

INCEPTION IMPACT ASSESSMENT			
TITLE OF THE INITIATIVE	Enhancement of EU-Turkey bilateral trade relations and modernisation of the EU-Turkey Customs Union		
LEAD DG – RESPONSIBLE UNIT – AP NUMBER	TRADE E2/NEAR A5	DATE OF ROADMAP	August 2015
LIKELY TYPE OF INITIATIVE	Trade Negotiation		
INDICATIVE PLANNING	4 <sup>th</sup> Quarter 2016		
ADDITIONAL INFORMATION	<a href="http://ec.europa.eu/trade/policy/countries-and-regions/countries/turkey/">http://ec.europa.eu/trade/policy/countries-and-regions/countries/turkey/</a>		
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### A. Context, Subsidiarity Check and Objectives

Context
<p>An Association Agreement was signed between the EEC and Turkey in 1963 (the Ankara Agreement), whereby the parties agreed to create a Customs Union (CU). An Additional Protocol was signed in November 1970 setting out a timetable for the abolition of tariffs and quotas on goods circulating between the parties. The final phase of the CU was established on 1 January 1996 through the EU-Turkey Association Council Decision 1/95, currently in application. Turkey was then officially recognized as a candidate country in December 1999 and accession negotiations began in October 2005. With the accession process ongoing, trade-related issues are being dealt with both in the context of the CU (market access, tariff, customs legislation, trade policy and related alignment) and bilateral trade agreements: Decision of the EU-Turkey Association Council No 1/98 relating to agricultural products and the FTA on coal and steel products respectively, and within the relevant economic chapters of the accession process, mainly with respect to legislative alignment.</p> <p>After 20 years, the framework of bilateral trade relations has become outdated: it is limited to industrial and certain processed agricultural products, with complementary alignment on some economic legislation and ad hoc preferential concessions on certain agricultural products. Until recently Turkey had linked enhancement of bilateral trade relations to the accession process. Attempts in the early 2000's to extend the bilateral framework to cover services and public procurement have failed. Turkey's position gradually evolved during 2013-2014 making it possible to contemplate the enhancement of bilateral trade relations, alongside consideration of some EU and Turkish concerns related to the functioning of the CU, such as Turkey's situation with regard to the FTA's concluded by the EU with third countries and the absence of an efficient and operational dispute settlement mechanism. A senior level working group was tasked with exploring the possibility to achieve the above. That working group concluded its exploratory works by recommending that the enhancement of the bilateral trade relations should cover i.a. services, public procurement, further liberalisation in agricultural products, and the modernisation of the Customs Union Agreement. Investment protection is not covered, whereas establishment will be covered under the services area.</p> <p>Based on a nearly 20-year old Customs Union, which enhanced two-way trade, economic integration and investment flows, the EU-Turkey trade relationship has been overtaken by a more ambitious trade policy of the enlarged EU and the negotiation and conclusion of a number of deeper and more comprehensive trade agreements with key economic partners. These developments have led to preference erosion for Turkey within the EU market and sometimes non preferential market access on the markets of EU FTA partners. With important free trade agreements of the EU with third countries and notably EU-US TTIP negotiations featuring highly on the trade agenda, the modernisation of the CU and, more importantly, the enhancement of the EU-Turkey bilateral trade relations can be a tool for Turkey to underpin its economic reforms, improve its competitiveness and have a better standing to be able to integrate later challenging trade deals such as TTIP.</p> <p>The recommendation to enhance bilateral trade relations and to modernise the CU was already part of the 2014 Enlargement Strategy adopted by the College on 8 October 2014, preparing the ground for pursuing this</p>

initiative now. This initiative is also connected to the expected Policy Communication “Trade and Investment Strategy for Jobs and Growth” (2015/TRADE/008) that would provide an overall policy orientation, priorities and identify proposed initiatives.

A number of *ad hoc* assessments have been carried out on the CU, mostly pointing at the economic benefits of the agreement. Moreover, an evaluation carried out by the World Bank was published in April 2014. It indicates a fourfold increase of bilateral trade in less than 20 years to reach some € 120 billion in 2014, and enhanced economic and industrial integration between the parties, with the EU being the largest foreign direct investor in Turkey and Turkish companies being integrated in European production networks and in global value chains. The overall conclusion is that EU-Turkey economic integration is irreversible but limited, and that there are ample opportunities that could be developed further for the benefit of both parties.

This initiative, although potentially wide-ranging, is not strictly speaking a new one since it builds on the existing Customs Union with Turkey and aims at enhancing bilateral trade relations in line with previous attempts. As such, it is not part of the REFIT agenda.

## Issue

Turkey is the EU's 6<sup>th</sup> biggest trading partner and accounts for nearly 4% of its total trade, with bilateral exchanges worth some € 120 billion. Three fourths of FDI inflows to Turkey originate in the EU, mainly greenfield and services investments. The level of integration between the EU and Turkish economies is intense, with more than 16.000 companies in Turkey owned by European capital, some of which use Turkey to access third markets in the region and beyond. Enhancing economic integration by improving market access in agricultural and public procurement markets, and fostering investments in the services sectors through better opening and regulatory alignment would increase further market integration to the benefits of both parties, particularly given Turkey's determination to remain anchored to the European economy as its main vector for economic growth.

This initiative will, therefore, basically address two main issues.

First, reaping the benefits of the already intense economic integration between the parties could be achieved by enhancing the trade relations to other areas, in line with current ambitious liberalisation efforts of the EU with third countries, such as on services, public procurement, agricultural trade and SPS, and other economic areas.

Second, a modernisation effort to improve the functioning of the CU, which currently requires Turkey to align on the EU's trade policy (customs, external tariff, GSP and preferential agreements) and technical legislation without having a say on trade policy formulation. This perceived asymmetry to the detriment of Turkey has prompted a number of reactions hampering the functioning of the CU (surveillance measures, external tariff increases, safeguard measures, NTBs and regulatory restrictions). In this respect, better consideration of Turkey in consultative mechanisms, and participation in the work of some of the committees/groups related to the CU functioning could be envisaged. A dispute settlement mechanism (DSM) should also be established to ensure correct functioning of the CU.

The above initiative will concern the EU and Turkish economies in their entirety, including business operators throughout the private sector (companies, manufacturers and SME's, agricultural producers, service providers, traders and intermediaries) as well as consumers of both partners. Turkish institutions and economic structures will be further encouraged to participate in interdependent institutional and administrative arrangements with the EU, such as those dealing with regulatory alignment (e.g. services, SPS), market access (e.g. agriculture), and institutional cooperation (integrating some consultation mechanisms which will increase acceptance of decisions taken, agreeing to a dispute settlement mechanism).

Poor functioning of the current CU is due to its obsolete nature, lack of a dispute settlement mechanism and the Turkish side's wish to review the CU which it claims is unduly asymmetrical. This originates a number of market access and trade irritants, lack of compliance with some basic provisions of the CU (common external tariff, non-tariff barriers, export and import restrictions) and constant pressures on the smooth functioning of the CU, including with respect to FTAs with third countries. Further to these non-compliance costs, additional potential from an out-of-date trade agreement only covering industrial goods cannot be reaped in other economic areas where modern trade relations require a more ambitious level of liberalisation and integration. In agriculture, public procurement and services sectors, for instance, additional benefits for two such close partners cannot be developed should no ambitious extensive policy action be taken.

## Subsidiarity check

The initiative concerns trade policy and the negotiation of international trade agreements (including market access in agriculture, services and public procurement), which are areas under the exclusive competence of the EU according to Article 207 of the Treaty on the Functioning of the European Union (TFEU). Therefore, the subsidiarity principle does not apply.

<b>Main policy objectives</b>
<p>The main policy objective is to enhance bilateral trade relations and to modernise the current EU-Turkey CU through a negotiation between the EU and Turkey, thereby bringing EU-Turkish economic relations to a new level of ambition and addressing issues inherent to the functioning of the CU.</p> <p>The twofold problem (poor implementation of the current CU and limitation to industrial goods only) can be addressed through the complementary and interdependent actions of modernising the functioning of the CU and of extending it to new areas. Through this two-pronged approach both sides' desiderata for a better functioning and extended application of the CU would be met by a coherent negotiation logic. This preferred and consistent option would not preclude alternative negotiating options such as an FTA approach, should the parties concur to this, including as part of the formal modalities of the negotiated deal.</p>
<b>B. Option Mapping</b>
<ul style="list-style-type: none"> <li>- The first option, or status quo scenario, would be to keep the CU as it stands, i.e. with the current and worsening implementation deficit and non-compliance record.</li> <li>- The second option would be to modernise the current CU and to make it more balanced and more operational, and improve its functioning. This would be achieved through amendment of Decision 1/95 without changing its sectoral scope.</li> <li>- The third option would be to enhance bilateral trade relations to a level comparable with that achieved in recent ambitious FTAs concluded by the EU, by concluding a new agreement to cover new areas. This could imply approving this enhancement either through a new Decision of the Association Council or through a new Protocol to the Association Agreement, thus requiring a full treaty-making procedure pursuant to TFEU Articles 217 and 218.</li> <li>- The fourth option would be to combine the second and third options, i.e. modernise the CU and deepen trade relations. This would be possible both by adapting Decision 1/95, and through a new Decision of the Association Council or through a new Protocol to the Association Agreement.</li> <li>- The fifth option would be to replace the CU with a new comprehensive FTA comparable to FTAs recently concluded by the EU, and covering e.g. industrial goods, agriculture, services, public procurement. This would represent a major shift in EU-Turkey contractual relations, requiring substantial adaptations to the Association Agreement.</li> </ul>
<b>Baseline scenario – no EU policy change</b>
<p>Under this scenario, specific opportunities are likely to be lost, and there is a risk of a possible deterioration in overall trade relations between the EU and Turkey. In fact, the cost of non-modernisation of the CU could well be substantial given the risk of further challenging its implementation, thus weakening its applicability and compliance. A re-balancing and modernisation of the CU, while enhancing bilateral trade relations would more safely depart from the baseline scenario and provide an acceptable level of negotiating gains for both sides to allow a smoother, wider and more beneficial implementation of the CU.</p>
<b>Options of improving implementation and enforcement of existing legislation or doing less/simplifying existing legislation</b>
See above
<b>Alternative policy approaches</b>
<p>Partial policy approaches (only CU modernisation or only bilateral trade enhancement) would not be possible for the negotiating parties in the absence of a comprehensive package deal meeting both parties' desiderata. As to the FTA option, although not to be totally discarded, there is limited interest at this juncture as this could be considered as backtracking from the achievements of an accession-oriented CU, which has proven to be beneficial to increase Turkey's market opening to the world. Also, transaction costs, such as those linked to the introduction of rules of origin, could be an issue under this scenario. Furthermore, undergoing the FTA option could prove more complex as this would represent a major shift in our contractual relations. This remains not the preferred option.</p>

<b>Alternative policy instruments</b>
No alternative policy instruments exist to govern international trade arrangements between the parties. Alternative policy instruments, such as non-regulatory alternatives, self- or co-regulation, market-based solutions would not be able to address tariff and non-tariff barriers to trade in goods, services and public procurement, and poor implementation of the CU.
<b>Alternative/differentiated scope</b>
Enhancement of bilateral trade relations and modernisation of the CU would upgrade current EU-Turkey trade relations in a more comprehensive manner, having a greater impact on trade and investment flows to the benefits for both parties' private sectors (including on SME's and micro-enterprises particularly in the agricultural sector) and consumers at large.
<b>Options that take account of new technological developments</b>
Market opening in agriculture, services and public procurement would necessarily have a digital dimension and be internet-compatible, given the current market entry information and access opportunities. Digital and internet readiness would furthermore enhance the benefits of planned market opening, thus providing additional benefits to operators and consumers.
<b>Preliminary proportionality check</b>
The proportionality in re-balancing the CU for its better functioning would be ensured through redress actions in line with EU prerogatives as the main actor of the CU. Actions to better involve Turkey in decision-shaping, in FTA negotiations and through a functioning dispute settlement would be operated in full respect of EU competence and interests, and in a way which is proportionate to the pursued objective. Extending the scope of the CU to other areas would be pursued by ensuring that the policy approach and its intensity match the identified objective of further trade liberalisation for the sake of additional economic benefits for EU and Turkish stakeholders at large.
<b>C. Data Collection and Better Regulation Instruments</b>
<b>Data collection</b>
A number of ad hoc studies and surveys are available detailing the trade, investment and economic data/effects of the EU-Turkey CU. The most comprehensive of these is the Evaluation of the EU-Turkey CU by the World Bank published in April 2014. This evaluation as well as other available main studies will be used in the Impact Assessment. Further information will be collected and analysed through an external study to be contracted to feed into the impact assessment. This external study will have two parts: an ex post analysis building on and complementing the World Bank evaluation on the current CU, and an ex ante analysis of possible enhancement of EU-Turkey trade relations.
<b>Consultation approach</b>
An open online public consultation of stakeholders lasting 12 weeks will take place in spring 2016.  Potentially interested stakeholders could be: a) the business sector from both sides, including social partners, companies and SMEs, chambers of commerce, and investors associations; b) think-tanks, universities, research institutes, academia and law firms; c) NGOs, profit and non-profit organisations; d) governmental agencies, ministries and regional authorities, all directly or indirectly affected by the initiative.  The launch of stakeholder consultations related to this initiative will be announced in the consultation planning that can be found at: <a href="http://ec.europa.eu/yourvoice/consultations/docs/planned-consultations_en.pdf">http://ec.europa.eu/yourvoice/consultations/docs/planned-consultations_en.pdf</a> .
<b>Will an Implementation plan be established?</b>
No implementation plan is foreseen as negotiations of international agreements in the trade area are conducted according to Article 218 of the TFEU.

## D. Information on the Impact Assessment Process

An Interservice Steering Group will be set up in July 2015 and is planned to meet regularly and as necessary. The following DGs and services will be invited: AGRI, SJ, BUDG, CLIMA, CNECT, COMM, COMP, DEVCO, FISMA, EEAS, EMPL, ENER, ENV, ESTAT, ECFIN, FPI, GROW, HOME, JRC, JUST, MARE, MOVE, OLAF, REGIO, RTD, SANTE, SG, TAXUD EAC, ECHO.

A study is planned to be contracted with an external contractor in September 2015 to feed into the impact assessment. The study is expected to be finalised before the summer break of 2016.

## E. Preliminary Assessment of Expected Impacts

### Likely economic impacts

Positive economic impacts are likely to be proportionate to the level of trade liberalisation and degree of preferential market access agreed in agriculture, public procurement and services. This is even more true given the high tariff and non-tariff protection of Turkish agriculture, the limited access to both sides' (incl. MS) procurement markets (with price preferences, exemptions and bidders qualifications constraints on the Turkish side), as well as regulatory and market access limitations on services. Improved preferential access to procurement and services markets will have a positive leverage effect on trade in goods which, coupled with better agricultural access, will increase the level of trade integration and positive spill-over effects on economic growth. Overall, with a better functioning and modernised CU, prospects and expectations of improved economic growth generated by more integrated economies are to be expected.

### Likely social impacts

Social and employment impacts should be positive insofar as increased wealth is generated by trade and investment-led economic growth due to increased liberalisation. The degree to which increased trade liberalisation will impact on economic reforms and competitiveness might have differing social impacts on concerned stakeholders, with higher risks in the agricultural area and in some services sectors. However, the overall balance in social and employment impacts out of deeper liberalisation and distributive gains is expected to be positive for both parties.

### Likely environmental impacts

Environmental impacts are unlikely to be relevant in a modernised CU and improved preferential access in public procurement and services. In agriculture and some services sectors (e.g. road transport), although overall economic benefits are to be expected through balanced negotiations and mutual concessions, these could just be offset by borderline environmental impacts in case, for instance, SPS alignment does not follow consistently trade liberalisation. In case of an agreement on road transport, increased economic benefits might be offset by some environmental impacts in transit MS.

### Likely impacts on simplification and/or administrative burden

A positive impact is expected in reducing the administrative burden on traders, namely in the areas of services and SPS.

### Likely impacts on SMEs

SME's are very likely to enjoy improved market access benefits, a streamlined functioning of the CU and additional trading opportunities to support their internationalisation. This is likely to be the case both in services areas and in procurement markets (including subcontracting), while small agricultural businesses from both sides could enjoy improved market access if they are competitive and export-oriented.

### Likely impacts on competitiveness and innovation

In all areas of improved preferential market access, innovative and competitive products are likely to be enhanced. Given the already close economic integration between the EU and Turkey, a wider economic space enabled by an upgraded CU and enhanced trade relations would increase the competitive edge of exported products and services, while triggering innovative investments and improving the connectivity of businesses and products in global value chains.

### Likely impacts on public administrations

Administrative adjustments on tariff and regulatory issues are likely to follow from the negotiations but will have moderate impacts on the relevant public administrations.

### Likely impacts on third countries, international trade or investment

Extension of the bilateral trade relations to other areas might counter erosion of current Turkish benefits in the

CU following EU comprehensive FTAs with major trading partners, both within the EU and on the markets of the EU preferential trade partners. Furthermore, increased economic integration between the EU and Turkey will also attract international investments in the liberalised sectors and consolidate joint business patterns to better compete internally and globally.