negatively in a 'hard' Brexit. As a result, if the UK and the EU adopt an exit without a deal, a discussion could be triggered regarding the benefit for Turkey of modernizing the Customs Union.

The Turkish government would also be assessing additional crucial points like searching for an immediate deal with the UK in areas not covered by the EU-Turkey Customs Union, such as raw agricultural products and services. Turkey and the UK can reach a bilateral agreement on these issues and others as well. For instance, the UK might need Turkey in terms of fruit and vegetables following its exit from the EU.

Around 49% of Turkey's exports are to the EU market. This figure would come down to 41% without Turkey's exports to the UK.⁷⁰ For imports, the share of the EU will come down to 36% from 40% without the UK. Although the EU share is still very significant, a possible FTA between the UK and Turkey is still mandatory for Turkey. Hence Turkey has established a Brexit-inspired working group with the UK in order to sustain the current bilateral market access structure in the short term, and to establish a deep and comprehensive FTA in medium to long term.⁷¹ The two countries have already started negotiations for a steady flow of washing machines, car parts, etc.⁷²

⁶⁸ Ministry of Trade data, 2019 figures, <https://ticaret.gov.tr/istatistikler/dis-ticaret-istatistikleri> (accessed 5 July 2020).

⁶⁹ UNCTAD, "Brexit Implications for Developing Countries", *Research Papers* 31 (April 2019): 9, https://unctad.org/en/PublicationsLibrary/ser-rp-2019d3_en.pdf (accessed 5 June 2020).

⁷⁰ Ministry of Trade data, 2019 figures, <https://ticaret.gov.tr/istatistikler/dis-ticaret-istatistikleri> (accessed 5 July 2020).

⁷¹ Information based on Turkish Ministry of Trade, <https://www.trade.gov.tr/free-trade-agreements> (accessed 3 July 2020).

⁷² James Rothwell, "Britain Eyes Turkey's Manufacturing Powerhouse in Key Trade Talks", *The Telegraph*, 7 May 2020, <https://www.telegraph.co.uk/business/2020/05/07/britain-eyes-turkeys-manufacturing-powerhouse-key-trade-talks/> (accessed 3 July 2020).

Brexit has still ambiguities and its impact on Turkish foreign trade requires an impact assessment considering the various scenarios. Based on this, Turkey would reassess its global competitiveness and trade strategy. If Turkey manages to adopt a lucrative FTA with the UK, the EU's declining (although still significant) share in Turkey's foreign trade and ongoing problems stemming from the current Customs Union could cause Turkey to revisit its priorities regarding the modernization and seek to show the EU that there could be other policy options out there.

As time passes without concrete steps towards modernization and unforeseen developments such as Brexit, it is becoming more challenging for Turkey and the EU to reach a deal on the modernization. Overall, Turkey clearly sees that the modernization of the Customs Union will be beneficial to its economy especially in the mid-long run, as per the impact assessments that have been conducted. Accordingly, the Turkish government is quite vocal on every platform concerning modernization. Nonetheless, in terms of regulatory convergence and implementation of some headlines, Turkey is not compliant with the EU *acquis*. In this sense Turkey is not fully ready. In addition, political prerequisites for the modernization of the Customs Union divert the issue into a more challenging territory. Although the post-pandemic era and the Council presidency of Germany could be evaluated as an opportunity on paper, sometimes opportunities on paper cannot be reflected in real life.

Opposition Parties and the Nationalist Movement Party

The Republican People's Party (CHP) was founded in 1923 and is the main opposition, defining itself as a social democrat party. The CHP has been a supporter of the EU membership of Turkey, and evaluates it as a social transformation process that could be qualified as an extension of Ataturk's modernization vision. On the other hand, there are various groups within the CHP with susceptibilities about national sovereignty since some policy actions regarding the EU membership process are perceived as a threat to Turkish sovereignty. But overall the party supports EU membership, vocalises its support publicly and includes it in its election manifestos and party programmes.

The CHP also supports the modernization of the Customs Union and adopted it in its election manifestos in both 2015 and 2018.⁷³ In 2015 the CHP's vision was 'deepening' the Customs Union. In its 2018 election manifesto, the CHP presented 10 main and immediate action points for execution, should it win the elections. Surprisingly one of them was the modernization of the Customs Union with reference to higher FDIs, sustainable growth and better relations with the EU. This shows that the CHP evaluates the modernization of the Customs Union as one of the potential policy options to fuel the struggling Turkish economy. Under the current status of relations between Turkey and the EU, the CHP management thinks that the EU, with the leadership of Germany, should support the democrat-oriented people of Turkey who are ready to advocate for reforms. According to the party management there is an urgent need for the modernization, however at this point even a non-comprehensive tiny step such as mobilising talks to improve the flaws of

⁷³ CHP 2015 and 2018 Election Manifestos, <https://chp.org.tr/yayinlar/secim-bildirgeleri> (accessed 6 July 2020).

the Customs Union agreement would be a beneficial tool to show some support to the democrat voters of Turkey.⁷⁴

The Nationalist Movement Party (MHP) is the ultra-nationalist conservative party of Turkey. The MHP was founded in 1969 and has been an important and very well established player in the Turkish political arena. The MHP has taken different roles in various coalition governments in different decades. During the ruling AKP era (since 2002) MHP was originally on the opposition front; however, after the coup attempt in 2016 the party became a strong ally to the AKP. With the support of the MHP, the AKP was successful in changing the constitution and governance system of Turkey from a parliamentary system to a presidential system in the 2017 referendum. The MHP did not appoint its own leader Devlet Bahçeli as a candidate for the presidency, and instead supported Tayyip Erdoğan in the 2018 presidential elections. Since then the two parties have proven to be strong allies especially on foreign policy issues. The MHP's approach to the EU has always been cautious since the party has been very sensitive on foreign policy issues such as Cyprus, the Aegean and overall national sovereignty. Its sensitivity could be easily observed in its party programmes and election manifestos. The MHP election manifesto for the 2015 elections incorporates the Customs Union, stating the goal of fixing the asymmetries stemming from the current Customs Union between the EU and Turkey.⁷⁵ In that manifesto no reference to modernization is made. In the 2018 elections, the Customs Union was totally removed from the election manifesto.⁷⁶ Although both election manifestos support the process of Turkey's membership in the EU, the manifestos implicitly underline several conditions such as the EU's respect for Turkey's national sovereignty, relations with Cyprus and Greece, etc.

The MHP is one of the few identities known to exert a lobbying power on the AKP on both foreign and domestic policy issues under the current political atmosphere in Turkey. However, it would be very hard to state that the Customs Union is an agenda for the MHP. On the other hand, if the ruling party goes back to its reform agenda for the sake of the Customs Union, it can be expected that the MHP will not block it.

The Good Party (İYİ Party) was founded in 2017. The leader of the İYİ Party is Meral Akşener who is an ex-deputy of the MHP. Akşener held the position of Minister of Interior Affairs back in 1997. The İYİ Party can be characterised as a nationalist party but with more secular policy targets, and its base can be described as more urban-based and secular compared to the MHP. It will not be wrong to describe the İYİ Party as very close to centre-right. The party is a supporter of Turkey's membership in the EU on the condition of bilateral benefits. In its party and elections manifestos there are no references to the modernization of the Customs Union. Since the party's foundation, its leadership has not had the opportunity to discuss the modernization of the Custom Union publicly given its relatively recent founding leading into a very aggressive election campaign period (2018 presidential and parliament elections and 2019 municipality elections). Given that İYİ Party leader and management are expected follow more liberal

⁷⁴ Kemal Kilicdaroglu, "Turkiye'nin demokratları yalnız bırakılmamalıdır" [Turkey's democrats should not be left alone], *Frankfurter Allgemeine Zeitung*, 29 November 2019, <http://chp-avrupabirligi.org/2018/11/30/chp-genel-baskani-kemal-kilicdaroglu-turkiyenin-demokratlari-yalniz-birakilmamali-dir/> (accessed 30 June 2020).

⁷⁵ MHP Election Manifesto 2015, p. 257, https://www.mhp.org.tr/usr_img/mhpweb/1kasimsecimleri/bevanname_1kasim2015.pdf (accessed 18 June 2020).

⁷⁶ MHP Election Manifesto 2018, https://www.mhp.org.tr/usr_img/mhp2007/kitalar/24haziran2018_secim_bevannamesi_tam_web.pdf (accessed 18 June 2020).

policies compared to the MHP, it could be surmised that the party would support the Customs Union modernisation.

Apart from the MHP and opposition parties the CHP and the İYİ Party, it is important to note two other parties that were recently founded. Although these parties are new, not represented in the parliament and, according to surveys, currently hold an insignificant following,⁷⁷ with the new presidential system they could have substantial impact in shaping the political landscape. What is more important about these parties is the profiles of their leaders, as outlined below.

The Democracy and Progress Party (DEVA) was founded in 2020 by Ali Babacan who was a long-time ally of President Erdogan. Babacan is the former economy tsar and Minister of Foreign Affairs of Turkey between 2002–2015 under Erdogan’s management. He was also the chief negotiator for Turkey in the membership negotiations with the EU. The DEVA can be described as a liberal/centre party with Western-oriented policy options. In its party manifesto there are strong references to Turkey’s EU membership. The DEVA also supports the modernisation of the Customs Union and incorporates it into its party programme. Accordingly, its aim is to liberalise agriculture and services industries within the modernization process.⁷⁸ In this way the DEVA aims to increase the competitiveness of these industries and attract more FDI. However, the party does not mention public procurement as an agenda item for the modernization of the Customs Union. Given Babacan’s background and the profile of DEVA management, one could expect this to be one of the parties that would be strongly in favour of Turkey’s EU membership and the modernization of the Customs Union.

The Future (Gelecek) Party was founded in 2019 by the ex-prime minister Ahmet Davutoglu. Davutoglu had also been a long-time ally of President Erdogan and was the Minister of Foreign Affairs between 2009–2014 under Erdogan’s management. Later he became the prime minister of Turkey between 2014–2016. The Gelecek Party can be considered as a conservative right party with liberal economic policy options. Its party manifesto incorporates the modernization of the Customs Union as a priority, with the orientation of minimizing the cost for Turkey stemming from the FTA agreements between the EU and third countries.⁷⁹ However, the Gelecek Party does not specifically mention services, public procurement and agriculture in its party programme.

Finally, the HDP (People’s Democracy Party) is a left-wing political party mostly getting support from the Kurdish population in Turkey. The party was founded in 2012 and is a successor to several other left-wing and Kurdish-backed parties. In Turkey, the Kurdish movement has always been under pressure by the state and many left-wing and Kurdish-supported parties were banned from political life for decades. The HDP operates under a co-presidential system of leadership, with one chairman and one chairwoman. Currently the party has two leaders, Pervin Buldan and Mithat Sancar, both of whom have long been in the Turkish political life and taken leadership roles in the Kurdish movement. Nine members of parliament from the HDP have been arrested and jailed since the 2016 coup attempt, including the party’s popular previous chair Selahattin Demirtas. The HDP

⁷⁷ According to trusted Metropoll Consultancy, DEVA and Gelecek are gaining 1.9% and 1.4% of the votes respectively as of June 2020.

⁷⁸ DEVA Party Programme, p. 57, <https://cdn.devapartisi.org/14/DEVA-PARTI%CC%87SI%CC%87-PROGRAMI2.pdf> (accessed 20 June 2020)

⁷⁹ Gelecek Party Programme, p. 126, https://wp.gelecekkpartisi.net/wp-content/uploads/2019/12/Gelecek_Partisi_Program.pdf (accessed July 2020).

is very vocal about issues such as freedom of expression, human rights and democratisation compared to economic policies. Its party programme and election manifestos contain no references to modernization of the Customs Union. The party's main battle is on the democratization side so it is not very common to hear economic policy suggestions from the HDP. According to HDP spokespersons in the parliament, the arrest of high-profile political figures such as Osman Kavala and Selahattin Demirtas is the main blocker for Turkey in its Customs Union modernization target.⁸⁰ It is worth noting that the HDP is the third biggest party in the Turkish parliament after the ruling AKP and the CHP but ahead of the MHP.

The Turkish people have always been supportive of their country's membership in the EU. According to Metropoll Consultancy 54% of the Turkish people supported Turkey's membership as of January 2020. This support increases to 72% among HDP voters, which is the highest support rate compared to other party voters.⁸¹ This is because HDP voters believe that if Turkey becomes a member of the EU, there will be significant progress in democratization and human right policies. Based on this, one can expect the HDP's support for the modernisation of the Customs Union. This support will be mainly based on a possible improvement in relations between the EU and Turkey as a result of the modernization. It is safe to underline that should there indeed be support from the HDP, it will be mainly based on political rather than economic reasons.

The table below summarises how the major political stakeholders approach the modernization of the Customs Union. For instance, the Presidency of the Republic of Turkey pinpoints the modernization as a policy target whereas the AKP focuses more on improving the current Customs Union agreement. Here, it should be recalled that Erdogan is the President of Turkey and also the head of the AKP. The CHP refers to both improving and modernizing; on the other hand, the MHP and IYI do not make a single reference to the Customs Union. Newcomers to the Turkish political life, the DEVA and Gelecek, are the two parties with the strongest references and the most detail about the modernization of the Customs Union. The HDP does not make a single reference to the modernization.

Table: References Made by Political Stakeholders to Customs Union in Official Documents

	Sources/ Documents	Moderniza- tion of the Customs Union	Improve- ment in the current Customs Union	Agriculture	Services	Public procure- ment
Presidency of Turkish Republic	MTEP 2020-2022	√				
AKP	Election Manifesto 2018		√			
CHP	Election Manifesto 2018	√	√			
HDP	Election Manifesto 2018					
MHP	Election Manifesto 2018					

⁸⁰ Garo Paylan, "Speech at the Turkish Parliament", HDP official Twitter account, 13 December 2019, <https://twitter.com/hdpgenelmerkezi/status/1205525538959441925?lang=da> (accessed August 2020).

⁸¹ "Halkın yarısından fazlası AB'ye girmekten yana", *Diken*, 8 January 2020, <http://www.diken.com.tr/metropoll-arastirma-halkin-yaridan-fazlasi-hala-abye-girmektan-yana/> (accessed August 2020).

IYI	Election Manifesto 2018					
DEVA	Party Programme 2019	√		√	√	
GELECEK	Party Programme 2020	√	√			

The AKP and the CHP constitute 73% of the parliament with 293 and 146 members respectively. The MHP is fully supportive of the AKP's overall agenda in the parliament, and the IYI Party as well as the HDP would also support a policy option such as the modernization of the Customs Union. However, it should be noted that under the new presidential system of Turkey, the effectiveness and power of the opposition parties and the parliament, especially on foreign policy and international relations, are quite limited. Hence not only the opposition parties, but also the parliament as a whole, will not have a chance to pressure the ruling party or the president regarding the modernization of the Customs Union. The sole decision-maker on this issue would be President Erdogan along with his European counterparts.

Business Decision-Makers

It can easily be stated that the Turkish business world is united for the modernization of the Customs Union. There are politically diversified business NGOs in Turkey but almost all of them have been proactively vocal in favour of the modernization, on every platform. TUSIAD, TOBB, the Foreign Economic Relations Council of Turkey, the Turkish Venture and Business World Confederation and IKV have sponsored their own impact assessments, policy papers and events.⁸² The fact that modernization of Customs Union would be beneficial to Turkey both economically and socially has been underlined as the common ground in those policy papers. What is more important, the policy papers also assessed that Turkey would benefit from the modernization by going back to a more rule- and governance-based economy. In addition, under the current nature of the relations between Turkey and the EU, business NGOs believe that modernisation is imperative and a rational policy option as opposed to visa liberalisation or Turkey's membership in the EU.⁸³

Apart from the NGOs mentioned above, another important business NGO is the Independent Industrialists' and Businessmen's Association (MUSIAD). MUSIAD was founded back in 1990 and its members are known to be more conservative, religion-oriented businesspeople who are close allies with the ruling party. MUSIAD sponsored a policy paper with the European Neighbourhood Council in 2017 that supports the

⁸² "A Modernized Customs Union", 2017, https://www.tepav.org.tr/upload/files/1491836076-0.A_Modernized_EU_Turkey_Customs_Union.pdf;

Sinan Ülgen, "The Business Case for a Turkey-EU Customs Union 2.0", December 2018, <https://www.deik.org.tr/publications-the-business-case-for-a-turkey-eu-customs-union-2-0>;

"New Era for the Customs Union and Business World", October 2015, <https://tusiad.org/en/reports/item/8685-a-new-era-for-the-customs-union-business-world>;

"Keeping Together in the Face of Multiple Challenges", 2017, <https://www.ikv.org.tr/images/files/Keeping%20Together%202020.pdf> (all sources accessed in June 2020). In addition, TURKKONFED, TOBB and IKV launched and executed various activities related to Turkey-EU relations and modernisation of the Customs Union.

⁸³ Sinan Ülgen, "The Business Case for a Turkey-EU Customs Union 2.0", *DEIK*, December 2018, 4, <https://www.deik.org.tr/publications-the-business-case-for-a-turkey-eu-customs-union-2-0> (accessed 10.6.2020).

modernization of the Customs Union.⁸⁴ In addition, following the RAG meeting held by the Turkish government in 2018, MUSIAD Europe published a press release in 10 different languages supporting Turkey's membership in the EU. In that press release MUSIAD strongly underlined the importance of modernization of the Customs Union.⁸⁵ Recently MUSIAD also published a report on how to improve exports in the post COVID-19 era. Although the modernization of the Customs Union was not specifically mentioned in the report, a possible shift in the EU's logistics needs due to the pandemic was discussed as an opportunity for Turkey.⁸⁶ It can be noted that although not as vocal and active as TUSIAD or TOBB, MUSIAD is also a supporter of the modernization of the Customs Union. However, it should also be underlined that MUSIAD is a close ally of the AKP and may reassess its position to align with that of the ruling party.

It can be observed that most of the work so far carried out in relation to modernisation was completed between the years 2014 and 2017. The following years can be evaluated as more of a standby period. However recently Turkish business cycles are regaining the momentum. For instance, TUSIAD is a strong supporter of modernization, such that it has enlarged the vision of modernization with the European Green Deal, digitalization, taxes on digitalization and 2030 climate goals. TUSIAD also underlines the importance of enlargement of the EU for a sustainable development of the country.⁸⁷ It should be noted that TUSIAD is one of the oldest and most powerful business NGOs of Turkey, with mainly a Western-oriented and secular business base. TOBB is also very active and could be a flagbearer for modernization, as the largest business NGO in Turkey. Very recently TOBB organised a webinar entitled 'Post COVID-19 Turkey-EU Relations' with Deputy Minister of Foreign Affairs for Turkey and Director for EU Affairs Ambassador Faruk Kaymakci, and Christian Berger, Head of the EU Delegation to Turkey along with the president of Eurochambres. In the meeting the Turkish side stressed how Turkey could be a strong aid in reducing the negative effects of the pandemic in Europe, trying to leverage all possible channels of communication.⁸⁸

The recent pandemic period could also result in positive expectations for the EU-Turkey relations to energise. Business elites of Turkey believe Turkey has managed the pandemic period successfully and its strong and relatively well-designed health system could be used as a contributing factor in EU-Turkey relations. Turkey has been sending supplies of medical equipment to 80⁸⁹ countries including Italy, Spain and England. While Turkey uses this politically as a diplomacy tool, business leaders in the country have a keen eye to the possibility that Turkey could take a more significant role in world supply chains. An op-ed by Josep Borell, Representative of the EU for Foreign Affairs and Security Policy and Vice-President of the Commission, published in some of Europe's well-known publications highlighted a very strategic and important fact. According to Borell, EU should avoid excessive dependence on specific countries in strategic sectors by building

⁸⁴ "A Modernized Customs Union", 2017, <https://www.tepav.org.tr/upload/files/1491836076-0.A Modernized EU Turkey Customs Union.pdf> (accessed 8 June 2020).

⁸⁵ "MUSIAD's Message of Support in 10 Languages for the EU Membership Process of Turkey", <http://web.musiad.org.tr/en/news/president-news/musiads-message-of-support-in-10-languages-for-the-eu-membership-process-of-turkey> (accessed 20 July 2020).

⁸⁶ MUSIAD, "COVID 19 Sonrası Döneme Global Bakış Tespit ve Öneriler", May 2020, 16, <https://www.musiad.org.tr/uploads/yayinlar/arastirma-raporlari/pdf/globalustkurulucovidraporu.pdf> (accessed 20 July 2020).

⁸⁷ "Simone Kaslowski Attended a Video Conference with the EU Deputy Vice President Franz Timmermans" [Simone Kaslowski AB Kideimli Başkan Yardımcısı Frans Timmermans İle Yapılan İstişare Video Konferansına Katıldı], <https://tusiad.org.tr/basin-bultenleri/item/10591-simone-kaslowski-ab-kidemli-baskan-yardimcisi-frans-timmermans-ile-yapilan-istisare-video-konferansina-katildi> (accessed 30 June 2020).

⁸⁸ Directorate of EU Affairs [Footnote 44].

⁸⁹ *TRT World* [Footnote 41].

stockpiles of critical materials and should also shorten and diversify its supply chains.⁹⁰ As per this opinion of a high-ranked EU diplomat, the Turkish business NGOs have a vision of Turkey acquiring a larger space in the world supply chain, which could give the EU and Turkey an opportunity to revive commercial issues.⁹¹

The Turkish business NGOs frequently meet with their counterparts and related political decision-makers in Europe. The main motivation behind these meetings is to move modernisation discussions back onto the agenda. The lobbying power and good relations of Turkish business NGOs have caused their counterparts to make recommendations concerning Turkey to the Council. The recommendation made by Business Europe, for instance, stated the importance of maintaining an open dialogue and upgrading the Customs Union.⁹² Another business NGO in Europe, Eurochambres, also published a position paper that underlined the importance of a modernized Customs Union and widening economic activity under the light of COVID-19.⁹³

The high motivation and strong relationships of the Turkish business NGOs seem enough to generate the support of European business NGOs. On the other hand, European business NGOs support the modernization process within the light of mutual economic interests.

As a natural impact of the modernization, there will be industries and companies that could be effected negatively. The diversified sectoral groups might be having concerns about the modernisation. For instance, according to the World Bank report the dairy product imports of Turkey will increase by around 1 billion USD, whereas the wheat imports will increase by at least the current amount (2014 data) of wheat imports as a result of the modernization.⁹⁴ On the other hand, Turkey might experience a positive impact on fruit and vegetables. So at a glance the agricultural sector is one of the sectors that could feel both positive and negative impacts from modernization. In addition, costs for the agriculture sector such as fuel, fertiliser, feed, etc. have increased for the last five years. Agriculture could have second thoughts about liberalisation of their industry, however it is not expected that farmers' unions or big agriculture firms would lobby onto the government since the modernization issue is not a very hot policy topic at this current time.

There are other industries that could be negatively or positively affected. For instance, the auto industry is a crucial industry for Turkey. With modernisation, there is a chance that second-hand cars would circulate in the context of free movement of goods from the EU to Turkey. That would be a serious concern for the Turkish auto industry. This does not necessarily mean that the auto industry would be against the modernisation of the Customs Union, but it could be expected that the industry may lobby the government on this specific issue.

In Turkey the telecommunications industry is a relatively competitive one, and Turkish Telecommunications Law has a high level of alignment with the EU *acquis*. With modernization, consumers might experience benefits from possibly declining international roaming costs, which would in turn mean declining revenues and profits for

⁹⁰ Rabia Iclal Turan, "Top EU Diplomat Calls for Probe into Virus' Origins", AA, 15 May 2020, <https://www.aa.com.tr/en/europe/top-eu-diplomat-calls-for-probe-into-virus-origins/1841902> (accessed 19 June 2020).

⁹¹ Directorate of EU Affairs [Footnote 44].

⁹² "A Trade Strategy Fit for the 21st Century", *Business Europe*, April 2019, <https://www.businesseurope.eu/publications/trade-strategy-fit-21st-century> (accessed 22 June 2020).

⁹³ "Strengthening EU and Turkey Relations Is Vital for Regional and Global Stability and Security", Eurochambres, 3 June 2020, <http://www.eurochambres.eu/Content/Default.asp?PageID=1&DocID=8442> (accessed 22 June 2020).

⁹⁴ The World Bank [Footnote 17].

telecommunication companies. On the other hand, declining international costs could trigger higher usage for consumers and this could be an adjustment for the declining revenues and profits for companies. Hence, it would be hard to state that telecommunication companies would try to hold the government back concerning modernization just for international roaming revenues.

The banking/finance industry is another relatively well established and competitive industry in Turkey. In terms of product diversification, human resources and profitability, the banking industry could compete with its European counterparts, should there be modernization. Especially countries like Germany and the Netherlands with an intense Turkish population could be a potential target for Turkish banks. Should this be the case, level of costs and profit margins will be very important for the Turkish banking industry in the customer acquisition process for such countries.

Further examples and industries could be numerated, however it should not be expected that each company and industry would fully benefit from modernization. The approach of both the Turkish government and the business NGOs is for Turkey to achieve an aggregate benefit from the modernization as opposed to industry-based benefit. It has been almost five years since the latest impact assessment for the modernisation of the Customs Union became publicly available. Due to the elapsed time and the intervening pandemic period, the Turkish government and NGOs should conduct a new impact assessment to evaluate the recent picture more accurately.

One of the leading business NGOs related to EU–Turkey affairs, IKV, states that in all three areas (agriculture, public procurement and services) that are subject to the discussions related to modernisation, Turkey may feel negative effects in the short run but in the mid and long run those negative impacts will shift to positive territory via FDIs and increasing productivity.⁹⁵

Overall, a number of industries may have concerns about potential negative impacts of modernization, however the general approach of the Turkish business NGOs is to concentrate on the bigger picture. And the bigger picture is increasing positive economic impact in the mid to long term and a better institutionalized, policy- and reform-based transparent economy.

As stated under the heading ‘Pandemic Period: An Opportunity to Re-energise the Focus on the Customs Union and Germany’s Presidency of the EU Council’, Germany will hold the president of the Council between 1 July and 31 December of 2020. Since term presidencies are limited to six months and the next heads of the Council will be Portugal and Slovenia, the Turkish business elite will increase pressure both on the local administration and its European counterparts to reaccelerate the relations with the EU (i.e. modernization of the Customs Union) during Germany’s presidency. After all, Turkey is materializing 9.1% of its cumulative foreign trade of almost 410 billion USD with Germany⁹⁶ and also 6.1% of the country’s FDI is flowing from Germany.⁹⁷ There are 6,800 Germany-based companies with production facilities located in Turkey. The economic value of these facilities is estimated to be 9 billion euros and 140,000 people are employed by these German firms.⁹⁸ Despite political tensions at the highest level between the countries, strong economic and social ties could pave way to a possible round of lobbying by the Turkish business NGOs towards the goal of modernization during Germany’s term presidency. However we can recall that

⁹⁵ Ayhan Zeytinoglu, “Turkey-EU Relations and Term Presidency of Germany”, *IKV Online Seminars*, 28 May 2020, https://www.ikv.org.tr/ikv.asp?ust_id=3631&id=3817 (accessed 26 May 2020).

⁹⁶ Ministry of Trade [Footnote 47].

⁹⁷ Investment Office of the Republic of Turkey [Footnote 48].

⁹⁸ “Türkiye’deki Alman Firmaları Tedirgin” [German Firms in Turkey Are Uncomfortable], *Deutsche Welle Türkçe*, 20 September 2017, <https://www.dw.com/tr/t%C3%BCrkiyedeki-alman-firmalar%C4%B1-tedirgin/a-40612951> (accessed 19 June 2020).

The Programme for Germany's Presidency of the Council of the EU does not incorporate an agenda related to Turkey and the modernization of the Customs Union⁹⁹. It could be argued that Germany's presidency of the EU Council could have signified an opportunity several months ago but after the launch of the Programme the chances now appear lower. In summary, the Turkish business world is practically united on the modernization target and indeed this could be evaluated as a sine qua non for the Turkish business community given that under the current tense relations between parties, modernization could be a very rational option both to push Turkey back into a policy-based business environment and to mend ties with the EU.

⁹⁹ "The Programme for Germany's Presidency of the Council of the EU" [Footnote 49].

Future and Conclusion

Turkey has been receiving heavy criticism for drifting away from the EU. On the economic front, the roots of this criticism have mainly to do with de-institutionalization, strong presence of the state in many industries, restrictive regulations, non-merit-based promotions in public administrations, and so on. In its very recent announcement¹⁰⁰ Morgan Stanley Capital International (MSCI) stated that they are considering to reclassify the MSCI Turkey Index as a Frontier Market or a Standalone Market status if the current restricted regulatory approach and de-institutionalization trend (such as accessibility level of the Turkish equity market, stock landing, etc.) of the Turkish administration further deteriorates. Just to have a better idea, some of the countries MSCI anchors as standalone and frontier markets are Oman, Sri Lanka, Zimbabwe and Palestine. Such examples have increased in recent years and may increase further in future, showing a clear picture of Turkey drifting apart from the EU.

However, as the years pass without concrete steps from both parties for modernization of the Customs Union, the possibility of a deal is becoming more challenging and modernization starts to look less attractive. Even implementation of the current Customs Union agreement is becoming more challenging. Turkey has a very strong rhetoric with some actions, albeit not as strong as its rhetoric, in the direction of modernization. On the other hand, the EU is very strict about Turkey's democratic reforms and international policy actions. At this dead-end point, parties should employ rational and doable strategies in their bilateral relations.

Turkey should:

1. Generate a rather trade-oriented explicit strategy for EU relations

The Turkish government is quite disappointed and de-motivated about its relations with the EU. Stated with a certain degree of cynicism, should the EU bodies cut all ties with Turkey, it could in fact be quite a relief for the current Turkish government. Given this mood, the government's rhetoric and executions are quite distant from each other. The administration is currently de-motivated to capitalize on democratic reforms however wants to maintain Turkey's targeted membership in the EU. The Turkish government is very vocal about the modernization of the Customs Union but is not ready for it.

The Turkish government should generate an overall strategy about how to take the EU relations further. Does Turkey want to be a member of the EU? Will modernizing the Customs Union be enough? Or will Turkey be satisfied with visa liberalization? Turkey needs a clear and explicit target of its own that its government can execute accordingly. With the Turkish government's unwillingness to execute democratic reforms, tense relations in the Eastern Mediterranean and the EU's strict stance towards the Turkish government, Turkey's membership trip to the EU is now at a dead-end of the road. For the time being, prioritising the modernization of the Customs Union could be a rational

¹⁰⁰ Akin Nazli, "Morgan Stanley Warns Turks MSCI Frontier Markets Status May Be Around Corner", *BNE-INTELLINEWS*, 24 June 2020, <https://intellinews.com/turkey-insight-morgan-stanley-warns-turks-msci-frontier-markets-status-may-be-around-corner-186109/> (accessed 24 June 2020).

strategy for Turkey both for to maintain a dialogue with the EU and to capitalise the economic benefits.

2. Focus on technical issues of modernization of the Customs Union and prove that political issues and trade should be discussed separately

Turkey can work on improving its current legislation and implementation on state aid, public procurement, customs regulations, dispute settlement and non-tariff barriers, which are technical issues directly linked to the modernization of the Customs Union. In this way, the Turkish government can display its motivation and demonstrate that the country is ready to talk about modernization. In addition, this will be a strong and clear message to the EU bodies regarding the Turkish government's willingness to discuss the trade-related headlines and political headlines separately.

3. Shift focus to reforms and diplomacy to have a more stabilized economy

The Turkish political elite has long been complaining about political issues being a pre-requisite for the modernization for the Customs Union. As per the impact assessments conducted, modernization of the Customs Union will contribute significantly to Turkish foreign trade and GDP.¹⁰¹ Under the current economic challenges and slowdown, rather than criticizing the EU about adopting political criteria as pre-requisites, the Turkish government should consider going back to diplomacy and a democratic reform agenda to re-energize the talks on modernization. This will eventually be beneficial to the Turkish economy.

4. Capitalize on the EU's need to shorten and diversify its supply chain in the post-pandemic era

In the post-pandemic era, the EU will try to avoid excessive dependence on China in strategic sectors and to shorten and diversify its supply chains. Turkey, geographically being a part of Europe and having a solid logistics industry, could capitalise on this and take a significant role in solving the EU's supply chain problems. This could give the EU and Turkey an opportunity to revive commercial issues and re-energise talks on modernization of the Customs Union. Post-pandemic-era opportunities could be one of the strategic communications options for the Turkish government and business NGOs vis-à-vis their counterparts in the EU.

5. Conduct a new impact analysis of the most recent situation in the post-pandemic era

The recent pandemic has caused serious changes in the conventional functioning of people, businesses, industries and states. For instance, Turkey's agriculture, healthcare, e-commerce, logistics, etc. have become more strategic and valuable than a year ago. Also, it has been almost five years since the latest impact assessment was made available to the public. The Turkish government should consider conducting a new detailed impact analysis in order to evaluate the most recent situation regarding the modernization of the Customs Union. There could be new findings for different industries in the post-pandemic era. In this respect, the Turkish government could see how valuable modernizing the Custom Union really is and then determine a more accurate strategy about it rather than using a daily rhetoric.

¹⁰¹As per the impact assessment of Turkish Ministry of Trade, the GDP increase for Turkey is expected to be around 1.9% whereas the EU Commission assessment expects the same figure to be 1.44%. Turkish Ministry of Trade [footnote 19]; EU Commission Staff Working Document [Footnote 11].

The EU:

Should not turn a blind eye to Turkey's further drift from the EU

The EU's strict stance towards Turkey has its own valid arguments and strategy. On the other hand, this strategy also causes a vast majority of people in Turkey, who are still in favour of EU membership, to feel abandoned. As political criteria continue to be the dominant factor regarding the modernisation of the Customs Union, Turkey proves to be incapable of taking the related policy actions and simultaneously continues to move farther away from a rule-oriented transparent economy, governance structure and civil society. With such intensive bilateral relations (current economic ties, ongoing Customs Union, Syrian refugee crisis, Eastern Mediterranean tensions, etc.), turning a blind eye on Turkey's further drift from the EU *acquis* could create a higher cost for the EU socially, economically and politically as opposed to its current status. The EU can focus more on commercial variables than on political variables for the modernization of the Customs Union, to provide a rational and achievable anchor for Turkey. Under the current status of the relations, this could be a very realistic and useful policy option for both parties.

Abbreviations

AKP	Justice and Development Party
CHP	Republican People's Party
Commission	European Commission
Council	European Union Council
DEIK	Foreign Economic Relations Council
DEVA	Democracy and Progress Party
EEC	European Economic Community
EC	European Community
EU	European Union
FTA	Free Trade Agreement
GDP	Gross Domestic Product
HDP	People Democracy's Party
IKV	Economic Development Foundation
IMF	International Monetary Fund
IYI Party	Good Party
MHP	Nationalist Movement Party
MSCI	Morgan Stanley Capital Index
MTEP	Medium Term Economic Programme
MUSIAD	Independent Industrialists' and Businessmen's Association
NGO	Non-Governmental Organization
RSG	Reform Screening Group
RAG	Reform Action Group
SME	Small Medium Enterprise
SOE	State Owned Enterprise
SWOG	Senior Official Working Group
TEPAV	The Economic Policy Research Foundation of Turkey
TOBB	Union of Chambers and Commodity Exchanges of Turkey
TRY	Turkish Lira
TURKKONFED	Turkish Venture and Business World Confederation of Turkey
TUSIAD	Turkey's industrialist business man association
TWF	Turkish Wealth Fund
UK	United Kingdom
USD	United States Dollar

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