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Thinking ahead for Europe

The Future of Turkish-EU Trade Relations

Deepening vs Widening

Sinan Ülgen and Yiannis Zahariadis

Abstract

Owing to the EU-Turkish customs union, there is already a considerable degree of convergence between Turkey and the EU in the area of trade. In fact, Turkey is the only candidate country that has a customs union with the EU. At least with respect to the trade in goods, Turkey is almost part of the Single Market. The challenge of enhancing the present state of trade integration could be approached in two ways. First, the customs union could be deepened by refining the arrangements and addressing its shortcomings. Secondly, the degree of trade integration could be enhanced by incorporating areas such as services and agriculture – thus widening the customs union – which is also explored in detail. The paper concludes that the Turkish-EU customs union has been a technical success overall and functioned on a sound basis. Nevertheless, both parties should work flexibly towards eliminating trade defence measures and forging a more comprehensive framework of trade integration.

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1. Introduction

Owing to the EU-Turkish customs union, there is already a considerable degree of convergence between Turkey and the EU in the area of trade. In fact, Turkey is the only candidate country that has a customs union with the EU. Therefore at least with respect to trade in goods, Turkey is almost part of the Single Market. The future challenge in terms of enhancing the present state of trade integration is two-fold. First, the present customs union needs to be deepened by refining the arrangements and addressing its shortcomings. Second, the degree of trade integration can be widened by incorporating hitherto excluded areas such as services and agriculture in the customs union.

2. The customs union: Overview and assessment

The EU-Turkish customs union came into effect on 31 December 1995. It represents the culmination of a long-standing relationship between the two parties and successfully solidifies 40 years of commercial association. This long historical relationship, combined with the unique status of a customs union between an existing regional trading block and an independent country, have contributed to the establishment of a successful, but also highly complex regional arrangement.

The customs union agreement (hereafter also referred to as the '1995 agreement') is not restricted to conventional border controls, but moves significantly beyond that by addressing areas of regulatory or deep integration. This depth of integration has been instrumental in both furthering the two parties' commercial association and paving the way for full membership in the future. Yet the very structure of the arrangement also limits the realisation of the full benefits of integration between the EU and Turkey. Indeed, alongside its depth of coverage, the customs union agreement also includes a number of serious discontinuities in policy focus, partial policy treatment of potential problem areas and a continuation of various holes and loopholes in the parties' bilateral commitments.

More specifically, the EU-Turkish customs union required that apart from the bilateral liberalisation of industrial tariffs and the alignment of external industrial tariffs, Turkey was obliged adopt the Community legislation, with respect to the elimination of technical barriers to trade, the protection of competition and the administration of border procedures including rules of origin. Turkey was also required to adopt the Community's commercial policy towards third countries, including establishing free trade areas with all the EU's preferential partners, implementing various sectoral provisions (such as measures covering textiles and apparel) and ensuring compatibility with international agreements for the protection of intellectual property rights. This substantial alignment of regulatory regimes not only deepens integration between the EU and Turkey, but also strengthens potential gains. Against this depth of integration, however, the 1995 agreement also allows for the continuation of contingent protection (anti-dumping and countervailing duties) and safeguards – which is in marked contrast to the Europe Agreements where trade defence measures are eliminated. Further, it retains significant leeway for the continuation of various technical barriers to trade and continues to exclude agriculture. A more detailed presentation of the principal components of the customs union is given in Box 1.

Box 1. Policy components of the EU-Turkish customs union

Measures dealing with traditional integration

The EU and Turkey were required to eliminate all customs duties and charges having an equivalent effect on industrial imports between them, as well as the industrial component in the tariffs of processed agricultural imports. Further, Turkey was required to harmonise its external tariffs for industrial products towards countries that do not participate in the EU's common external tariff (CET).

Measures related to traditional integration having non-traditional implications

Turkey was required to adopt all free trade agreements with the Community's preferential partners by January 2001. While these agreements are perfectly justifiable in achieving further alignment to the EU's CET, they have also required a sophisticated system for their administration. In effect, Turkey has been required to adopt the EU's customs provisions in the fields of origin of goods, customs valuation of goods, introduction of goods into the territory of the customs union, customs declaration, release of goods for free circulation, suspensive arrangements and movement of goods. Further, the 1995 agreement requires the elimination of all quantitative restrictions or measures having an equivalent effect in the bilateral trade for industrial products and the adoption by Turkey of the EU's commercial policy with regard to common rules for imports and the administration of quantitative quotas. These measures have particular significance in the area of textiles and wearing apparel, where EU quotas against Turkish imports are to be eliminated and Turkey is to adopt the EU regime towards third countries.

Measures dealing with deep integration

Turkey was required to incorporate into its internal legislation all the Community instruments dealing with the removal of technical barriers to trade. It was further required that Turkey adopt EU rules concerning the protection of competition. These include measures dealing with pure competition disciplines as well as state aid to industry. A final, but less strict integration provision, required that Turkey ensure the adequate and effective protection of intellectual, industrial and commercial property rights as specified under the agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Measures dealing with exemptions and exclusions

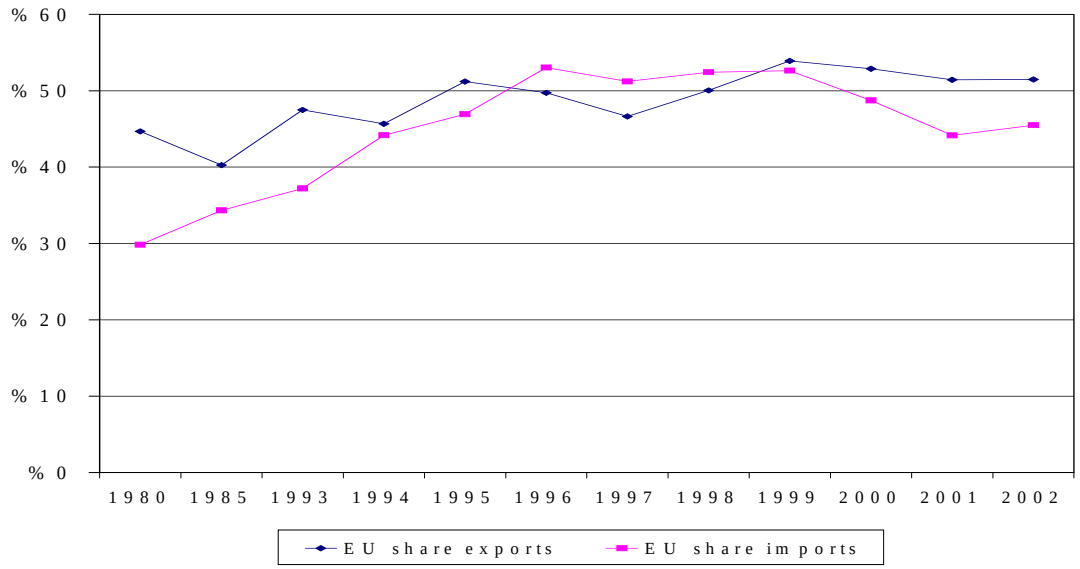
Despite the substantial liberalisation and harmonisation in the foregoing areas, the 1995 agreement also allows for a number of exemptions and exclusions in the commercial relations of the two parties. The first and obvious area is agriculture. The agreement makes no provisions regarding the Community's common agricultural policy and excludes agricultural products from the arrangement. The second area concerns trade defence measures. Under the agreement both parties can initiate, investigate and impose anti-dumping and countervailing duties in cases where trade practices do not conform to the correct functioning of the customs union. The third and final area is safeguards. If serious disturbances occur in a sector of either of the two parties, then that party may take necessary protective measures.

Despite its complex character, the EU-Turkish customs union has developed to represent the most concrete point of reference in the two parties' commercial relations today. Indeed, the arrangement has managed to significantly enhance bilateral market access, progress the harmonisation of regulatory structures and set an institutional framework for cooperation. Most importantly, the customs union represents Turkey's first step towards full integration into the EU Single Market.

In terms of its economic impact, so far, the customs union has been positive. In understanding this, one has to keep in mind that the EU had already opened its markets for Turkish exports long before the customs union agreement was concluded.[1] That is why the customs union itself has not caused a major shift in relative trade shares between the two parties. The EU has been a key trading partner for Turkey ever since its inception in the late 1950s and the customs union agreement did not noticeably increase the share of Turkish exports going to the EU (Figure 1).

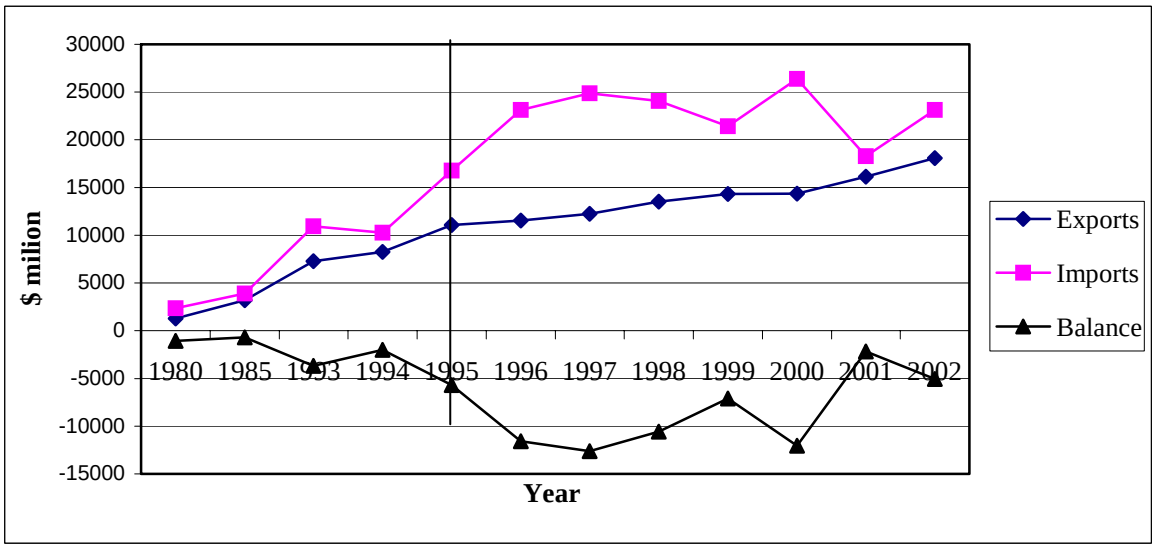
[1] The EU had been gradually reducing industrial tariffs against Turkey throughout the 1970s and 1980s, so that by early 1990s tariff barriers only remained on a few sensitive products.

Figure 1. The EU's share in Turkey's exports and imports



Nevertheless, the volume of bilateral trade has considerably increased over the last decade, especially following the completion of the customs union. As illustrated in Figure 2, bilateral trade has grown dramatically since the 1990s, with both exports and imports more than doubling over the last ten years. That is what one would expect given the fact that the main effect of the customs union was to force Turkey to further liberalise its foreign trade (Turkey's external rate of protection had been much higher than that of the EU (as embodied in the CET).

Figure 2. EU-Turkish bilateral trade ($ million)



Economic theory shows that a customs union can act like a double-edged sword. On the positive side, the elimination of tariffs among the two partners should lead to additional trade, which can be welfare enhancing if it replaces high-cost domestic production with low-cost imports from (trade creation). But if tariff barriers with respect to the rest of the world remain high, there is also a danger that the resulting additional trade between partners would replace lower-cost imports from the rest of the world

(a so-called 'trade diversion'). It is the relative weight of these two effects that will determine the overall impact of the customs union.

The data available for the EU-Turkish case generally suggest that there has been considerable trade creation, but little trade diversion. As shown above, the strong increase in bilateral trade relations has not been at the expense of trade with the rest of the world since the EU's share of Turkish exports has remained roughly constant. Stronger bilateral trade has thus been accompanied by stronger trade growth overall (for Turkey). This combination translates into important welfare gains for Turkey.

It is estimated that the bilateral liberalisation of industrial tariffs alone has benefited Turkey at around 1% of GDP.[2] Further liberalisation towards third countries and adoption of free trade areas has also led to important gains. Estimates suggest that harmonisation with the EU's common external tariff has led to an additional 0.5-1% of GDP.[3] Most importantly, deep integration measures such as harmonisation with EU technical regulations have further enhanced market access. Estimates of the gains are not as strong as those obtained through traditional integration, but it is suggested that Turkey has gained around 0.5% of GDP from harmonisation with EU technical regulations.[4] These are important gains and should be strongly emphasised. Nevertheless, as already argued, the realisation of full potential is still limited. More specifically, contingent protection continues to represent a serious barrier in bilateral market access. Estimates suggest that the continuation of EU anti-dumping duties have led to welfare losses of up to $70 million for Turkey.[5] These are non-negligible losses. Equally, in the area of technical barriers to trade, Turkish exports produced under European specifications continue to be restricted owing to the EU's lack of recognition of certain Turkish certification procedures. If Turkey's certification procedures were to be recognised by the EU, then the gains from the abolition of technical barriers in this area could reach up to 0.8-1% of GDP.[6]

Table 1 recapitulates and compares the EU's share in the total exports of some accession and candidate countries for 2002.

Table 1. EU's share in total exports of accession and candidate countries

	Destination country (€ million)		
Exports from	**EU-15**	**World**	**EU-15/World (%)**
EU-15	1,577,005	2,582,331	61.07
Czech Republic	27,769	40,464	68.63
Hungary	27,091	36,042	75.16
Poland	29,954	43,552	68.78
Bulgaria	3,358	5,983	56.13
Romania	9,920	14,736	67.32
Turkey	19,191	37,253	51.51

Source: IMF DOT statistics (2002).

As can be seen, the EU's share in Turkey's exports is slightly less than that of a number of other countries. But the difference is marginal and essentially the result of Turkey's more diversified foreign markets. A similar picture prevails on the import side as well (Table 2).

[2] See G. Harrison, T. Rutherford and D. Tarr (1996), *The Economic Implications for Turkey of a Customs Union with the European Union*, Policy Research Working Paper No. 1599, World Bank, Washington, D.C.

[3] Ibid.

[4] See Y. Zahariadis (2004), "The Economic Implications of Deep Integration in the EU-Turkey Customs Union", unpublished Ph.D. thesis, University of Sussex.

[5] Ibid.

[6] Ibid.

Table 2. The EU's share in total imports of some accession and candidate countries

	Source country (€ millions)		
Imports of	**EU-15**	**World**	**EU-15/World (%)**
EU-15	1,446,411	2,467,251	58.62
Czech Republic	23,537	38,588	60.99
Estonia	3,338	6,230	53.58
Hungary	22,284	40,175	55.47
Latvia	2,273	4,294	52.94
Lithuania	3,326	7,817	42.55
Malta	2,969	5,328	55.72
Poland	36,134	58,516	61.75
Bulgaria	4,205	8,321	50.53
Romania	10,096	17,214	58.65
Turkey	24,572	54,001	45.50

Source: IMF DOT statistics (2003).

Overall, therefore, we could argue that the customs union represents an important milestone in EU-Turkish commercial relations, as well as an arrangement with significant potential for furthering integration. A number of areas contribute to this, including substantial overall liberalisation, the external liberalisation of tariff regimes and the significant alignment of regulatory structures (technical barriers to trade, competition policy, customs administration and intellectual property rights). The full realisation of the customs union's integration potential, however, is still restricted by a number of remaining policy barriers: technical barriers to trade remain partially addressed; trade defence measures and safeguards also continue, along with barriers in external trade policy.

The asymmetric nature of the integration between the two parties in turn creates the possibility for a substantial policy conflict. By going deeper in some areas, while restricting others, the EU and Turkey have faced and will continue to face harmonisation inconsistencies, which raise serious questions about the future of the arrangement. Our next section considers some of these areas and shows that despite inconsistencies, the dynamics of the EU-Turkish customs union point towards the direction of deepening integration.

Before ending this section, we should also highlight the ever-present perception problem related to the customs union in Turkey. The customs union has become the rallying point for all the anti-EU and anti-globalisation campaigns in Turkey. The Turkish-EU trade deficit is depicted by mercantilist and populist circles as a net loss to the country. As a result, the public perception of the customs union is generally a negative one. It is seen as a price Turkey had to pay for enhancing its ties with the EU. A more concerted effort by government circles, the business community and civil society as a whole is definitely needed to improve the public image of the customs union. There are, we believe, lessons to be drawn from this experience as to the future of trade integration between the two sides. Additional steps must be accompanied by a pertinent communications campaign, which would aim at explaining to the public at large the reasons, the possible impact and the expected gains from this endeavour of economic integration.

3. Deepening the customs union

3.1 External trade policy

As described in more detail in the previous section, the customs union has been a catalyst in Turkey's integration with the EU and more generally with the global economy. Our general evaluation of the Turkish-EU customs union is a positive one. It is believed to have been a welfare-enhancing form of trade integration dominated by trade creation. Yet the dynamic effects have proven to be more important than the purely static effects. In more concrete terms, the customs union has helped the

transformation of Turkish industry by introducing stronger competition and accentuating the need for gaining a competitive edge, which led to improvements in productivity. It has also assisted in the rationalisation of the industrial structure, whereby domestic industries sought ways to integrate with global webs of production and distribution. It has further contributed to the modernisation of Turkey's economic legislation and therefore to its business environment. These are all factors that reveal the beneficial effects of the customs union.

As to the drawbacks of the customs union, there are two major issues that came to the fore in the past. The first one relates to the inconsistencies between the trade policies of the two sides. As a result of the customs union, Turkey proceeded with the harmonisation of its commercial policy with that of the EU. That meant concluding a number of free trade agreements with the countries with which the EU had made similar agreements in the past. Table 3 shows the trade impact of these agreements.

Table 3. Impact of free trade agreements on Turkey's foreign trade ($ thousands)

		1997	1998	1999	2000	2001
EFTA	Import	1,287,220	1,169,225	926,179	1,155,270	1,480,928
	Export	414,273	356,677	361,613	324,252	316,116
	Total	1,701,493	1,525,902	1,287,792	1,479,522	1,797,044
	Balance	-872,947	-812,548	-564,566	-831,018	-1,164,812
Bulgaria	Import	408,852	367,420	295,574	465,408	393,517
	Export	175,887	213,316	233,606	252,934	299,415
	Total	584,739	580,736	529,180	718,342	692,932
	Balance	-232,965	-154,104	-61,968	-212,474	-94,102
Romania	Import	394,087	344,672	401,157	673,928	481,139
	Export	358,783	468,178	268,295	325,818	392,027
	Total	752,870	812,851	669,452	999,746	873,166
	Balance	-35,304	123,506	-132,862	-348,110	-89,112
Israel	Import	233,681	282,827	298,258	505,482	529,489
	Export	391,514	479,507	585,239	650,142	805,218
	Total	625,195	762,334	883,497	1,155,624	1,334,707
	Balance	157,833	196,679	2,863,981	144,660	275,729
Czech Rep.	Import	98,491	93,302	82,018	158,740	126,873
	Export	82,896	69,557	67,257	101,571	109,399
	Total	181,387	162,859	149,275	260,311	236,272
	Balance	-15,595	-23,744	-14,761	-57,169	-17,474
Slovakia	Import	22,432	23,577	45,675	51,533	49,418
	Export	25,157	18,056	16,986	20,199	27,565
	Total	47,589	41,633	62,661	71,732	76,893
	Balance	2,724	-5,521	-28,689	-31,334	-21,853
Hungary	Import	106,514	152,389	95,000	216,262	186,673
	Export	133,966	113,684	121,919	109,994	170,230
	Total	240,480	266,073	216,919	326,256	356,903
	Balance	27,452	-38,705	26,919	-106,268	-16,443
Lithuania	Import	39,151	79,531	61,070	71,499	77,796
	Export	55,591	34,675	25,764	23,953	32,586
	Total	94,742	114,206	86,834	95,452	110,382
	Balance	16,440	-44,856	-35,306	-47,546	-45,210

Estonia	Import	30,958	10,258	4,748	7,091	1,336
	Export	5,769	6,176	9,046	9,439	13,169
	Total	36,727	16,434	13,794	16,530	14,505
	Balance	-25,189	-4,082	4,298	2,348	11,833
Latvia	Import	1,625	2,618	1,659	11,949	151
	Export	2,992	11,605	9,841	16,086	16,108
	Total	4,618	14,223	11,500	28,035	16,259
	Balance	1,367	8,987	8,182	4,137	15,957
Slovenia	Import	29,976	43,320	48,005	55,652	48,948
	Export	34,291	39,016	36,681	47,581	62,667
	Total	64,267	82,336	86,686	103,233	111,615
	Balance	4,315	-4,304	-9,324	-8,071	13,719
Poland	Import	91,954	82,052	81,245	164,681	168,070
	Export	255,260	290,850	219,624	174,596	241,233
	Total	347,214	372,902	300,869	339,277	409,303
	Balance	163,306	208,798	138,379	9,915	73,163
Macedonia	Import	30,217	13,237	7,878	10,470	9,116
	Export	77,392	68,190	93,670	107,765	89,816
	Total	107,609	81,427	101,548	118,235	98,932
	Balance	47,175	54,953	85,792	97,295	80,700
Croatia	Import	8,579	14,757	7,893	25,375	17,330
	Export	36,136	27,768	29,897	23,589	30,112
	Total	44,715	42,525	37,790	48,964	47,442
	Balance	27,557	13,011	22,004	-1,786	12,782
Bosna-Herz.	Import	1,295	5,298	16,222	7,497	4,927
	Export	31,871	38,077	39,892	26,871	27,585
	Total	33,166	43,375	56,114	34,368	32,512
	Balance	30,576	32,779	23,670	19,374	22,658
Total FTAs	Import	2,785,033	2,684,484	2,372,581	3,580,837	3,575,711
	Export	2,081,778	2,235,332	2,121,330	2,214,790	2,633,246
	Total	4,866,811	4,919,816	4,493,911	5,795,627	6,208,957
	Balance	-703,255	-449,152	-251,251	-1,366,047	-942,465
World	Import	48,558,721	45,921,392	40,671,272	54,502,821	41,399,083
	Export	26,261,072	26,973,952	26,587,225	27,774,906	31,334,216
	Total	74,819,793	72,895,344	67,258,497	82,277,727	72,733,299
	Balance	-22,297,649	-18,947,440	-14,084,047	-26,727,915	-10,064,867

Source: Undersecretariat of Foreign Trade.

It can be seen from this table that these preferential agreements contributed to a growth in Turkey's trade volume. The growth in trade with these countries has been higher than Turkey's growth in its trade with the rest of the world. As a result, the share of these countries in Turkey's trade has been on the increase. Whereas these countries' share in Turkey's total imports was 7.9% in 1997, it increased to 8.4% in 2001. Similarly their share in Turkey's exports, which stood at 5.7% in 1997, increased to 8.6% in 2001. The share of these countries in Turkey's trade deficit went up from 3% in 1997 to 9% in 2001.

In contrast with these developments, even after the completion of the customs union (which by definition requires a common commercial policy), changes in commercial policies were carried out

without proper cooperation or consultation between the parties. The most visible example is provided by the series of free trade agreements concluded by the EU after 1996. The EU went ahead and concluded these agreements without actually taking into consideration the existence of a customs union arrangement with Turkey. As such, there were no prior consultations with Turkey and therefore Turkish concerns did not come into play during these negotiations. Yet because of the customs union arrangement, Turkey was forced to conclude a similar agreement with those countries after the EU did. The problem was that more often than not, those countries did not want to negotiate with Turkey for a simple reason. Their agreement with the EU allowed them to export tariff-free (although indirectly) to the Turkish market, as their goods would enter into free circulation within the Community and therefore within the Turkish-EU customs union. In return, they did not have to reciprocate because under the free trade agreement only goods originating from the EU member states would profit from the preferential arrangements. As a result, they could export to Turkey on a preferential basis but did not have to extend this preferential arrangement to Turkey. Furthermore, this asymmetric structure also put Turkish exporters at a disadvantageous position with regard to Community exporters in those third countries. In addition, Turkey has been at risk of losing potential tariff revenues since goods originating from these third countries might not have been exported to Turkey directly but re-exported from the Community so as to take advantage of the lack of import duties. Although there are no direct estimates of the welfare loss caused by this asymmetric arrangement, an evaluation can be made on the basis of the number and trade impact of the free trade agreements concluded by the Community with third countries since the establishment of the customs union in 1996.

Table 4 shows that as of the end of 2002, the discrepancy between the EU's and Turkey's commercial policy resulted in a one-sided preferential trade volume of €86 billion between the EU and third countries. These countries were able to export €36 billion worth of goods to the EU on a preferential basis while the EU was able to export €50 billion worth of goods on a preferential basis to them.[7]

Table 4. Impact of free trade agreements between the EU and third countries (€ millions)

	EU TRADE								
		1999		**2000**		**2001**		**2002**	
	FTA	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**	**Exports**
Macedonia*	01.06.01	593	1,173	747	1,326	646	1,184	557	1,021
Croatia*	01.01.02	1,914	4,023	2,215	4,631	2,500	5,492	2,459	6,497
Cyprus	01.01.98	605	2,368	1,004	3,123	955	2,956	715	2,901
Malta	01.01.71	851	2,078	1,035	2,787	1,171	2,501	1,120	2,695
Tunisia	01.03.98	4,774	6,031	5,495	7,283	6,188	7,965	6,045	7,584
Morocco	01.03.00	5,553	6,627	6,015	7,736	6,241	7,476	6,295	7,697
Israel*	01.06.00	7,648	12,866	9,957	15,846	9,568	14,449	8,547	13,455
Jordan	01.05.02	169	1,244	180	1,622	151	1,830	295	1,960
Mexico	01.07.00	4,695	10,422	7,042	14,042	7,382	15,034	6,222	15,060
South Africa	01.01.00	10,700	9,731	14,475	11,715	16,018	12,480	15,635	12,453

* These countries have an FTA with Turkey as well.

Source: IMF DOT statistics (2002).

There are, however, no simple solutions to this dilemma. Turkey cannot automatically be made a party to the free trade agreements that the Community has negotiated or will negotiate. There will have to be separate negotiations. Yet the Community can induce a trading partner to open and conduct these negotiations in good faith with Turkey as well. Indeed, the EU started to introduce a 'Turkish clause'

[7] It should also be recalled that third-country preferences may have been gradually extended to the EU so that not all EU exports were able to take advantage of preferential treatment as of the end of 2002.

in its new bilateral trade agreements in which it asks its trading partner to negotiate a similar agreement with Turkey.[8] A suggestion in that regard may be to invoke a new sort of conditionality, whereby the ratification of the free trade agreement between the EU and a third country could be made conditional to the conclusion of a free trade agreement with Turkey. A more procedural suggestion may be to arrange the negotiations so that any round of negotiations between the third country and the EU should be followed by a round of negotiations between Turkey and that third country. In short, we believe that a solution can be found to this problem, which prevents unnecessary friction between the customs union partners or a perceived trade diversion and export impediment for the Turkish side.

To close this section, it has to be stated that an asymmetric customs union is an inherently difficult arrangement to sustain in view of the requirement of establishing and maintaining a common commercial policy between the partners. In this specific case, Turkey and the EU went ahead with the option of the customs union in contrast to the free-trade-agreement solution that was being implemented between the Community and the Central and Eastern European states, essentially because of a legacy issue. The Ankara Association Agreement (unlike the Europe Agreements) is based on a customs union. The parties' contractual obligations stemming from the Ankara agreement included the establishment of a customs union. There was very little discussion during the customs union negotiations about whether to implement a free trade agreement as opposed to a customs union, since changing the specific model of trade integration would have had political ramifications as well. In addition, Turkey viewed the customs union as a more integrationist project, which would have paved the way towards full membership. By the same token, however, it should be underlined that the customs union regime will be sustainable in the longer term only if there is concrete progress towards Turkey's full membership. The policy-dependency aspect of the customs union would otherwise create a political cost that would militate for a modification of the trade regime into a free trade area in the long run.

3.2 Holes and loopholes in trade policy under the customs union

Despite the substantial depth of integration envisaged under the EU-Turkish customs union, bilateral trade relations continue to be limited by various holes and loopholes in the 1995 agreement. As argued earlier in our discussion, the two most important areas in this context include the continuation of contingent protection and safeguards.

Starting with contingent protection, under the 1995 agreement both parties retain the right to initiate, investigate and impose trade defence measures in cases of unfair practices in their bilateral trade. These measures include anti-dumping and countervailing duties.[9] Such measures will only be allowed to lapse if Turkey can convincingly demonstrate to the Community that all competition and anti-subsidy disciplines as well as other areas of the *acquis communautaire* have been adopted and enforced in the Turkish economy. There exists, however, no specific timetable for their elimination and thus there is no explicit guarantee about their future in the context of the customs union.

Over the past decade, the EU has made extensive use of trade defence measures against Turkey. Since 1990 the Community has initiated 19 anti-dumping cases against Turkey (Table 5). Of these cases, six were terminated with no imposition of duties, two involved undertaking – whereby the Turkish firm agreed to raise prices to a minimum level – while the remaining imposed a definite duty on Turkish firms. In terms of sectors, cases appear to be concentrated in low-skill manufacturing, with textile and apparel industries leading. Other industries also targeted by anti-dumping duties include metals and

[8] The first time this clause was invoked was in the draft free trade agreement with Vietnam.

[9] Anti-dumping measures consist of special import duties imposed on products when the price of imports is alleged to be below the price (or normal value) charged by the foreign firm in its domestic market. Countervailing measures involve special import duties imposed when subsidised exports in foreign countries result in a costly reallocation of resources in the importing country or when subsidised exporters are able to pre-empt competitors in the home market and enjoy monopoly power.

metal products, while more recently there has been a case involving pharmaceuticals (paracetamol) and a case involving electronics (televisions).

Table 5. Some examples of EU anti-dumping measures taken against Turkey

Product	Initiation	Status
Hollow sections	2002	Provisional measures rejected
Flat-rolled products of iron	2001	Terminated: No duty
Welded tubes of iron & non-alloy steel	29/6/01	Imposed
Paracetamol	13/5/2000	Terminated: No duty
Steel-stranded ropes and cables	5/5/2000	Imposed
	5/5/2000	Undertaking: No duty
Televisions (colour)	15/7/ 2000	Ongoing Investigation
Steel wire rod	22/5/1999	Terminated: No duty
Cotton fabric (unbleached)	11/7/1997	Expired/No definite measure
Unbleached cotton fabrics	21/2/1996	Terminated
Polyester yarn (PTY)	4/1995	Expired
Polyester yarn (POY)	3/1995	Expired
Cotton fabric	20/1/1994	Terminated: No duty
Cotton yarn	1994	Expired
Bed linen	25/1/1994	Terminated: No duty
Portland cement	22/4/1992	Terminated: No duty
Semi-finished rod of alloy steel	9/4/1992	Expired
Polyester yarn (manmade fibres)	3/10/1991	Expired
Asbestos cement pipes	13/3/1990	Terminated due to undertaking

Sources: EU Commission (2003), *Annual Report to the European Parliament on the Community's Anti-dumping Activities, Anti-dumping and Anti-subsidy Measures List* (various issues); *Official Journal of the European Communities*, C&L Series (various issues).

Given this extensive use of anti-dumping measures, the question arises as to whether the establishment of the customs union has had any visible impact on the pattern of cases. More specifically, has the elimination of conventional border controls increased pressures in the EU for more trade-defence measures against Turkey? With regard to the number of cases, it is very difficult to provide a conclusive answer on the issue. Chronologically, the EU's anti-dumping measures against Turkish exporters appear to be evenly spread throughout the decade. There does not appear to be any major break from 1996 onwards that would allow us to suggest that there has been an increase in protectionist pressures in the Community.

Turning next to the case of Turkey, it was only in 1989 that the government adopted a law on the prevention of unfair competition. Since then Turkish authorities have made extensive use of anti-dumping measures. Around 29 cases were initiated over the past ten years, of which only two were terminated with no imposition of duty (Table 6). In terms of sectors, cases tend to be concentrated in textiles, chemicals and some light manufacturing. Regionally, cases have mainly arisen against Central and Eastern European countries as well as Asian countries. There have also been four anti-dumping cases initiated against EU member states.

The foregoing cases clearly demonstrate that anti-dumping measures continue to play an important role in EU-Turkish trade relations. Since the establishment of the customs union, both parties have invoked the provision on trade defence measures, with the weight falling mainly on the EU's side. While it has not been possible to argue whether such trade defence measures have gained prominence after the customs union, it would be wrong not to stress that their continuation has hindered market access in the EU-Turkish arrangement. Surely such barriers have predominantly affected Turkish exporters to the EU, but as our discussion has suggested, EU exporters have not remained unaffected.

Table 6. Some examples of Turkey's anti-dumping measures taken against third countries

Product	Origin	Initiation	Status
Woven fabrics: Stable fibres	China	n.a.	Imposed
Fittings	Brazil, China	n.a	Imposed
Polyester textured yarn	India, Korea	n.a	Imposed
Polyester synthetic staple fibres	Korea, Indonesia	n.a	Imposed
Polyester flat yarns	Korea	n.a	Imposed
Refillable pocket lighters	China	n.a	Imposed
Polyester synthetic staple fibres	Belarus	n.a	Imposed
Ball bearings	EU	29/6/1997	No duty
Benzoic acid	Netherlands	5/12/1996	No duty
Universal lathes	Bulgaria	26/1/1995	Expired
Steel billets	Russia, Ukraine	9/2/1994	Imposed
Polyvinyl chloride	Russia, Ukraine	28/1/1994	Expired
Citric acid	China	4/6/1994	Expired
Refillable pocket lighters	China	28/9/1994	Expired
Low density polyethylene	Russia, Bulgaria	9/10/1993	Expired
Polyester synthetic staple fibres	Russia, Belarus	30/7/1993	Expired
Polyester synthetic staple fibres	Italy	9/7/1991	Expired
Drawn or brown glass	Bulgaria, Russia	1/10/1992	Expired
Polyester synthetic staple fibres (processed)	Romania	20/5/1992	Expired
Benzoic acid	Netherlands	14/8/1991	Expired
Lead-acid elect. accumulators	Korea	22/5/1991	Expired
Glassware	Indonesia	6/6/1991	Expired
Universal lathes	China	22/6/1991	Expired
Articles of porcelain/china	China	3/4/1990	Expired
Slide fasteners	Chinese Taipei	13/7/1990	Expired
Roller chain	Chinese Taipei	21/3/1990	Expired
Lathe chucks	Poland	21/3/1990	Expired
Cast glass and rolled glass	Romania	21/3/1990	Expired
Drawn or brown glass	Romania	21/3/1990	Expired

Sources: WTO (1998) & Undersecretariat of Foreign Trade.

Given the above conclusions, it is finally important to ask whether there could be any possibility for the elimination of trade defence measures between the two parties in the future. Contingent protection arises in response to a variety of reasons, ranging from cross-border abuse of a dominant position – such as predatory pricing – to damaging foreign-industrial policy. Some of these areas could in principle be dealt with by competition policy. For example, cross-border predatory pricing (traditionally in the arena of anti-dumping) could be addressed by competition disciplines. Equally negative spillovers of national industrial policy, traditionally dealt with by countervailing measures, could also be addressed by strict disciplines on state aid. In effect, one could argue that in line with the 1995 agreement, anti-dumping measures could lapse if Turkey can convincingly demonstrate to the Community that all competition and anti-subsidy disciplines have been implemented. There is, however, a further dimension to contingent protection where competition policy becomes irrelevant. This dimension involves the more protectionist aspects of anti-dumping. Specifically, it has been argued that governments use anti-dumping measures not merely to remedy predation by foreign firms, but particularly to protect domestic monopolists or cartels from fringe competition. In the context of the EU, Messerlin (1995) argues that the Commission has, in the past, used anti-dumping for the protection of European cartels against foreign competition. There are no such allegations in the context of EU-Turkish relations. Yet there have been cases where the allegedly dumping Turkish firm

has a negligible share of the EU market (below 5%), which would suggest that European complainants were not targeting predation, but rather protecting their dominant position in the market.[10] Therefore in this context, while harmonisation with the EU's competition policy could deal with some aspects of contingent protection, it could never lead to their full abolition. Such elimination will be a matter of political choice, to be made later in the association, quite possibly with full accession.

Turning next to the second major loophole in the EU-Turkish arrangement, our analysis considers the role of safeguards. According to the 1995 agreement the customs union will retain the modalities of the 1970 Additional Protocol, which states that "if serious disturbances occur in a sector of any of the parties [Turkey, the Community or individual member states], or prejudice its external financial stability, or if difficulties arise which adversely affect the economic situation in a region of any party, then *that party* may take the necessary protective measures".[11] In the choice of measures, preference should be given to those that will least disturb the functioning of the customs union and should not exceed what is strictly necessary to remedy the difficulties that have arisen. If the targeted party finds that the measure creates an imbalance between the rights and obligations under the customs union agreement, then it may take rebalancing measures.

It is clear from the above that safeguards can potentially have serious consequences on the depth of integration between the two parties. The mere existence of safeguard provisions can incite rent-seeking activities from import-competing interests. Producers in the EU or Turkey could adapt their behaviour so as to increase the probability of satisfying the conditions necessary to obtain protection.[12] One could go as far as to argue that with safeguard provisions in place, import-competing firms have an interest in taking advantage of possible protection possibilities. Equally, it is interesting that the agreement makes no explicit mention of the possible causes of disturbance, prejudice or difficulty that have given rise to the safeguard or protection measure. It is therefore open to the interpretation of the Association Council or the arbitration tribunal (or both) to determine whether the measure is necessary. Much depends on the neutrality of the Association Council and the transparency of procedures. Yet to date the minutes of the Association Council and its relevant sub-committees have been hidden from the public. It should be noted that so far, neither party in the EU-Turkish customs union has invoked the safeguard provision.

The discussion above certainly underlines the importance of the dispute-settlement mechanism in the arrangement. In the context of the customs union, either of contracting parties (Turkey, the Community or individual member states) can submit to the Association Council any dispute relating to the application or interpretation of the agreement. The Council of Association may settle the dispute by decision, which will be binding for both parties. In the event that it fails to do so within six months, either party can refer the dispute to an arbitration tribunal. Thus, the binding powers of the mechanism could either lock significant liberalisation through its decisions or allow protectionist pressures to dominate.

To conclude, with regard to anti-dumping measures, safeguards and dispute settlement in Turkish-EU trade relations, our analysis suggests the following policy recommendations for the two parties:

- In the area of anti-dumping, it appears that unless the two parties are willing to push for further market integration, contingent protection will remain. Even if competition policy is fully aligned and the Commission is convinced that Turkish measures and processes are fully compatible with the EU, there will still be scope for anti-dumping measures (outside the strict confines of predatory pricing). It is important that use of anti-dumping measures becomes completely separate from protectionist efforts, which in turn will pave the way for their abolition.

[10] This argument has also been made by P. Messerlin (1995). Of particular interest is the case of unbleached cotton where the alleged initial share of the Turkish exporter was 5.3%.

[11] See Art. 60 of the Additional Protocol.

[12] See B. Hoekman and M. Leidy (1993), "Holes and Loopholes in Integration Agreements: History and Prospects", in K. Anderson and R. Blackhurst (eds), *Regional Integration and the Global Trading System*, Hemel Hempstead: Harvester.

- In the area of safeguards and dispute settlement, our analysis showed that the binding powers of the mechanism/process are such that significant liberalisation could be enforced in the future. This development, however, depends primarily on the transparency of the system. Only if processes and procedures are transparent will the system be geared towards further liberalisation and integration.

3.3 Technical barriers to trade

Technical barriers to trade (TBTs) have, as already argued, played a central role in the customs union, as they represent an important step forward in Turkey's integration with the EU Single Market. Nevertheless, the actual incorporation of TBTs in the 1995 agreement has been characterised by serious asymmetries, which in turn allow significant leeway for the continuation of barriers. More specifically, the 1995 agreement focuses primarily on standardisation – the process by which product standards and regulations are developed and adopted. By contrast, the agreement adopts a relatively minimalist position in the area of conformity assessment – the process that certifies that a product conforms to the requirements set out by a given standard or regulation. This in turn means that Turkish goods produced under correct EU specifications can still face barriers upon export to the EU, since their certification is not recognised by the Community. The same of course is true for EU exports into Turkey, as Turkish authorities may not recognise procedures in the EU and require duplicative testing and inspection. In general, as Stephenson rightly argued, it is no good for producers to comply with a standard if they or the sellers cannot demonstrate this to the satisfaction of the purchaser; equally, it is useless to comply with a regulation if the authorities cannot be persuaded of this at a reasonable cost.[13]

Given this highly asymmetric approach to TBTs, progress in the area has been relatively mixed. In considering developments and prospects, our analysis focuses on three main areas: first, problems arising from the institutional setting in Turkey; second, progress and prospects in the area of standardisation; and third, progress and prospects in the area of conformity assessment.

Starting with the institutional environment, the current system of standardisation and conformity assessment in Turkey includes several governmental and semi-governmental bodies with direct control over the creation and enforcement of standards. The centrepiece of the system is the Turkish Standards Institute (TSE)[14] with primary authority and responsibility for preparing and publishing Turkish standards for all types of materials, products and services. Although envisaged as a non-governmental organisation, the TSE remains a public institution under the heavy influence of the state. Around 10% of its revenue comes from the government, while the highest decision making authority – the General Assembly – is primarily composed of various ministry representatives.[15] Internationally, the TSE carries an active profile, with full or affiliate memberships in major organisations in the field.[16] In the area of conformity assessment, the Turkish system is characterised by various levels of authority. Testing and certification procedures on imported products are performed by different national bodies, including the TSE and relevant ministries.[17] In terms of enforcement, all imported products that are

[13] See S. Stephenson (1997a), *Conformity Assessment and Developing Countries*, Policy Working Paper, World Bank, Washington D.C., May.

[14] The TSE was established in 1960 (by Law No.132).

[15] See the Statute for the Establishment of the Turkish Standards Institution (1960), No. 132, November.

[16] The TSE has full memberships in the International Standardisation Organisation (ISO) and International Electrotechnical Commission (IEC), as well as, affiliate memberships in the CEN and the European Committee for Electotechnical Standardisation (CENELEC). According to the authorities, all standardisation work is carried out in parallel to ISO/IEC standards and in line with the TBT Agreement. Turkey is a full signatory of the WTO Sanitary and Phytosanitary Measures (SPS) agreement, while Turkish food norms are fully harmonised to the FAO Codex Alimentarius.

[17] The TSE undertakes the testing and certification of industrial products, the Ministry of Environment focuses on environment-related products, the Undersecretariat of Foreign Trade and the Ministry of Agriculture and

subject to mandatory standards must hold a Certificate of Conformity (TSE mark) and a Quality Conformance Certificate (TSEK), produced by the TSE prior to importation.[18] In obtaining the TSE and TSEK marks, exporters to Turkey have to go through a lengthy and costly procedure, which involves the adoption of an inspection or control certificate by the TSE. The authorities stress that although the procedure is obligatory only for mandatory standards, it is also *highly recommended* for the marketing of products subject to voluntary standards. Finally, in the area of accreditation, Turkey has only recently established an independent audit. The newly founded Turkish accreditation authority (TURKAK) is argued to be an independent legal entity with administrative and financial autonomy.[19] This is a positive development and although it is relatively early to make any robust judgments on the functioning of TURKAK, the law still allows for substantial interference from the state.

Thus it appears that the current institutional environment in Turkey allows for considerable room for the continuation of barriers between the two parties. Problems seem to arise from the relatively low levels of transparency and openness of the system. This is evident from the obligatory or near obligatory use of the TSE and TSEK marks. European officials claim that the number and nature of products subject to mandatory standards (and obliged to use Turkish marks) are above and beyond international standards. Notable examples include rigorous regulations on certain chemical and cosmetic goods such as detergents and soap, as well as certain foodstuffs and beverages such as lentils and alcohol.[20] Most hindering, however, is that with regard to products subject to voluntary standards the Turkish authorities also stress the *highly recommended* use of TSE marks. In effect, although not openly stated, the authorities imply that unmarked products will face marketing difficulties. Further, delays and unnecessary documentation continue to act as a serious technical barrier against foreign producers, placing them in a disadvantageous position in the Turkish market.

Turning next to the area of standardisation, Turkey's process of harmonisation with the EU system has concentrated on two principal domains. The first relates to the preparation and adoption of the necessary *horizontal* legislation and is primarily under the authority of the Undersecretariat of Foreign Trade. The second deals with the adoption of *vertical* legislation (the EU *acquis*) relating to the removal of TBTs and has a much more detailed, sectoral coverage.

Starting with the horizontal legislation, a major development in this area has been the adoption of the new framework law[21] in July 2001, designed to enhance transparency and efficiency in the implementation of the harmonised technical regulations. The draft framework law lays down the main principles for placing products on the market, and the obligations of producers and distributors. It also addresses market surveillance and the prohibition of products destined for the market. All regulations have recently been adopted and integrated in the Turkish internal legal infrastructure. Yet their enforcement and implementation is believed by Turkish authorities to face numerous difficulties. As stressed by the recent progress report of the EU-Turkey Internal Market Sub-committee, there is a substantial lack of information in the administration and documentation for market surveillance and other import controls.[22] As such, administrative delays, inconsistencies and other red-tape costs are likely to persist.

Rural Affairs undertake testing and certification of agricultural and processed agricultural products, and finally the Ministry of Health focuses on medical products, cosmetics and detergents.

[18] This procedure also holds for goods that are produced and are in free circulation in the EU, albeit it is argued that certificates are issued directly in this case, as long as the producer submits a technical file to the TSE prior to importation.

[19] See Turkish Prime Ministry (2001a), *NPAA: National Program for the Adoption of the Acquis*, Ankara.

[20] See Turkish Standards Institute (2001), Standards Database (retrievable from http://www.tse.org.tr).

[21] See the draft law relating to the Preparation and Implementation of Technical Regulations on Products (2001), July.

[22] Undersecretariat of Foreign Trade, General Directorate of Standardisation for Foreign Trade (2001), *Progress Activities of the Harmonisation of the EU Technical Legislation in Turkey*, Ankara, April.

Turning to the adoption of vertical legislation, the customs union agreement requires Turkey to adopt all 319 EU Directives. The responsibilities for the harmonisation of the Turkish infrastructure with different directives have been delegated to the respective Turkish authorities and are currently being implemented. Table 7 documents progress in harmonisation.

Table 7. Progress on the harmonisation of TBTs between EU and Turkey

Sector	Authority responsible	Fully harmonised	In progress or partially harmonised	Total
Motor vehicles	Ministry of Industry and Trade	26	39	65
Agricultural & forestry tractors	Ministry of Industry and Trade	9	14	23
Lifting & mechanical appliances	Ministry of Industry and Trade	0	5	5
Household appliances	Ministry of Industry and Trade	0	3	3
Gas appliances	Ministry of Industry and Trade	1	2	3
Household appliances	Ministry of Industry and Trade	0	3	3
Construction plant & equipment	Ministry of Industry and Trade	0	9	9
Other machines	Ministry of Industry and Trade	0	1	1
Pressure vessels	Ministry of Industry and Trade	5	1	6
Measuring instruments	Ministry of Industry and Trade	6	21	27
Electrical material	Ministry of Industry and Trade	0	8	8
Textiles	Ministry of Industry and Trade	0	4	4
Foodstuffs	Ministry of Agric. & Rural Affairs	26	39	65
Medicinal products	Ministry of Health	5	13	18
Fertilizers	Ministry of Agri. & Rural Affairs	0	7	7
Dangerous substances	Ministry of Environment	0	19	19
Cosmetics	Ministry of Health	1	7	8
Environment protection	Ministry of Environment	2	5	7
Info. tech. telecoms & data	Ministry of Transportation	13	1	14
General Provisions in TBTs	Undersecretary of Foreign Trade	1	8	9
Construction products	Ministry of Public Works	0	3	3
Personal protective equipment	Ministry of Labour & Social Sec.	1	0	1
Toys	Ministry of Health	1	0	1
Machinery	Ministry of Industry and Trade	1	0	1
Tobacco	TEKEL	0	2	2
Energy	Ministry of Energy	0	0	0
Spirit drinks	Ministry of Agri. & Rural Affairs	1	0	1
Cultural goods	Ministry of Culture	1	0	1
Explosives for civil use	Ministry of Industry and Trade	1	0	1
Medical devices	Ministry of Health	1	0	1
Recreational craft	Undersec. of Maritime Affairs	1	0	1
Miscellaneous	Ministry of Industry and Trade	1	1	2
Total		104	215	319
Total in percentages		32%	68%	100%

Source: Own calculations and Undersecretariat of Foreign Trade (2001).

Of the total 319 Directives, around 32% are currently in full harmony, while the remaining 68% are either in progress or partially harmonised. Significant progress could be reported in motor vehicles, foodstuffs and particularly telecommunications sectors, given the bulk of regulations in these areas. Other areas with significant progress are pressure vessels, medical products and toys. Nevertheless, in the crucial areas of measuring instruments, medicinal and other chemical products (such as fertilizers and dangerous substances), progress appears to be rather slow with most directives still under or partial harmonisation.

Turning finally to the area of conformity assessment, largely reflecting a minimalist approach to the 1995 agreement, the two parties' relationship here is still underdeveloped. Much remains to be done to

reduce barriers for Turkish exporters. Efforts should focus on strengthening the technical capacity of the Turkish system of certification and 'institutionalising' confidence and mutual trust between the two parties.

More specifically, Turkey continues to lack the technical capacity and infrastructure to fully meet the needs of the testing and certification process. The most serious problems appear to be concentrated in the crucial areas of metrology and calibration, quality certification and laboratory testing. Such lack of infrastructure in turn translates into a lack of confidence in Turkish processes and procedures. In effect, the resulting burden for Turkish exporters has become significant, as they need to certify their products with foreign laboratories and institutes, which in turn means increased transport and other administrative costs. To overcome these difficulties, two major projects have been launched over the past few years. The first is an initiative supported by the World Bank, which aims among other things at strengthening the country's technology and metrology infrastructure to serve a larger section of the industry as well as to become recognised by European institutions. The second and more recent one is a project financed by the EU MEDA programme, which aims at strengthening the country's testing and certification infrastructure and establishing the necessary mechanisms for market surveillance.[23] Although both of these projects have been described as touching the 'tip of the iceberg', they also represent significant developments towards bridging the technical gap and reducing the resulting trade barriers from the lack of infrastructure.

Finally, the institutionalisation of confidence and mutual trust between the two parties can be a lengthy and costly process. No strategy is a panacea in this field, but we could identify three areas where future work could focus. The first regards broader cooperation in the field both at regional and international levels. Overall, in the realm of technical barriers to trade Turkish institutes and organisations have been working to build up a more active profile in recent years. Turkey has gained full membership in all the major international standardisation initiatives. The most important of these include the ISO, which works to promote standardisation among national standards bodies, the IEC, which focuses on standardisation in electro-technical products, the FAO, which focuses on standards in food and agricultural products, and of course the WTO TBT/SPS agreements, which focus on formalising the rules that govern the relationship between international standards and national regulations. Turkey is also actively pursuing memberships in the relevant European standardisation initiatives – focusing mainly on the CEN and CENELEC. This active profile in both international and European arenas suggests that Turkish standards and technical regulations are gradually being brought in line with relevant European and international ones.

Nevertheless, the country's participation in vital certification and accreditation initiatives at the European and international levels is still limited. Turkey's non-participation in the European Organisation for Conformity Assessment is a clear example. Given the seriousness of potential barriers in these two areas, lack of progress in international and regional involvement and lack of recognition could put Turkey in a disadvantageous position relative to its trading partners. Further work is also needed with the development or upgrading of Turkey's infrastructure to the levels of the EU. New laboratories will have to be established and existing ones restructured and upgraded to international standards. The efforts that have started in this field through the two previously mentioned projects are very important for building a reputation and promoting the development of equivalency.

The second and most important area of work relates to policy initiatives. Unlike the case between the EU and Turkey, countries with established mutual trust in respective practices and procedures could negotiate and reach mutual recognition agreements, whereby confidence is imposed by law. In the EU-Turkish case, where confidence is low, preliminary agreements should be reached with the aim of setting the procedure through which confidence can be developed. In effect, instead of leaving the responsibility of confidence-building to the marketplace alone, EU and Turkish authorities can enhance and speed up the process through formal agreements. Such is the case for the Protocols on

[23] See the Delegation of the European Commission in Turkey (2001), *EU Supports Turkey's Exports and Quality Infrastructure Project*, press release, 17 April (retrievable from http://www.deltur.eu.int).

European Conformity Assessment (PECAs) currently in place between the EU and certain Central European countries.[24] PECAs focus on specific sectors where the *acquis* has been adopted and the necessary infrastructure exists, aiming at serving as a testing ground to enhance confidence and thus the recognition of respective practices. Their sectoral focus will allow the EU and Turkish authorities to identify in detail the principal problem areas for different products and if necessary, undertake action for their resolution. Most importantly however, the agreement will serve as a platform for greater information exchange and provide the necessary requirements for the gradual development of confidence, trust and indeed recognition. But it should be noted that the Commission does not have the power to initiate negotiations on PECAs with Turkey. Under the current agreement, only the Turkish authorities can initiate discussions and request further cooperation in conformity assessment.

Finally, a word of warning is also needed with regard to the establishment of unions of importers in Turkey. Although the alleged claim is to be able to better monitor imports, these bodies are arguably in violation of Turkey's commitments under the customs union decision. They may be interpreted as a measure having equivalent effect to quantitative restrictions and therefore are in violation of Art. 5 of the decision by virtue of introducing additional red tape in connection with imports. Their mandatory participation fees may also be interpreted as having an equivalent effect to customs duties. These features of the unions of importers will most likely give rise to a complaint from the EU side and may be seen as another element of Turkey's disguised protectionism.

To conclude, our analysis would suggest the following policy recommendations:

- Internally, greater emphasis should be placed on strengthening the transparency of the Turkish system of standardisation and conformity assessment. The adoption of the new framework law and the establishment of TURKAK are important developments in this respect.
- Greater effort should be placed in strengthening Turkey's technical capacity and infrastructure in order to fully meet the needs of testing and certification processes. Particular attention should be given to critical areas of conformity assessment including metrology and calibration, quality certification and laboratory testing.
- Turkish institutes and organisations should energetically continue their efforts to promote a more active international profile. Alignment with and participation in European and international initiatives should continue in order to strengthen reputation-building and promote the recognition of equivalency. It is vital that efforts continue in the pursuit of memberships to the European CEN and CENELEC, but equal emphasis should be placed on the area of conformity assessment.
- Bilateral contractual initiatives in the form of PECAs should also be sought by Turkish authorities. Such arrangements can set the platform for enhancing confidence and thus recognising respective practices.

3.4 Competition law and state aids

The topic of competition policy entered Turkey's agenda with the establishment of the customs union. As such, the application of competition rules in Turkey is a direct consequence of the country's trade integration with the EU. The customs union decision stipulates that Turkey shall apply a substantially similar competition policy to that of the EU. In that regard, Law No. 4054 on the Protection of Competition incorporates a parallel wording of the Arts. 81 and 82 and the relevant sections of the EU's merger regulation. In addition, the implementing legislation issued by the Turkish Competition Board (or in other words the block exemption regulations) are modelled after the block exemption regulations of the EU. In short, the legislative framework of the Turkish competition law is very similar to the EU's. In terms of the approximation or harmonisation of legislation, competition rules stand out as a major success.

[24] These countries are the Czech Republic, Hungary and Poland.

This success story is further strengthened by the performance of the Turkish Competition Authority. It can be claimed that the Turkish Competition Authority is among the best-performing regulatory institutions in Turkey. Although it was established relatively late (in 1997) – a full three years after the promulgation of the law on competition, it blossomed into a high quality, professional body whose performance has also been commended by the European Commission in its regular progress reports on Turkey. Finally, one of the major shortcomings of competition law in Turkey was addressed in 2003 when an amendment to the law enabled the Competition Board to give teeth to its ability to impose fines on violating entities. Before the amendment, in case the decision of the board was appealed, the fines in question would not come into effect until the board's decision was finally approved by the appellate body, namely the Higher Administrative Court.

Against this generally positive backdrop, there are still areas of concern that relate to the future.

The first one relates to the aim of competition policy. It is clear that one of the aims of competition policy in Europe is to support the objective of market integration. Competition policy is one of the regulatory tools used to further this objective. Therefore the outlook of the European Commission on competition cases is necessarily affected by this market-integration objective. The case law on competition in the EU reflects this concern. This is quite normal in view of the nature of the EU where a supranational structure tries to integrate what were hitherto national markets. It is worth recalling in this instance that the European competition law is a supranational law. With the customs union, Turkey took on the responsibility of applying a substantially similar competition law. The conceptual problem is that a set of rules designed for supranational integration is to be applied on a national scale. Although objectives such as promoting market integration or the prevention of market fragmentation are relevant at the supranational dimension, these are nonexistent at the national dimension. Optimally, the application of the law at a national level should have taken this difference in objectives into consideration. But the application of competition rules in Turkey since 1997 has demonstrated that this was not the approach adopted by the Turkish Competition Authority. The decisions of the Turkish Competition Authority were influenced too much by the relevant EU case law. As a result, on issues dealing with vertical restraints for instance, the interpretation of the Turkish Competition Authority turned out to be too restrictive and less beneficial for enhancing competition in the domestic market. While vertical restraints can become a priority issue in dealing with supranational market integration, it is much less relevant for a market that is already integrated. Therefore in the future, the Turkish Competition Authority should enforce competition rules in a manner that considers the difference in aims between EU competition law and Turkish competition law. Such consideration would mean a justifiably differentiated approach to competition cases where to date a blind commitment to EU case law has been the standard. It is worth recalling that until a few years ago, the UK's national competition legislation was very different from the EU's competition legislation.

Although in some cases a subtly different approach to protecting competition is needed in Turkey, in other areas the exact opposite is true. The two most relevant topics in this respect are the enhancement of the culture of competition and the implementation of leniency rules and *de minimis* rules.

Standing in stark contrast to its performance on competition cases is the statutory role of the Turkish Competition Authority in developing the culture of competition. This has been the most visible area of underperformance of the Authority. The Authority has been unable to fulfil its role in educating public opinion about the value and role of competition policy. According to Ismen,[25] "the Competition Board is much more focused on and concerned with business centres, its main foes, than it is with its main clients, consumers and the small and medium-sized enterprises". Ismen claims that this choice is both expected and understandable in light of Turkey's political and social environment where there are no serious consumer groups. That is nonetheless an area where the Authority should follow EU practice more closely. It may therefore be important to launch a cooperation programme between the European

[25] See T. Ismen (2003), "A critical assessment of competition policy in Turkey", *Turkish Policy Quarterly*, Fall, Istanbul.

Commission, some national competition authorities and the Turkish Competition Authority on successful awareness-raising campaigns for competition rules.

There are also areas where the harmonisation of legislation is not complete and as a result the application of competition rules is made more difficult and uncertain. The first one of these areas concerns leniency rules. Leniency rules are designed to give incentives to participants in cartel arrangements to blow the whistle on the cartel. Although the European Commission makes use of these rules and furthermore underlines[26] the importance of the rules in discovering cartel cases, Turkey does not yet have such rules. As a result, the efforts of the Turkish Competition Board towards targeting collusion and cartel-like arrangements are seriously undermined. The institution is thus forced to spend its time in examining the notification files for individual exemptions, merger notifications and investigating the odd case of alleged anti-competitive behaviour. There is also a serious need in Turkey to divert the efforts of the competition authorities towards the economically more important and more damaging cases of anti-competitive behaviour as there is in the EU. Leniency rules are an indispensable element in this regard. The Turkish Competition Authority should be called upon to adopt these rules as soon as possible.

A similar situation prevails as regards *de minimis* rules. *De minimis* rules in competition law are used to weed out economically insignificant cases of anti-competitive behaviour. The Competition Authority can therefore concentrate its resources on other more meaningful cases. The EU's practice in this area is well-developed, unlike Turkey where there are no *de minimis* rules. As a result, the Competition Authority is actually forced to investigate even very minor instances of anti-competitive practices, which leads to a severe misallocation of resources. Therefore the harmonisation of Turkey's competition legislation with that of the EU should proceed so as to include *de minimis* rules.

Concerning the question of harmonisation, a more important issue is the maintenance of harmonised legislation. The customs union does not only oblige Turkey to harmonise its competition law with that of the EU but it also commits Turkey to follow the changes in competition law adopted by the EU. This policy dependence is at the root nowadays of a significant challenge for Turkey. The EU is in the process of implementing a radical reform of its competition rules. The new rules are set to decentralise decision-making in competition policy. They foresee a more active involvement of national courts in competition cases. They also introduce a more flexible enforcement regime characterised by the abolition of the authorisation system requiring the notification of restrictive agreements to the Commission for clearance. The establishment of a European competition network (ECN) composed of the Commission and the national competition authorities is also foreseen.

The flexibility and decentralisation introduced by the enforcement of competition rules at the European level came about as the policy-makers were convinced that after 40 years of application, the European business community had developed an understanding of and knowledge about competition rules. In other words, the culture of competition was well entrenched in Europe. Therefore a switch towards a more flexible regime of enforcement where national authorities and national courts would have an increased role was possible. The radical transformation of the enforcement regime hinged on the understanding that the public awareness of competition rules was sufficient in Europe.

The situation in Turkey is vastly different, but because of the relevant provisions of the customs union decision, Turkey is nonetheless bound to follow the EU in transforming its own enforcement policy. The mandatory notification procedure that had been applied in the EU for more than 40 years and now for almost seven years in Turkey has to be considered as an indispensable element in the spread of the competition culture. The lifting of this obligation at a time when awareness about competition issues is still low is tantamount to severely restricting the effectiveness of competition rules. From the Turkish standpoint, it would make no sense to follow the EU at this point in time. There is still a lot of distance to cover in terms of spreading the competition culture in Turkey. Thus there may be a need to agree on

[26] European Commission (2004), *Communication on A pro-active Competition Policy for a Competitive Europe*, COM(2004) 293 final, Brussels.

a longer transition period than the one foreseen by the customs union decision for Turkey's adoption of the new rules introduced by the EU.

Finally, the question of state aid needs to be addressed at this point. Although also foreseen by the customs union decision, Turkey has refrained so far from establishing an independent authority to monitor state aid at the domestic level. This deficiency has been highlighted in successive regular reports by the Commission. There is now a draft law before parliament that calls for the establishment of a state aids monitoring authority. The current draft law has several drawbacks though. First, the regulatory body in question shall not be independent for instance. It is to be headed by the Undersecretariat of the State Planning Organisation and include representatives from other governmental and quasi-governmental bodies such as the Treasury, the Ministry of Industry and the Competition Authority. Second, it is drafted in such a way that it sheds doubt on how well the concept of state aid is understood in practice. It should actually be considered as a relic of the past where the concept of state aid was essentially limited to government incentive schemes. Furthermore, it seems to leave services of general interest out of its scope. Therefore it is essential that the current draft law be amended in order to bring about a framework law for the monitoring of state aid that would be more effective and also compatible with EU practice.

The independent enforcement of state-aid control is important not only on account of fulfilling Turkey's obligations stemming from the customs union but also in order to succeed in the game of liberalising and de-regulating hitherto state-owned or dominated domains of activity in utilities such as telecommunications, energy, postal services or even banking. The application of state-aid rules will also contribute positively to Turkey's image *vis-à-vis* international investors. The state's potential for unfair competition is a significant impediment to foreign investment.

To conclude, the recommendations in relation to the topic of competition policy can be summarised as follows:

- Awareness should be raised of the need for a slightly differentiated approach between the European Commission and the Turkish Competition Authority in relation to alleged anti-competitive behaviours and especially in connection with vertical restraints resulting from the difference in aims between European competition policy applied at the supranational level and Turkish competition policy applied at the national level.
- Institutional support by the European Commission or national competition authorities (or both) is needed to enable the Turkish Competition Authority to be more effective in its role of promoting the culture of competition.
- The harmonisation of legislation in relation to leniency rules and *de minimis* rules should be accelerated.
- A five- to ten-year transition period should be granted to Turkey for the adoption of the new competition rules introduced as of the 1st of May 2004 in the EU.
- The draft framework law on the monitoring of state aid should be amended to achieve a more effective regime for state-aid control in a manner that is compatible with EU practice.

3.5 Intellectual property rights

Intellectual property rights (IPRs) also represent an important area of deep integration in the context of the EU-Turkish customs union. Nevertheless, the approach adopted by the two parties for IPRs could be described as somewhat less aggressive, involving less harmonisation/approximation of respective rules and focusing more on mutual compatibility with international regulations. Indeed, the 1995 agreement requires the EU and Turkey to re-confirm the importance they attach to the obligations arising from the agreement on trade-related aspects of intellectual property rights (TRIPs) concluded in the Uruguay round of multilateral free trade negotiations. In this context, Turkey was required to: adopt and implement no later than 1999 the provisions of the WTO TRIPs agreement; accede by 1996

to the Paris Act, Rome Convention, Stockholm Act and the Nice agreement;[27] and adopt by 1996 domestic legislation on the protection of IPRs that is compatible with EU directives.

Turkey has made considerable progress in the area of IPRs. The Turkish Patent Institute has administrative and financial autonomy and has full responsibility for the registration and administration of patents and IPRs (trademarks, industrial designs and destination of origin). On the legislative side, a first important step has been the adoption of detailed legislation aiming at *strengthening* alignment with EU directives on rental rights and lending, copyrights and the provisions of the Rome and Bern Conventions, TRIPs and the World Intellectual Property Organisation (WIPO) 'Internet' Treaties.[28] Furthermore, in November 2000 Turkey ratified and acceded to the European Patent Convention.[29] Moreover, in the area of protection and supervision, in 2001, Turkey adopted new legislation identifying the division of legislative powers between the general civil and penal courts and new specialised courts that are handling cases related to IPRs.

Given the above developments a number of commentators now describe Turkey as an attractive investment environment, which is in compliance with the TRIPs and the WTO.[30] This qualification is an important step forward for Turkey that should be emphasised. IPRs essentially set a rules-based system for the marketing and trade of innovative new ideas and thus act as a powerful signalling mechanism for potential foreign investors. By acquiring a sound set of IPR rules and a transparent and reliable monitoring system, Turkey creates better opportunities for strengthening foreign investment flows and in particular foreign direct investment (FDI).

Table 8. Estimated trade losses owing to piracy and levels of piracy

Industry	2003 Loss ($ mil.)	Level (%)	2002 Loss ($ mil.)	Level (%)	2001 Loss ($ mil.)	Level (%)
Motion pictures	50	45	50	45	50	40
Music	15	75	18	75	3.5	35
Business software	n.a.	n.a.	38	58	22.4	58
Entertainment software	n.a.	n.a.	n.a.	n.a.	23.7	90
Books	25	25	n.a.	n.a.	27	n.a.
Total	n.a.	-	131.5	-	126.6	-

Source: International Intellectual Property Alliance (2004), *2004 Special 301 Report, Turkey*, IIPA, Washington, D.C. (retrievable from http://www.iipa.com/rbc/2004/2004SPEC301TURKEY.pdf).

Despite these positive steps, however, much remains to be done to promote compatibility and integration with the EU system. Piracy and counterfeit remain serious problems in the country. See Table 8. The International Intellectual Property Alliance estimates that in 2002, the total trade loss due to piracy reached $131.5 million with counterfeit levels as high as 58% and 75% in the music and business software industries respectively. Even if these estimates are to be taken 'with a grain of salt', they do indicate an alarming environment that should be addressed by the authorities. One positive development has been the establishment of provincial enforcement committees in 2002, but

[27] The Paris Act (1971) of the Bern Convention protects library and artistic works, the Rome Convention (1961) protects performers, producers of phonograms and broadcasting organisations, the Stockholm Act (1967) of the Paris Convention protects industrial property (as amended in 1979) and the Nice Agreement concerns the international classification of goods and services for the purposes of the registration.

[28] See the European Commission (2002), *Regular Progress Report on Turkey*, Brussels.

[29] See D. Ilgaz (2002), "Turkey Aims at Full Harmonisation with the EU Acquis Communautaire in Intellectual Property as a Requirement of Membership", in Peter G. Xuereb (ed.), *Euro-Mediterranean Integration: The Mediterranean's European Challenge – Vol. III*, Malta: Publishers Enterprises Group Ltd.

[30] See P. Sheridan (2002), *Doing Business in Turkey*, London: Denton, Wilde, Sapte & Guner, October.

administrative capacity should be strengthened with "training and more inter-institutional cooperation between the police, customs offices and the judiciary".[31]

On the legislative side, the Commission remains critical about the level compatibility with international treaties and relevant EU directives. Despite progress towards strengthening alignment, Turkey has not yet joined the WIPO Copyright Treaty or the WIPO Performances and Phonograms Treaty, while the official publication of the ratified adoption of the Rome and Bern agreements remains pending.[32] Further, in the area of industrial property rights, the Commission stresses that Turkish law on the legal protection of designs remains incompatible with EU directives.

The foregoing analysis suggests that despite the positive words from international commentators, Turkey has yet to establish a fully secure environment for international investors in the area of IPRs. A number of positive steps have been taken on the legislative, institutional and monitoring fronts. In particular, Turkey strengthened its regime of IPR-enforcement with the enactment of two pieces of legislation in 2004.[33] But problems remain in compatibility with major international agreements and EU directives in the area. It is against this background that foreign investment flows into Turkey remain significantly weak (Table 9). While macroeconomic instability has played an important role in limiting appetite for foreign investments in the country, the institutional environment is also a key contributor. Indeed, one would expect that from 1995 onwards, foreign investment inflows would have increased into Turkey. Yet the weak institutional framework combined with the financial turbulence at the end of the decade has led to a steady deterioration of FDI flows.

Table 9. Foreign direct investment ($ millions)

Years	Manufacturing	Agriculture	Mining	Services	Total
1994	1107.29	28.27	6.2	335.85	1477.61
1995	1996.48	31.74	60.62	849.48	2938.32
1996	640.59	64.1	8.54	3123.74	3836.97
1997	871.81	12.22	26.7	767.47	1678.2
1998	1018.29	5.75	13.73	609.67	1647.44
1999	1123.22	17.19	6.76	553.4	1700.57

Source: Turkish Treasury Statistics (2001).

Finally a peculiarity of the customs union should also be recalled. Although the customs union reflects a desire for harmonising Turkey's legislation with that of the Community, the area of IPRs provide an interesting exception. According to Art. 10(2) of Annex No. 8, unlike the prevailing regime within the Single Market, the exhaustion principle is not applied to trade between Turkey and the EU. In practice, this means that parallel imports into Turkey can still be prevented by the owners of intellectual, industrial or commercial property rights. This situation is detrimental to the establishment of genuine competition in the domestic market and also helps to sustain higher mark-ups for producers with a negative impact on consumer surplus. Hence the principle of the exhaustion of IPRs, which has been in existence in the EU for more than a decade, should also be applied to the EU-Turkish trade.

To conclude, our analysis suggests the following policy recommendations in the area of intellectual property rights:

- Turkey should further strengthen its efforts in the fight against piracy. The establishment of enforcement committees at a provincial level has been a positive development, but administrative capacity should be strengthened. All international assessments (including the Commission's

[31] European Commission (2002), op. cit.

[32] Ibid.

[33] The first set of legislation introduced higher penalties regarding infringement of intellectual property rights while the second set of legislation aimed at the same objective with regard to industrial property rights.

annual report in 2003) point towards increasing human capacity (e.g. training) and promoting cooperation among the authorities involved.

- On the legislative side, efforts should concentrate on achieving full alignment with EU directives. Problems remain with regard to Turkey's accession to the WIPO Copyright Treaty and a number of incompatibilities persist in the area of industrial property rights.
- The principle of the exhaustion of intellectual, industrial and commercial property rights in Turkish-EU trade should be introduced. The prevailing regime, based on the non-exhaustion of these rights, is an anomaly and is not compatible with the Single Market.

4. Widening the customs union

4.1 Services

The incorporation of services is the next step in the widening of the customs union. It is also one step that is likely to have a significant impact on the Turkish economy given that services represent approximately 60% of the national economy.

Table 10 highlights the absolute and also the relative importance of the services sector in the Turkish economy. Whereas the average of total exports as expressed as a percentage of total exports of goods is 1.34% for the EU-15 and the EU-27, the same ratio for Turkey is 1.37%.

Table 10. Export composition

	Year	Goods Exports ($ millions)	Services ($ millions)	(Goods + Services)/Goods (%)
EU-15	–	1,412,198	487,024	1.34
Cyprus	2001	977	3,353	4.43
Czech Republic	2001	33,404	7,092	1.21
Estonia	2001	3,338	1,643	1.49
Hungary	2002	34,792	7,807	1.22
Latvia	2002	2,576	1,252	1.49
Lithuania	2002	6,028	1,464	1.24
Malta	2002	2,150	1,096	1.51
Poland	2001	41,664	9,755	1.23
Slovak Republic	2000	11,896	2,241	1.19
Slovenia	2002	10,473	2,292	1.22
Bulgaria	2002	5,688	2,594	1.46
Romania	2002	13,869	2,332	1.17
Turkey	2002	39,827	14,781	1.37
EU-27	–	1,579,053	529,944	1.34
EU-28	–	1,618,880	571,725	1.35

Source: Direction of Trade Statistics, IMF, 2003.

In addition, the liberalisation of trade in services also presents a set of special challenges owing to the nature of the topic. Before addressing the impact and challenges posed by this additional step towards more complete trade integration, it is worth recalling the present state of affairs.

4.1.1 Trade in services between Turkey and the EU: Overview

The Ankara Association Agreement of 1963, which represents the first contractual agreement between the two sides, was modelled after the Rome Treaty. As such, it called for the establishment of a common market between Turkey and the EEC. As a result, the liberalisation of trade in services was to be accomplished in parallel with the liberalisation of trade in goods, along with the free circulation of

capital and labour. The Additional Protocol of 1973, which set out a detailed timetable as regards the completion of the customs union, also mentioned the objective of achieving the other three fundamental freedoms. In fact, Arts. 13 and 14 of the Ankara Agreement, as well as Art. 41(2) of the Additional Protocol foresaw, by decision of the Association Council, the progressive abolition of restrictions on the freedom to provide services and the freedom of establishment, using the relevant provisions of the EC Treaty as guidelines. Yet the efforts for economic integration were suspended in 1974. They were resumed in 1987 but focused on the liberalisation of trade in goods (or in other words the completion of the customs union). Indeed, the customs union was finally completed on the 31st of December 1995.

In parallel with the negotiations that were undertaken to complete the customs union, a set of exploratory talks with a view towards simultaneously reaching an agreement to liberalise trade in services were initiated in 1993 and were carried on in 1994. As a result, a set of provisions regarding trade in services were incorporated in the initial draft of the customs union decision. It appeared soon after that member states were not ready to accept the initial formulation. The main fear was that the liberalisation of trade in services between Turkey and the EU would necessarily entail some degree of liberalisation as regards the right of establishment of service providers. Hence there were fears that this could provide the opportunity for many Turkish service providers to immigrate to EU countries. Apparently the EU wanted to avoid a repetition of the situation that led to the so-called 'Rush *Portugesa*' judgment of the European Court of Justice (ECJ), where it ruled that a Portuguese company providing construction services in France could use its own Portuguese workforce for that purpose despite the fact that the movement of workers had not yet been liberalised between the EU and Portugal. Faced with such political difficulties, the Commission and the Turkish side agreed to a more restrictive version of the initial text. Nevertheless, the EU's position hardened even more and eventually it resisted any attempt to incorporate provisions related to the liberalisation of trade in services in the customs union decision. It should be underlined at this point that the Turkish side had wanted to include services in the eventual agreement. It was the Community side (the Council rather than the Commission) that prevented this objective from being fulfilled. Eventually, the goal of achieving free trade in services was mentioned not in the Association Council Decision of January 1995 on the completion of the customs union but as one of the items of the Resolution that the Association Council adopted on the same day.

The dynamics for having a free trade agreement in services were rekindled following the December 1999 Helsinki EU summit where Turkey was granted candidate status. The negotiations on trade in services resumed thereafter. The parties have now completed several rounds of negotiations and a basic text targeting the full liberalisation of trade in services is expected to be agreed upon before the end of 2004. Thus Turkey and the EU will embark upon the next journey in their economic integration. As in the case of the customs union (and unlike many other candidate countries), liberalisation of trade in services will be completed before Turkey's full membership.

It is therefore worth examining not only the economic impact of this endeavour but also the particular challenges posed by this unique level of integration.

4.1.2 Political and institutional aspects

The services area brings to the fore a host of problems that do not exist for the manufacturing trade. There are essentially two different models that can be adopted for that purpose. The first model is the approach of the WTO General Agreement on Trade in Services (GATS). GATS provides a framework for the multilateral liberalisation of trade in services. It rests on the commitment of the contracting parties for market access and for national treatment. In their schedule of specific commitments, contracting parties specify the limitations with regard to market access and limitations concerning national treatment for the four different modes of supply of services identified by GATS, which are cross-border, consumption abroad, commercial presence in the consuming country and the presence of naturalised persons. As such, GATS provides a somewhat complicated framework that essentially

aims at transposing the General Agreement on Tariffs and Trade (GATT) framework onto the services sector.

In contrast, the EU takes a different route to the trade of services. The EU approach rests on the 'deep integration' model, which in addition to the pure liberalisation of trade in services also aims at policy convergence. In other words, in the EU model, the trading partner is called upon to adopt the EU *acquis* in the services area in addition to eliminating the barriers to services trade. This is seen as an indispensable condition for being part of the European Single Market. The liberalisation of the services trade is to go in parallel with policy harmonisation.

It may be contended that the EU approach is more rigorous and more ambitious. But at the same time, the requirement of policy convergence makes the EU approach a more difficult model to adopt for the trading partner for whom full membership – which would have necessitated full policy harmonisation in any case – is not imminent or not foreseen. The flaw in this arrangement is a political one. The trading partner is called upon to adopt a body of legislation that was prepared and developed by a third party, i.e. EU member states. Furthermore, once the free trade agreement is in place, the trading partner will be asked to follow the changes made in the EU legislation and incorporate these in its national legislation. In other words, the trading partner will have lost its ability to follow an independent policy in all the other areas covered by the free trade agreement. Given that the agreement is set to cover a substantial part of the services economy, including such sectors as the financial sector, telecommunications, transport and energy, the loss of independence in policy-making is indeed significant. The challenge is one of creating a model that will minimise the detrimental impact of this policy dependence. It may be claimed that creation of the European Economic Area (EEA) in 1993 – which basically incorporated former European Free Trade Agreement (EFTA) countries within the European internal market but at the expense of eroding their policy independence in many areas – was instrumental in accelerating some of the former EFTA members' (Sweden, Finland and Austria) decision to join the EU. This occurred even though the EU and EFTA created a detailed arrangement for joint decision-shaping if not decision-making. As such, EFTA representatives were allowed to participate in the work of the EU's many technical committees where new legislation was being discussed. In addition, the EEA agreement contains a detailed procedure for consultations between the parties on legislation related to the areas covered by the agreement. Finally, it should also be pointed out that these provisions for institutional cooperation were put into practice unlike the provisions of institutional cooperation that were agreed upon for the Turkish-EU customs union.

It is therefore imperative that due attention is devoted to the question of institutional cooperation for an agreement on the liberalisation of trade in services between the EU and a third party to function effectively. The focus must be on achieving a genuine, joint decision-shaping ability. Such consideration is important not only in the case of Turkey, since free trade in services is likely to precede full membership but also for the Wider Europe initiative where trading partners will not be offered the prospect of full membership in the foreseeable future (if ever). Failure to achieve genuine, joint decision-shaping will open agreements based on policy integration to political criticism on the side of the trading partner – so much so that it may jeopardise the political attractiveness and the acceptability of the whole deal.

4.1.3 Impact

The liberalisation of trade in services between Turkey and the EU will certainly have a much more pronounced impact on the Turkish economy than on the EU economy. Notwithstanding sectoral differences, the Turkish economy in general stands to benefit from this liberalisation for two reasons. First, such a deal would allow genuine competition to emerge in many sectors of the economy. It is a well-known fact that Turkey's competitiveness is negatively affected by lack of competition and poor productivity in the services sector. The low level of productivity in this area stems from the direct involvement of the state as an economic agent in service industries. Telecommunications, energy and air transport are all cases in point. This economic structure leads to a lacklustre performance of the service sector, which in turn raises the cost of all industries given that these are indispensable inputs

for the economy as a whole. Therefore the liberalisation of trade in services and the accompanying de-regulation is set to radically change the performance of the service economy in Turkey. As a result, the service sector should be expected to grow faster than in the past and create a larger proportion of the added value in Turkey. By the same token, the benefits of a more productive and a more competitive service sector would also accrue to the manufacturing industry, which would then see its international competitiveness enhanced by being able to significantly reduce its cost structure.

Second, the policy integration aspect of trade liberalisation in services will ensure the improvement of governance of the economy. Good governance is of critical importance in the long-term performance of the economy. The regulatory framework established by the relevant EU *acquis* and especially the independent regulatory institutions, which are or shall be set up for that purpose, will be instrumental in achieving an improved governance of the economy. It may be of interest to conjecture that had services been incorporated in the customs union decision of 1995 and the regulatory framework been established in line with EU practice, the severe banking and then the financial and economic crises the country underwent in 2000 and 2001 would probably not have happened. The answer to this hypothetical question would need to take into consideration the fact that the poor regulatory oversight of the banking industry and the ensuing losses of many privately held banks had a major role in igniting the crises and in increasing the costs of dealing with them. In short, it can be claimed that the liberalisation of trade in services and the accompanying regulatory policy convergence with the EU will lead to an enhanced governance of the economy and better prospects for a less fragile, less volatile economy set on a path of sustainable growth.

4.1.4 Policy recommendations

The parties are currently negotiating the agreement to liberalise trade in services between them. The current text foresees a gradual liberalisation over a ten-year period. Some services will be opened to competition before others. The transition towards full liberalisation will depend on Turkey's adoption of the relevant *acquis*. The question of sequencing, namely how to determine different transition periods for different segments of the service sector, therefore becomes of interest. The most economically sound rule would be to prioritise business services such as financial services, telecommunications and to some extent energy and allow liberalisation to proceed sooner in these areas so that the productivity and competitiveness gains mentioned in the previous section would be achieved sooner rather than later. In addition, the impact of this form of trade integration on good governance of the economy would also be ensured in the areas where it matters most.

Contracting services may also be included in the fields of activity to be liberalised in the short term. This is an area where Turkey feels it has the most to gain given its strong, internationally competitive and experienced construction industry. As such, it is also a crucial area that would make the whole services deal more palatable, as well as politically more feasible and sellable to the Turkish public.

The mutual liberalisation of contracting services would, however, imply more flexible rules for the temporary establishment of Turkish construction workers in EU countries. As such, it would require a 'leap of faith' from the EU member states, which have been quite adamant in the past about liberalising these rules.

A related issue in this respect is the whole question of the temporary movement of service providers. The services deal would need to address this question appropriately, given that in some service activities, this forms one of the *sine qua nons* for the supply of the service. Both Turkey and the EU would in this instance need to move beyond the current GATS framework, which is more restrictive in nature. There could, however, be references to GATS definitions on questions such as the determination of 'key personnel', which could be considered as advantageous with regard to the freedom of establishment. Furthermore, the Community's visa regime with regard to Turkish service providers would also need to be amended so as to give essence to these freedoms.

The Community's approach to the issue of the temporary movement of workers linked to the freedom to provide services has been a rather conservative one given the political and social sensibilities in

certain member states. As such, the EU offer in the ongoing negotiations parallels the GATS framework, which refers almost exclusively to higher-level personnel, especially to intra-corporate transferees. Indeed in its GATS commitments, the EU limits the supply of services through the presence of naturalised persons to those employed by a legal citizen and belonging to the following categories: senior management, specialists possessing 'uncommon knowledge' and occasional business visitors. Following the conclusion of the Uruguay round, this was expanded for periods of up to three months to naturalised persons employed by a legal citizen who has no commercial presence in the EU and upon the condition that the naturalised person supplies a service for which his or her employer has obtained a contract in the EU. Yet this only applies to knowledge-intensive sectors such as legal, architectural or engineering services. Finally, there are no commitments with regard to the supply of services by self-employed naturalised persons. The EU's GATS concessions would have limited significance for Turkey since its comparative advantage lies in low- and medium-skilled labour-intensive services such as construction services.

If Turkey is to be integrated in the European Single Market, the question of the temporary movement of workers must be addressed within a more appropriate framework. A failure to set up this framework would result in a failure to derive the expected benefits from a services agreement. There are many constraints on the movement of naturalised persons, most of which stem from the fact that there is no separation between temporary and permanent labour movement. At present, the temporary movement of labour comes under the purview of EU immigration legislation and labour market policy rather than that of international trade. It should be possible to establish a predictable, harmonised and transparent system with the overall objective of allowing the necessary mobility of service providers on a temporary basis without compromising immigration policy.

More than the EEA model, the North American Free Trade Agreement (NAFTA) may provide a reference framework for that purpose. As outlined by Winters et al.,[34] there are various categories of temporary entry for business persons among the NAFTA member states: business visitors, traders and investors, intra-company transferees and professionals. The basic principles for the temporary entry for businesspersons in NAFTA are transparent criteria and procedures, reciprocity and recognition of the preferential trading relationship. There are no conditions – such as labour certification tests, prior approval procedures, petition, or other procedures of similar effect – and with one broad exception related to professional services there are no numerical quota restrictions.

The definition of a 'business visitor' is a citizen of a party who is engaged in the trade of goods, the provision of services or the conduct of investment activities. 'Temporary' is defined as having no intent to establish permanent residence. NAFTA grants temporary entry visas to business visitors seeking to engage in a business activity without requiring that person to obtain an employment authorisation from the host country. Visitors must ensure that their primary source of remuneration for the proposed business activity is their home country, not the territory of the party granting temporary entry; their principal place of business and actual place of accrual of profits must, at least predominantly, remain outside such territory. Instead of defining what kind of persons or professions may move, the NAFTA agreement defines the business activities in which such persons engage. Business activities include: research and design; growth, manufacture and production; agriculture (harvester-owner supervising a harvesting crew admitted under the applicable law); marketing (market researchers and analysts conducting research); sales, distribution, after-sales services and general service including tourism. Under the category of sales, for example, Mexican sales representatives and agents are allowed to enter Canada to take orders or negotiate contracts for goods or services for the Mexican firm. They are not, however, allowed to deliver goods or provide services to the public in Canada. Relatively low-skilled workers, such as transportation operators (tour-bus operators) are allowed move across countries to provide services under the auspices of their domestic companies.

[34] See A. Winters, Terrie L. Walmsley, Zhen Kun Wang and Roman Grynberg (2002), *Negotiating the Liberalisation of the Temporary Movement of Natural Persons*, Discussion Paper 87, University of Sussex, October.

The second NAFTA category under the temporary entry of businesspersons is for traders and investors. Traders, who carry on substantial trade in goods and services *between* member states are granted temporary entry. Investors are those who are seeking to establish, develop, administer or provide advice or key technical services to the operation of an investment. The investment does not have to be owned by the person who is seeking the temporary entry nor does it have to be committed, but can rather be in the process of commitment. The agreement indicates that the investment should involve a 'substantial' amount of capital, but without spelling out how much this would be.

Under the category of intra-company transferees, the person involved must have been employed continuously by the enterprise for one year in the previous three-year period. He/she must work in the capacity of manager or executive, or be the repository of special knowledge. As with all the other categories, there are no numerical quotas imposed on the intra-companies transferees between NAFTA members.

Under the category of professionals, NAFTA encourages the mutual recognition of accreditation, licensing and certification requirements. A person seeking to engage in a business activity at a competent level in a profession is permitted temporary entry. Unlike the other categories, however, this category allows the US to impose annual numerical limits on Mexico. Initially, the US approved up to 5,500 professional Mexicans per annum seeking temporary entry to the US; NAFTA requires that the US should, in consultation with Mexico, increase its annual quota each year. The US and Mexico agreed that the US would phase out the annual quotas if it grants a better treatment to a third party (a most-favoured nation clause) or ten years after signing the agreement, whichever is sooner. In defining 'professionals', most require a university degree or equivalent qualification.

To conclude, the parties must show the political willingness to go beyond the rather restrictive framework of GATS. A more imaginative model is definitely needed. Some elements of this framework could incorporate the following:

- the introduction of a special, multi-entry 'services' visa;
- the establishment of a transparent and responsive system for the granting of services visas;
- wider coverage of service personnel categories so as to include middle- and lower-skilled workers and professionals;
- acceleration of the mutual recognition of qualifications; and
- possibly the separation of social security contributions into short-term (work-related accident and health) and long-term (pension) social protection.

The institutional capacity of existing and recently established regulatory institutions such as the Telecommunications Regulatory Authority, the Energy Market Regulatory Authority or even the Banking Regulatory and Supervisory Board would be instrumental in ensuring the proper functioning of the services agreement by providing effective regulatory oversight of the whole service sector. As such, it would be of interest to launch specific programmes to strengthen the institutional capacity of such institutions and to enhance their knowledge of the related EU *acquis* and practice.

It should be recalled that the Turkish Competition Authority, which will also have a significant role in Turkey's adoption and implementation of those aspects of the EU *acquis* that are pertinent to the service sector, has a fine record of upholding competition rules in Turkey. It has been lauded in the past by the European Commission for its effective role in this regard. It should therefore be pointed out that the existence of such an important and well-established regulatory authority in Turkey would definitely be a major advantage during the transition process to the full freedom to provide cross-border services. The one area where the Competition Authority has had no competence and therefore no experience has been the area of state aid. At the time of writing, Turkey had still not fulfilled its obligations stemming from the customs union decision to set up an independent regulatory body to monitor state aid in Turkey. There is a draft law prepared for this purpose. It would thus be of significant importance to initiate a cooperation programme between the Commission and the soon-to-be-established Turkish state aid monitoring authority, with a view to the effective implementation of

state aid rules in Turkey. This is even more important for some service sectors where the state remains a major player (banking), a dominant player (telecommunications and air transport) or even a monopolist (electricity and natural gas transport along with rail transport).

It should also be recalled that in addition to an agreement to liberalise trade in services, the parties are also negotiating an agreement for the mutual liberalisation of public procurement markets. The negotiations are carried out as a package deal where nothing is agreed until everything is agreed. Therefore the completion of the services negotiations will depend on exogenous factors, such as the success of a deal involving the opening up of the public procurement markets.

To conclude, the recommendations of our working group with regard to the liberalisation of trade in services between Turkey and the EU are as follows:

- The liberalisation of trade in services between Turkey and the EU should be accomplished before Turkey's full membership.
- A model of institutional cooperation should be developed, which would allow decision-shaping in policy areas covered by the agreement. The EEA model can be a reference point in that respect.
- The sequencing of the fields of activity that are to be liberalised should occur in accordance with the importance of backward and forward linkages to the rest of the economy that the specific service sector provides. As such, priority should be given to business services.
- Contracting services should also be included among the short-term priorities for liberalisation, given its importance for the Turkish economy.
- This measure would necessitate more flexible rules for the temporary movement of Turkish workers.
- A related issue is the amendment of the EU's visa regime with regard to the temporary movement of key Turkish personnel.
- A specific assistance programme to enhance the institutional capacity of Turkish regulatory authorities should be implemented.
- A cooperation programme between the Commission and the Turkish Competition Authority with a view to the effective implementation of state-aid rules in Turkey should also be envisaged.

5. Conclusion

A customs union is an intrinsically complex arrangement to carry out. It creates a policy-dependency framework that is difficult to manage between two sovereign entities of a totally different size. Turkey and the EU ended up in a customs-union setting essentially as a result of a legacy issue. The customs union was the model of trade integration that was adopted by the EEC internally and initially externally as illustrated by its earliest association agreements with Greece[35] and Turkey. In fact, most of the problems identified in the Turkish-EU customs union stem from this factor. A second set of problems derive from 'hidden protectionism'. The EU's complaints with regard to the functioning of the customs union are indeed related to this type of protectionism, characterised by the non-tariff barriers to trade that are still witnessed on the Turkish side. Yet, notwithstanding this range of problems, the Turkish-EU customs union must be defined as a technical success. Since its establishment, the customs union has been able to function on a sound basis.

It may appear at first sight disappointing that the customs union has not had a major impact on the direction of trade. But this is understandable given that the EU had already liberalised its trade with Turkey (except in the area of textiles) well before the customs union entered into force and thus the EU had already become the most important trading partner of Turkey. The customs union did not

[35] Like Turkey, Greece applied for an Association Agreement with the Community in the late 1950s. The agreement envisaged the establishment of a customs union (as in the case of Turkey), but it took the form of full membership in the early 1980s.

change this, yet it was instrumental in the growth of the volume of trade between the partners and the growth of overall trade of Turkey. In light of the growth in trade volume and a lack of significant change in trade direction, it can be concluded that the Turkish-EU customs union has been a welfare-creating one, leading to more trade creation than trade diversion.

There are, however, a number of issues that remain regarding the future of trade integration between the two parties. These issues can be summarised under two headings: the deepening of the customs union and the widening of the customs union. With respect to the deepening of the customs union, we believe that the EU must undertake a significant effort to alleviate the concerns of the Turkish side in terms of the policy dependency framework, particularly in relation to the development of a genuinely common commercial policy. As for Turkey, the most important aspect related to the current functioning of the customs union would be to eliminate the hidden forms of protectionism, especially in the area of technical barriers to trade. Finally, both parties should focus on the elimination of trade defence instruments vis-à-vis each other and should define the conditions related to the abolition of these instruments in clearer terms.

In relation to the widening of the customs union, an agreement on the liberalisation of trade in services and the incorporation of the agricultural sector[36] within the customs union is to be expected. The liberalisation of trade in services will thus be the next 'new thing' in the Turkish-EU trade integration path. This development is bound to have a significant impact on the Turkish economy given the high share of services. Yet both the EU and Turkey must start to address this issue in more imaginative ways so as to bring workable, adaptable and flexible solutions to the core problems of policy dependency, institutional cooperation and the question of the freedom of establishment.

Finally, given the experience of the customs union, this new step in trade integration needs to be coupled with a more effective communications strategy. The customs union became a scapegoat for many ills of the Turkish economy as well as a rallying point for all the anti-globalisation and anti-liberalisation circles. As a result, the public image of the customs union in Turkey has been severely tarnished and remains as such. The more ambitious project of economic integration involving services and agriculture should not go down the same path. It is imperative that this time around trade integration is accompanied by a pertinent communications campaign that would aim at explaining to the public at large the reasons, the possible impact and the expected gains from this endeavour of economic integration.

Achieving these goals would help the parties to undertake a more comprehensive framework of trade integration with less friction and more welfare creation.

[36] The impact of the liberalisation of trade in agricultural products is being analysed in a separate working paper.

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